AMERICAN VANGUARD CORP
Form 10-K/A
October 20, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K/A

(Amendment No. 1)

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

For The Year 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 001-13795

AMERICAN VANGUARD CORPORATION

Delaware	**95-2588080**
(State or other jurisdiction of Incorporation or organization)	**(I.R.S. Employer Identification Number)**
4695 MacArthur Court, Newport Beach, California	**92660**
(Address of principal executive offices)	**(Zip Code)**

(949) 260-1200

(Registrant s telephone number, including area code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class:	**Name of each exchange on which registered:**
Common Stock, $.10 par value	American Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: NONE

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ¨

Indicate by checkmark whether the registrant is an accelerated filer as defined in Rule 12b-2 of the Securities and Exchange Act of 1934. Yes ¨ No x

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AMERICAN VANGUARD CORPORATION

ANNUAL REPORT ON FORM 10-K /A

December 31, 2003

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Explanatory Note:

Item 7 listed above is hereby amended by deleting the Item in its entirety and replacing it with the corresponding Item attached hereto and filed herewith. Item 15 listed above is hereby amended by replacing the specified portions indicated herein.

The purpose of this Amendment is to make certain changes to the above referenced Items in the Company s Annual Report on Form 10-K for the year ended December 31, 2003 that was originally filed on March 31, 2004 (the Original Filing). We are filing this amended Annual Report on Form 10-K/A in response to comments received from the Securities and Exchange Commission (the SEC) in connection with our Registration Statement on Form S-3 filed on September 30, 2003. This report continues to speak as of the date of the Original Filing and we have not updated the disclosure in this report to speak to any later date. While this report primarily relates to the historical period covered, events may have taken place since the date of the Original Filing that might have been reflected in this report if they had taken place prior to the Original Filing.

Any items in the Original Filing not expressly changed hereby shall be as set forth in the Original Filing. All information contained in this Amendment and the Original Filing is subject to updating and supplementing as provided in the Company s periodic reports filed with the SEC subsequent to the date of such reports.

PART II

AMERICAN VANGUARD CORPORATION AND SUBSIDIARIES

ITEM 7 MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATION

Results of Operations

2003 Compared with 2002:

	2003	2002	Change
Net sales:			
Crop	$ 104,895,000	$ 79,271,000	$ 25,624,000
Non-crop	19,968,000	21,400,000	(1,432,000)
	$ 124,863,000	$ 100,671,000	$ 24,192,000
Gross profit:			
Crop	$ 47,932,000	$ 32,834,000	$ 15,098,000
Non-crop	10,942,000	11,041,000	(99,000)
	$ 58,874,000	$ 43,875,000	$ 14,999,000

The Company reported net income of $10,263,000 or $1.10 per diluted share in 2003 as compared to net income of $7,049,000 or $.78 per diluted share in 2002. (Net income per share data have been restated to reflect the effect of a 3 for 2 stock split that will be distributed on April 16, 2004.)

Net sales in 2003 increased by 24% to $124,863,000 from $100,671,000 in 2002. The record sales levels were as a result of increased sales (primarily attributable to higher sales volume) of the Company s product lines used for crop protection. Specifically, increased sales of the Company s insecticides, soil fumigants, molluscicides, and plant growth regulators product lines more than offset a decline in sales of the Company s defoliant and fungicide product lines, resulting in the overall increase in net sales. There were no unusual or infrequent events or transactions outside of the ordinary course of business, which materially impact net sales.

Net sales in 2002 increased by 21% or $17,544,000 to $100,671,000 from $83,127,000 in 2001 (primarily attributable to higher sales volume). Sales of the Company s crop product lines increased 19% or $12,896,000 to $79,271,000 in 2002 from $66,375,000 in 2001, while sales of the Company s non-crop product lines increased by 28% or $4,648,000 to $21,400,000 in 2002 as compared to $16,752,000 in 2001. Increased sales of the Company s insecticides, soil fumigants, and defoliant product lines more than offset a decline in the Company s fungicide and plant growth regulators product lines. There were no unusual or infrequent events or transactions outside of the ordinary course of business, which materially impact net sales.

Gross profits increased $14,999,000 to $58,874,000 in 2003 from $43,875,000 in 2002. Gross profit margins increased to 47% in 2003 from 44% in 2002. The improvement in gross profit margins was due to the changes in the sales mix of the Company s products.

Gross profit margins may not be comparable to those of other companies, since some companies include their distribution network in cost of goods sold and the Company, as well as others, include distribution costs in operating expenses (or other line items other than cost of goods sold).

Operating expenses, which are net of other income and expenses, increased by $10,336,000 to $42,332,000 in 2003 from $31,996,000 in 2002. Operating expenses as a percentage of sales were 34% in 2003 as compared to 32% in 2002. The differences in operating expenses by specific departmental costs are as follows:

Selling expenses increased by $5,602,000 to $16,278,000 in 2003 from $10,676,000 in 2002. The increase was due primarily to increased variable selling expenses that relate to both increased sales levels and the product mix of sales.

