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SL INDUSTRIES INC  
Form 10-Q  
August 12, 2004

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE  
SECURITIES EXCHANGE ACT OF 1934  
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2004  
OR

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

Commission file number 1-4987

SL INDUSTRIES, INC.  
(Exact name of registrant as specified in its charter)

NEW JERSEY

21-0682685

-----  
(State or other jurisdiction of  
incorporation or organization)

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

520 FELLOWSHIP ROAD, SUITE A114, MT. LAUREL, NJ

08054

-----  
(Address of principal executive offices)

-----  
(Zip Code)

Registrant's telephone number, including area code: 856-727-1500

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 common stock outstanding as of  
August 2, 2004 were 5,859,153.

TABLE OF CONTENTS

|  | PAGE |
|--|------|
|  | ---- |
| PART I. FINANCIAL INFORMATION            |      |
| Item 1. Financial Statements             |      |
| Consolidated Balance Sheets              |      |
| June 30, 2004 and December 31, 2003..... | 1    |

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|   |    |
|---|----|
| Consolidated Statements of Operations   |    |
| Three Months Ended June 30, 2004 and 2003   |    |
| and Six Months Ended June 30, 2004 and 2003.....  | 2  |
| Consolidated Statements of Cash Flows   |    |
| Six Months Ended June 30, 2004 and 2003.....  | 3  |
| Notes to Consolidated Financial Statements.....   | 4  |
| <br>  |    |
| Item 2. Management's Discussion and Analysis of Financial<br>Condition and Results of Operations..... | 16 |
| <br>  |    |
| Item 3. Quantitative and Qualitative Disclosures about Market Risk.....                               | 29 |
| <br>  |    |
| Item 4. Controls and Procedures.....  | 29 |
| <br>  |    |
| PART II. OTHER INFORMATION  |    |
| <br>  |    |
| Item 1. Legal Proceedings.....  | 29 |
| <br>  |    |
| Item 2. Changes in Securities, Use of Proceeds and<br>Issuer Purchases of Equity Securities.....      | 29 |
| <br>  |    |
| Item 4. Submission of Matters to a Vote of Security Holders.....                                      | 30 |
| <br>  |    |
| Item 5. Other Information.....  | 30 |