General and administrative increased by $1,000,000 to $9,427,000 in 2003 as compared to $8,427,000 in 2002. The increase was due to increases in expenses related to the amortization of intangible assets in connection with new asset acquisitions in 2003 and increased payroll and payroll related costs.

Research and product development costs and regulatory registration expenses increased by $2,008,000 to $7,725,000 in 2003 from $5,717,000 in 2002. The increase was a result of increases in costs incurred to generate scientific data related to the registration and possible new uses of the Company s products (which accounted for approximately 85% of the increase) and increased payroll and payroll related costs.

Freight, delivery and warehousing costs increased $1,726,000 to $8,902,000 in 2003 as compared to $7,176,000 in 2002 due to the increased sales levels.

Interest costs before capitalized interest and interest income remained virtually unchanged at $986,000 in 2003 as compared to $973,000 in 2002. The Company recorded $303,000 in interest income in 2003, which primarily relates to income taxes receivable from the state of California as a result of filing amended tax returns for the years ended December 31, 1995 through 1998. (The overall after tax effect of recording the tax benefit due from California (franchise tax) generated $.033 per diluted share in 2003. The refund was received in July 2003.) The Company capitalized $323,000 of interest costs related to construction in progress during 2003 as compared to $347,000 in 2002.

Income tax expense increased by $1,690,000 to $5,919,000 in 2003 as compared to $4,229,000 in 2002. The Company s effective tax rate was 36.6% in 2003 as compared to 37.5% in 2002. (See note 4 to the Consolidated Financial Statements for additional analysis of the changes in income tax expense.)

Weather patterns can have an impact on the Company s operations. Weather conditions influence pest population by impacting gestation cycles for particular pests and the effectiveness of some of the Company s products, among other factors. The end user of some of the Company s products may, because of weather patterns, delay or intermittently disrupt field work during the planting season which may result in a reduction of the use of some of the Company s products. During 2003, weather patterns did not have a material adverse effect on the Company s results of operations.

Because of elements inherent to the Company s business, such as differing and unpredictable weather patterns, crop growing cycles, changes in product mix of sales, ordering patterns that may vary in timing, and promotional programs, measuring the Company s performance on a quarterly basis, (gross profit margins on a quarterly basis may vary significantly) even when such comparisons are favorable, is not as meaningful an indicator as full-year comparisons. The primary reason is that the use cycles do not necessarily coincide with financial reporting cycles. Because of the Company s cost structure, the combination of variable revenue streams, and the changing product mixes, results in varying quarterly levels of profitability.

Results of Operations

2002 Compared with 2001:

	2002	2001	Change
Net sales:			
Crop	$ 79,271,000	$ 66,375,000	$ 12,896,000
Non-crop	21,400,000	16,752,000	4,648,000
	$ 100,671,000	$ 83,127,000	$ 17,544,000

Gross profit:			
Crop	$ 32,834,000	$ 29,369,000	$ 3,465,000
Non-crop	11,041,000	8,562,000	2,479,000
	$ 43,875,000	$ 37,931,000	$ 5,944,000

The Company reported net income of $7,049,000 or $.78 per diluted share in 2002 as compared to net income of $5,639,000 or $.64 per diluted share in 2001. (Net income per share data have been restated to reflect the effect for all stock splits.)

Net sales in 2002 increased by 21% or $17,544,000 to $100,671,000 from $83,127,000 in 2001 (primarily attributable to higher sales volume). Sales of the Company s crop product lines increased 19% or $12,896,000 to $79,271,000 in 2002 from $66,375,000 in 2001, while sales of the Company s non-crop product lines increased by 28% or $4,648,000 to $21,400,000 in 2002 as compared to $16,752,000 in 2001. There were no unusual or infrequent events or transactions outside of the ordinary course of business which materially impact net sales.

Gross profits increased $5,944,000 to $43,875,000 in 2002 from $37,931,000 in 2001. Gross profit margins declined to 44% in 2002 from 46% in 2001. The reduction in gross profit margins was due to the changes in the sales mix of the Company s products.

Gross profit margins may not be comparable to those of other companies, since some companies include their distribution network in cost of goods sold and the Company, as well as others, include distribution costs in operating expenses (or other line items other than cost of goods sold).

Operating expenses, which are net of other income and expenses, increased by $3,670,000 to $31,996,000 in 2002 from $28,326,000 in 2001. Operating expenses as a percentage of sales were 32% in 2002 as compared to 34% in 2001. The differences in operating expenses by specific departmental costs are as follows:

Selling expenses increased by $1,406,000 to $10,676,000 in 2002 from $9,270,000 in 2001. The increase was due primarily to increased variable selling expenses that relate to both increased sales levels and the product mix of sales, as well as, increases in payroll and payroll related items.

General and administrative increased by $906,000 to $8,427,000 in 2002 as compared to $7,521,000 in 2001. The increase was due to increases in outside professional fees (primarily legal), coupled with the fact that the same period in 2001 realized the benefit of certain costs that were capitalized in the re-commissioning of the Company s Axis, Alabama facility.

Research and product development costs and regulatory registration expenses increased by $770,000 to $5,717,000 in 2002 from $4,947,000 in 2001. The increase was a result of increases in costs incurred to generate scientific data related to the registration and possible new uses of the Company s products.

Freight, delivery and warehousing costs increased $588,000 to $7,176,000 in 2002 as compared to $6,588,000 in 2001 due to the increased sales levels.

In 1986, the Company constructed an incinerator to destroy a waste gas that had been previously discharged to the atmosphere pursuant to an air permit. By reducing this emission, the Company was entitled to transfer a portion of its emission credits to others. The Company recognized a net gain before taxes of $466,000 in 2001 as a result of sales of a portion of its credits.

The Company settled negotiations with an insurance carrier related to the recovery of certain costs pertaining to the completed remediation work of a railroad siding which resulted in a net gain before taxes of $208,000 in 2001. The Company also settled a dispute over data compensation which resulted in a net gain before taxes of $88,000 in 2001.

Interest costs before capitalized interest and interest income were $973,000 in 2002 as compared to $1,363,000 in 2001. Lower effective interest rates coupled with lower overall debt levels resulted in the decline in interest costs. The Company capitalized $347,000 of interest costs related to the re-commissioning the Company s Axis, Alabama facility in 2002. (See note 3 to the Consolidated Financial Statements.)

Income tax expense increased by $845,000 to $4,229,000 in 2002 as compared to $3,384,000 in 2001. The Company s effective tax rate remained unchanged at 37.5%. (See note 4 to the Consolidated Financial Statements for additional analysis of the changes in income tax expense.)

Effective January 1, 2002, the Company adopted Emerging Issues Task Force Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor s Products* (EITF 01-9). Upon adoption of EITF 01-9, the Company was required to classify certain payments to its customers as a reduction of sales. The Company previously classified certain of these payments as operating expenses in the

consolidated statement of income. The amounts reclassified resulted in a reduction of net sales (and an offsetting reduction of operating expenses) of $3,649,000 in 2002 and $3,889,000 in 2001. Additionally, the Company engages in various customer programs. The Company accounts for these programs as operating expenses in accordance with EITF 01-9 as the Company receives an identifiable benefit in exchange for the consideration. Amounts charged to operating expenses were $2,222,000 in 2002 and $1,761,000 in 2001.

Liquidity and Capital Resources

Operating activities provided $4,424,000 of cash during the year ended December 31, 2003. Net income of $10,263,000, non-cash depreciation and amortization of $4,053,000 and an increase in trade payables, other payables and accrued expenses and deferred income taxes of $7,872,000, $4,754,000 and $833,000, respectively, provided $27,775,000 of cash for operations. Increases in receivables, inventories and prepaid expenses of $11,003,000, $12,161,000 and $187,000 respectively used $23,351,000 in of cash for operating activities.

The Company used $10,641,000 in investing activities in 2003. It invested $10,726,000 in the acquisition of new products (of which, $5,926,000 was disbursed in cash) and $4,448,000 in capital expenditures while other non-current assets declined by $267,000.

Financing activities provided $3,764,000 during 2003. Net borrowing under the Company s fully-secured revolving line of credit increased by $6,200,000. The Company made payments on its debt of $2,199,000, received $778,000 from the issuance of common stock, paid cash dividends of $807,000 and purchased treasury stock for $208,000.

In May 2001, the Company announced that Amvac Chemical Corporation, a wholly-owned subsidiary of the Company, completed the acquisition of a manufacturing facility from E.I. Du Pont de Nemours and Company (DuPont). The facility, termed Amvac Axis, Alabama (AAA) is one of three such units located on DuPont s five hundred and ten acre complex in Axis, Alabama. The acquisition of AAA consisted of a long-term ground lease of twenty-five acres and the purchase of all improvements thereon. AAA is a multipurpose plant designed primarily to manufacture pyrethroids and organophosphates, including Fortress®, a corn soil insecticide that the Company purchased from DuPont in 2000. The acquisition of AAA increased the Company s capacity while also providing flexibility and geographic diversity. Management believes, as the Company looks to acquire additional product lines, AAA will allow the Company to produce compounds that could not be manufactured at the Company s Los Angeles (Commerce, California) facility and will further complement the Company s toll manufacturing capabilities. The Company began the commissioning phase of AAA during the third quarter of 2001 and this facility was placed in service in May 2003. The Company intends to focus its efforts, in addition to acquiring new product lines and expanding the use of its current products, on discussions with companies that in this time of consolidation in the Company s industry, may be interested in utilizing the Company s toll manufacturing capabilities of AAA.

In May 2002, the Company entered into a new $45,000,000 fully-secured long-term credit agreement. The Company s primary bank (the Bank) acted as sole administrative agent arranger and syndication agent. The Bank syndicated the new credit facility with another bank. The $45,000,000 credit facility consists of a senior secured revolving line of credit of $35,000,000 and a $10,000,000 senior secured term loan. The borrowings under the credit agreement bear interest at the prime rate (Referenced Loans), or at the Company s option, a fixed rate of interest offered by the Bank (Fixed Loans) for terms of one, two, three, six, nine or twelve months. Interest on the Referenced Loans are payable quarterly, in arrears, on the last day of each March, June, September, and December, and on the maturity date of such loan in the amount of interest then accrued but unpaid. Interest on the Fixed Loans are payable on the last day of the interest period, provided that, with an interest period longer than three months, interest is payable on the last day of each three-month period after the commencement of such interest period. The senior secured revolving line of credit matures on May 31, 2005. The term loan matures on May 31, 2007. The principal payments of the term loan are payable in equal quarterly installments of $625,000 each, on or before the last business day of each February, May, August and November, commencing May 31, 2003 and in one final installment in the amount necessary to repay the remaining outstanding principal balance of the term loan in full on the maturity date.

Management continues to believe, to continue to improve its working capital position and maintain flexibility in financing interim needs, it is prudent to explore all available sources of financing.

Contractual Obligations and Off-Balance Sheet Arrangements

The following summarizes our contractual obligations at December 31, 2003 and the effects such obligations are expected to have on liquidity and cash flow in future periods:

	Payments Due by Period				
	Total	**Less than**	**1 3**	**4 5**	**After**

		1 Year	Years	Years	5 Years
Long-term debt	$ 14,316,000	$ 6,374,000	$ 7,317,000	$ 625,000	$ 0
Note payable to bank	14,200,000	0	14,200,000	0	0
Accrued royalty obligations	1,521,000	1,521,000	0	0	0
Employment agreement(s)	2,255,000	667,000	1,141,000	447,000	0
Operating leases	1,491,000	255,000	489,000	534,000	213,000
	$ 33,783,000	$ 8,817,000	$ 23,147,000	$ 1,606,000	$ 213,000

Recent Accounting Pronouncements

In July 2002, the FASB issued SFAS No. 146, *Accounting for Costs Associated with Exit or Disposal Activities* (SFAS 146), effective for exit or disposal activities initiated after December 31, 2002, SFAS 146 addresses the financial accounting and reporting for certain costs associated with exit or disposal activities, including restructuring actions. SFAS 146 excludes from its scope

severance benefits that are subject to an on-going benefit arrangement governed by SFAS 112, Employer s Accounting for Post employment Benefits, and asset impairments governed by SFAS 144, Accounting for the Impairment or Disposal of Long-Lived Assets. The adoption of SFAS 146 did not have a material impact on the Company s financial statements.

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45) *Guarantor s Accounting and Disclosure Requirement for Guarantees, Including Indirect Guarantees of Indebtedness of Others*. This Interpretation elaborates on the disclosures to be made by a guarantor in its interim and annual financial statements about its obligations under certain guarantees that it has issued. It also clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in issuing the guarantee. The initial recognition and initial measurement provisions of this Interpretation are applicable on a prospective basis to guarantees issued or modified after December 31, 2002. The following is a summary of the Company s agreements that the Company has determined is within the scope of FIN 45.

Under its bylaws, the Company has agreed to indemnify its officers and directors for certain events or occurrences arising as a result of the officer or director s serving in such capacity. The term of the indemnification period is for the officer s or director s lifetime. The maximum potential amount of future payments the Company could be required to make under these indemnification agreements is unlimited. However, the Company has a directors and officers liability insurance policy that reduces its exposure and enables it to recover a portion of any future amounts paid. As a result of its insurance policy coverage, the Company believes the estimated fair value of these indemnification agreements is minimal and has no liability recorded for these agreements as of December 31, 2003.

The Company enters into indemnification provisions under its agreements with other companies in its ordinary course of business (typically customers). Under these provisions the Company generally indemnifies and holds harmless the indemnified party for losses suffered or incurred by the indemnified party as a result of the Company s activities or, in some cases, as a result of the indemnified party s activities under the agreement. The indemnification provisions may survive the termination of the underlying agreement. In addition, in some cases, the Company has agreed to reimburse employees for certain expenses and to provide salary continuation during short-term disability. The maximum potential amount of future payments the Company could be required to make under these indemnification provisions may be unlimited. The Company has not incurred material costs to defend lawsuits or settle claims related to these indemnification provisions. As a result, the Company believes the estimated fair value of these provisions is minimal. Accordingly, the Company has no liabilities recorded for these agreements as of December 31, 2003.

In December 2002, the FASB issued SFAS No. 148, *Accounting for Stock Based Compensation* an Amendment of SFAS No. 123 (SFAS 148). This statement amends SFAS No. 123 to provide alternative methods of transition for a voluntary change to the fair value based method of accounting for stock-based employee compensation. In addition, this statement amends the disclosure requirements of SFAS No. 123 to require prominent disclosures in both annual and interim financial statements about the method of accounting for stock-based employee compensation and the effect of the method used on reported results. The Company adopted SFAS 148 on January 1, 2003, and has elected to continue to use the intrinsic method to account for employee stock options and accordingly, the adoption did not have a material impact on the Company s financial statements.

In January 2003, the FASB issued FASB Interpretation No. 46, *Consolidation of Variable Interest Entities* (FIN 46). This Interpretation requires that variable interest entities created after January 31, 2003, and variable interest entities in which an interest is obtained after that date, be evaluated for consolidation into an entity s financial statements. This interpretation also applies, beginning July 1, 2003 for the Company, to all variable interest entities in which an enterprise holds an interest that it acquired before February 1, 2003. The company has adopted this statement and the adoption did not have a material impact on the Company s financial statements.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Instruments with Characteristics of Both Liabilities and Equity,* (SFAS 150) which establishes standards for how an issuer classifies and measures certain financial instruments with characteristics of both liabilities and equity. SFAS 150 requires that an issuer classify a financial instrument that is within its scope, which may have previously been reported as equity, as a liability (or an asset in some circumstances). This statement is effective for financial instruments entered into or modified after May

31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003 for public companies. The Company adopted SFAS 150 on July 1, 2003. The adoption of SFAS 150 did not have a material impact on the Company s financial statements.

In December 2003, the Securities and Exchange Commission (SEC) issued staff accounting bulletin No. 104 (SAB 104) Revenue Recognition, which codifies, revises and rescinds certain sections of Staff Accounting Bulletin No. 101 Revenue Recognition, in order to make this interpretive guidance consistent with current authoritative accounting guidance and SEC rules and regulations. The changes noted in SAB 104 did not have a material effect on the Company s financial statements.

In November 2002, the Emerging Issues Task Force (EITF) issued Issue No. 00-21, *Accounting for Revenue Arrangements with Multiple Deliverables* . This issue addresses determination of whether an arrangement involving more than one deliverable contains more than one unit of accounting and how arrangement consideration should be measured and allocated to the separate units of accounting. EITF Issue No. 00-21 is effective for revenue arrangements entered into in fiscal quarters beginning after June 15, 2003. The Company adopted this issue on July 1, 2003 and the adoption had no material impact on our operating results or financial position.

Foreign Exchange

Management does not believe that the fluctuation in the value of the dollar in relation to the currencies of its customers in the last three fiscal years has adversely affected the Company s ability to sell products at agreed upon prices denominated in U.S. dollars. No assurance can be given, however, that adverse currency exchange rate fluctuations will not occur in the future. Should adverse currency exchange rate fluctuations occur in geographies where the Company sells/exports its products, management is not certain such fluctuations will materially impact the Company s operating results.

Inflation

Management believes inflation has not had a significant impact on the Company s operations during the past three years.

CRITICAL ACCOUNTING POLICIES

The Company s accounting policies are more fully described preceding the Company s consolidated financial statements. Certain of the Company s policies require the application of judgment by management in selecting the appropriate assumptions for calculating financial estimates. These judgments are based on historical experience, terms of existing contracts, commonly accepted industry practices and other assumptions that the Company believes are reasonable under the circumstances. These estimates and assumptions are reviewed periodically and the effects of revisions are reflected in the consolidated financial statements in the period they are determined to be necessary. Actual results may differ from these estimates under different assumptions or conditions. The Company s critical accounting polices and estimates include:

Revenue Recognition

Revenue from sales is recognized at the time title and the risks of ownership passes. This is when the customer has made the fixed commitment to purchase the goods, the products are shipped per the customers instructions, the sales price is determinable, and collection is reasonably assured.

Programs

Effective January 1, 2002, the Company adopted Emerging Issues Task Force Issue No. 01-9, *Accounting for Consideration Given by a Vendor to a Customer or a Reseller of the Vendor s Products* (EITF 01-9). Upon adoption of EITF 01-9, the Company was required to classify certain

payments to its customers as a reduction of sales. The Company previously classified certain of these payments as operating expenses in the consolidated statement of income. The amounts reclassified resulted in a reduction of net sales (and an offsetting reduction of operating expenses) of $3,649,100 in 2002 and $3,888,600 in 2001. Additionally, the Company engages in various customer programs. The Company accounts for these programs as operating expenses in accordance with EITF 01-9 as the Company receives an identifiable benefit in exchange for the consideration. Amounts charged to operating expenses were $2,222,000 in 2002 and $1,760,500 in 2001.

Advertising Expense

The Company expenses advertising costs in the period incurred. Advertising expenses, which include promotional costs, is recognized in operating costs (specifically in selling expenses) in the consolidated statements of income and was $1,207,000 in 2003, $570,000 in 2002 and $503,000 in 2001.

Cost of Goods Sold

In addition to normal centers (i.e., direct labor, raw materials) of cost of goods sold, the Company includes such cost centers as Health and Safety, Environmental, Maintenance and Quality Control in cost of goods sold.

Other Than Cost of Goods Sold Operating Expenses

Operating expenses include such cost centers as Selling, General and Administrative, Research and Product Development, Regulatory/Registration, Freight, Delivery and Warehousing in operating expenses.

Freight, Delivery and Warehousing Expense

Freight, delivery and warehousing costs incurred by the Company are reported as operating expenses. All amounts billed to a customer in a sales transaction related to freight, delivery and warehousing are recorded as a reduction in operating expenses. Freight, delivery and warehousing costs were $8,902,000 in 2003, $7,176,000 in 2003 and $6,588,000 in 2001.

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using the first-in, first-out method.

Long-lived Assets

The carrying value of long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Measurement of the impairment loss is based on the fair value of the asset. Generally, fair value will be determined using valuation techniques such as the present value of expected future cash flows.

Property, Plant and Equipment and Depreciation

Property, plant and equipment includes the cost of land, buildings, machinery and equipment, office furniture and fixtures, automobiles, and construction projects and significant improvements to existing plant and equipment. Interest costs related to significant construction projects may be capitalized at the Company s weighted average cost of capital. Expenditures for maintenance and minor repairs are expensed as incurred. When property or equipment is sold or otherwise disposed of, the related cost and accumulated depreciation is removed from the respective accounts and the gain or loss realized on disposition is reflected in earnings. All plant and equipment is depreciated using the straight-line method, utilizing estimated useful property lives. Building lives range from 10 to 30 years; machinery and equipment lives range from 3 to 15 years; office furniture and fixture lives range from 3 to 10 years, automobile lives range from 3 to 6 years; construction projects and significant improvements to existing plant and equipment lives range from 3 to 15 years when placed in service.

Foreign Currency Translation

Assets and liabilities of foreign subsidiaries, where the local currency is the functional currency, have been translated at year end exchange rates and profit and loss accounts have been translated using weighted average yearly exchange rates. Adjustments resulting from translation have been recorded in the equity section of the balance sheet as cumulative translation adjustments in other comprehensive income.

The effect of foreign currency exchange gains and losses on transactions that are denominated in currencies other that the entity s functional currency are remeasured into the functional currency using the end of the period exchange rates. The effects of remeasurement related to foreign currency transactions are included in current profit and loss accounts.

Fair Value of Financial Instruments

The carrying values of cash, receivables and accounts payable approximate their fair values because of the short maturity of these instruments.

The fair value of the Company s long-term debt and note payable to bank is estimated based on the quoted market prices for the same or similar issues or on the current rates offered to the Company for debt of the same remaining maturities. Such fair value approximates the respective carrying values of the Company s long-term debt and note payable to bank.

Income Taxes

The Company uses the asset and liability method to account for income taxes, including recognition of deferred tax assets for the anticipated future tax consequences attributable to differences between financial statement amounts and their respective tax bases. Income tax expense is recognized currently for taxes payable. The Company reviews its deferred tax assets for recovery. A valuation allowance is established when the Company believes that it is more likely than not that some portion of its deferred tax assets will not be realized. Changes in valuation allowances from period to period are included in the Company s tax provision in the period of change.

Goodwill and Other Intangible Assets

The primary identifiable intangible assets of the Company relate to product rights associated with its product acquisitions. The Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 142, Goodwill and Other Intangible Assets. Under the provisions of SFAS No. 142, identifiable intangibles with finite lives are amortized and those with indefinite lives are not amortized. The estimated useful life of an identifiable intangible asset to the Company is based upon a number of factors including the effects of demand, competition, and expected changes in the marketability of the Company s products. The Company tests identifiable intangible assets for impairment at least annually, relying on a number of factors including operating results, business plans and future cash flows. Identifiable intangible assets that are subject to amortization are evaluated for impairment using a process similar to that used to evaluate elements of property. The impairment test for identifiable intangible assets not subject to amortization consists of a comparison of the fair value of the intangible asset with its carrying amount. An impairment loss, if any, is recognized for the amount by which the carrying value exceeds the fair value of the asset. Fair value is typically estimated using a discounted cash flow analysis, which requires the Company to estimate the future cash flows anticipated to be generated by the particular asset(s) being tested for impairment as well as select a discount rate to measure the present value of the anticipated cash flows. When determining future cash flow estimates, the Company considers historical results adjusted to reflect current and anticipated operating conditions. Estimating future cash flows requires significant judgment by the Company in such areas as future economic conditions, industry-specific conditions, product pricing and necessary capital expenditures. The use of different assumptions or estimates for future cash flows could produce different impairment amounts (or none at all) for long-lived assets, goodwill and identifiable intangible assets. As of January 1, 2002, the Company had an immaterial amount of goodwill and amortization related to the goodwill. As such, the adoption of SFAS 142, did not have a material impact on the Company s financial statements.

Risk Factors

The Company s business may be adversely affected by cyclical and seasonal effects.

The chemical industry in general is cyclical and demands for its products tend to be slightly seasonal. Seasonal usage follows varying agricultural seasonal patterns, weather conditions and weather related pressure from pests, and customer marketing programs and requirements. Weather patterns can have an impact on the Company s operations. The end user of some of its products may, because of weather patterns, delay or intermittently disrupt field work during the planting season which may result in a reduction of the use of some products and therefore reduce our revenues and profitability. There can be no assurance that the Company will adequately address any adverse seasonal effects.

The industry in which the Company does business is extremely competitive and its business may suffer if the Company is unable to compete effectively.

Generally, the treatment against pests of any kind is broad in scope, there being more than one way or one product for treatment, eradication, or suppression. The Company faces competition from many domestic and foreign manufacturers, marketers and distributors participating in its marketplace. Competition in the marketplace is based primarily on efficacy, price, safety and ease of application. Many of the Company s competitors are larger and have substantially greater financial and technical resources. The Company s ability to compete depends on its ability to develop additional applications for its current products, and to expand its product lines and customer base. The Company competes principally on the basis of the quality of its products, and the technical service and support given to its customers. There can be no assurance that the Company will compete successfully with existing competitors or with any new competitors.

If the Company is unable to successfully position itself in smaller niche markets, its business may be adversely affected.

The Company has attempted to position itself in smaller niche markets that have been or are being abandoned by larger chemical companies. These types of markets tend not to attract larger chemical companies due to the smaller volume demand. As a result, larger chemical companies have been divesting themselves of products that fall into such smaller niche markets. These smaller niche markets require significant and intensive management input and ongoing product research and are near product maturity. There can be no assurance that the Company will be successful in these smaller niche markets or, if it is successful in one or more niche markets, that it will continue to be successful in such niche markets.

The manufacturing of the Company s products is subject to governmental regulations.

The Company operates two manufacturing facilities one in Los Angeles, California and the other in Axis, Alabama (the Facilities). The Facilities operate under the terms and conditions imposed by required licenses and permits by state and local authorities. The manufacturing of key ingredients for the Company s products occurs at the Facilities. An inability to renew or maintain a license or permit or if the fees for such licenses or permits were increased significantly, wither would impede the Company s access to key ingredients and the cost of production would increase, either of which would materially and adversely affect the Company s ability to provide its products in a timely and affordable manner.

The distribution and sale of the Company s products are subject to prior governmental approvals and thereafter ongoing governmental regulation.

The Company s products are subject to laws administered by federal, state and foreign governments, including regulations requiring registration, approval and labeling of its products. The labeling requirements restrict the use of and type of application for our products. More stringent restrictions could make our products less desirable which would adversely affect our revenues and profitability. Substantially all of the Company s products are subject to the United States Environmental Protection Agency (U.S. EPA) registration and re-registration requirements, and are conditionally registered in accordance with the Federal Insecticide, Fungicide and Rodenticide Act (FIFRA). Such registration requirements are based, among other things, on data demonstrating that the product will not cause unreasonable adverse effects on human health or the environment when used according to approved label directions. All states where any of the Company s products are used also require registration before they can be marketed or used in that state. Governmental regulatory authorities have required, and may require in the future, that certain scientific data requirements be performed on the Company s products. The Company, on its behalf and in joint efforts with other registrants, have and are currently furnishing certain required data relative to its products. Under FIFRA, the federal government requires registrants to submit a wide range of scientific data to support U.S. registrations. This requirement has significantly increased the Company s operating expenses in such areas as testing and the production of new products. The Company expects such increases to continue in the future. Because scientific analyses are constantly improving, it cannot be determined with certainty whether or not new or additional tests may be required by regulatory authorities. Responding to such requirements may cause delays in the sales of our products which delays would adversely affect our profitability. While FIFRA Good Laboratory Practice standards specify the minimum practices and procedures which must be followed in order to ensure the quality and integrity of data related to these tests submitted to the U.S. EPA, there can be no assurance the EPA will not request certain tests or studies be repeated. In addition, more stringent legislation or requirements may be imposed in the future. The Company can provide no assurance that any testing approvals or registrations will be granted on a timely basis, if at all, or that its resources will be adequate to meet the costs of regulatory compliance.

The Company may be subject to environmental liabilities.

The Company, its facilities and its products are subject to numerous federal and state laws and governmental regulations concerning environmental matters and employee health and safety. The Company continually adapts its manufacturing process to the environmental control standards of the various regulatory agencies. The U.S. EPA and other federal and state agencies have the authority to promulgate regulations that could have a material adverse impact on the Company s operations. The Company expends substantial funds to minimize the discharge of materials in the environment and to comply with governmental regulations relating to protection of the environment. Federal and state authorities may seek fines and penalties for violation of the various laws and governmental regulations, and could, among other things, impose liability on the Company for cleaning up the damage resulting from release of pesticides and other agents into the environment.

The Company s use of hazardous materials exposes it to potential liabilities.

The Company s development and manufacturing of chemical products involve the controlled use of hazardous materials. While the Company continually adapts its manufacturing process to the environmental control standards of regulatory authorities, it cannot completely eliminate the risk of accidental contamination or injury from hazardous or regulated materials. In the event of such contamination or injury, the Company may be held liable for significant damages or fines. In the event that such damages or fines are assessed, it could have a material adverse effect on the Company s financial and operating results.

The Company s business may give rise to product liability claims not covered by insurance or indemnity agreements.

The manufacturing, marketing, distribution and use of chemical products involve substantial risk of product liability claims. A successful product liability claim which is not insured may require the Company to pay substantial amounts of damages. In the event that such damages are paid, it could have a material adverse effect on the Company s financial and operating results.

Adverse results in pending legal and regulatory proceedings could have adverse effects on the Company s business.

The Company is currently involved in certain legal and regulatory proceedings, as described above. The Company has and will continue to expend resources and incur expenses in connection with these proceedings. There can be no assurance that the Company will be successful in these proceedings. An adverse determination in one or more of these proceedings could subject the Company to significant liabilities, which could have a material adverse effect on its financial and operating results.

The Company s future success will depend on its ability to develop additional applications for its products, and to expand its product lines and customer base.

The Company has grown primarily by a strategy of acquiring mature product lines from larger competitors and expanding sales of these products based on new applications and new users. The Company s success will depend, in part, on its ability to develop additional applications for its products, and to expand its product lines and customer base in a highly competitive market. There can be no assurance that the Company will be successful in adequately addressing these development needs on a timely basis or that, if these developments are addressed, the Company will be successful in the marketplace. In addition, there can be no assurance that products or technologies (e.g., genetic engineering) developed by others will not render the Company s products noncompetitive or obsolete which would have a material adverse effect on its financial and operating results. Many of the mature product lines the Company has acquired from larger competitors were divested as a result of a merger involving such large competitor.

The Company faces risks related to acquisitions of product lines.

The Company has expanded and intends to continue to expand its operations through the acquisition of additional product lines from these larger competitors. There can be no assurance that the Company will be able to identify, acquire or profitably manage additional product lines, or successfully integrate any acquired product lines without substantial expenses, delays or other operational or financial problems. There is an increasing trend in selling mature product lines through a competitive bid process. As a result, we may not be the successful bidder for a desirable product, or, if successful, we may pay a higher price for such product than if there was no competitive bid process. Further, acquisitions may involve a number of special risks or effects, including diversion of management s attention, failure to retain key acquired personnel, unanticipated events or circumstances, minimum purchase quantities, legal liabilities and amortization of acquired intangible assets and other one-time or ongoing acquisition related expenses. Some or all of these special risks or effects could have a material adverse effect on the Company s financial and operating results. Client satisfaction or performance problems associated with a business or product line could have a material adverse impact on the Company s reputation. In addition, there can be no assurance that acquired product lines, if any, will achieve anticipated revenues and earnings.

The Company relies on intellectual property which it may be unable to protect, or may be found to infringe the rights of others.

The Company s proprietary product formulations are protected, to the extent possible, as trade secrets and, to a lesser extent, by patents and trademarks. Most of the mature products that the Company has acquired which were patented are currently off patent because the patent has expired. The Company can provide no assurance that the way it protects its proprietary rights will be adequate or that its competitors will not independently develop similar or competing products.

Further, the Company can provide no assurance that its is not infringing other parties rights. Any claims could require the Company to spend significant sums in litigation, pay damages, develop non-infringing intellectual property, or acquire licenses to the intellectual property which is

the subject of asserted infringement.

The Company relies on key executives in large part for its success.

The Company s success is highly dependent upon the efforts and abilities of its executive officers, particularly Eric G. Wintemute, its President and Chief Executive Officer. Although Mr. Wintemute has entered into an employment agreement with the Company, this does not guarantee that he will continue his employment. The loss of the services of Mr. Wintemute or other executive officers could have a material adverse effect upon its financial and operating results.

Concentration of ownership among the Company s Co-Chairmen of the Board of Directors may prevent new investors from influencing significant corporate decisions.

As of March 22, 2004, Herbert A. Kraft and Glenn A. Wintemute, the Company s Co-Chairmen of the Board of Directors, beneficially owned approximately 17% and 12%, respectively, of the Company s common stock. These stockholders as a group will be able to influence substantially the Company s Board of Directors and thus its management and affairs. If acting together, they would be able to influence most matters requiring the approval by the Company s stockholders, including the election of directors, any merger, consolidation or sale of all or substantially all of the Company s assets and any other significant corporate transaction. The concentration of ownership may also delay or prevent a change in control if opposed by these stockholders irrespective of whether the proposed transaction is at a premium price or otherwise beneficial to the Company s stockholders as a whole.

The Company s stock price may be volatile and an investment in the Company s stock could decline in value.

The market prices for securities of companies in the Company s industry have been highly volatile and may continue to be highly volatile in the future. Often this volatility is unrelated to operating performance of a company.

The Company s business may be adversely affected by terrorist activities.

The Company s business depends on the free flow of products and services through the channels of commerce. Recently, in response to terrorists activities and threats aimed at the United States, transportation, mail, financial and other services have been slowed or stopped altogether. Further delays or stoppages in transportation, mail, financial or other services could have a material adverse effect on the business, results of operations and financial condition. Furthermore, the Company may experience an increase in operating costs, such as costs for transportation, insurance and security as a result of the activities and potential activities. The Company may also experience delays in receiving payments from payers that have been affected by the terrorist activities and potential activities. The U.S. economy in general is being adversely affected by the terrorist activities and potential activities and any economic downturn could adversely impact results of operations, impair the ability to raise capital or otherwise adversely affect the ability to grow the business.

This report contains forward-looking statements. Forward-looking statements relate to future periods and include descriptions of our plans, objectives, and underlying assumptions for future operations, our market opportunities, our acquisition opportunities, and our ability to compete. Generally, may, could, will, would, expect, believe, estimate, anticipate, intend, continue and similar words identify forward-
Forward-looking statements are based on our current expectations and are subject to risks and uncertainties that can cause actual results to differ materially. For information on these risks and uncertainties, see the Risk Factors in this report. We urge you to consider these factors carefully in evaluating the forward-looking statements contained in this report. Forward-looking statements are made only as of the date of this report.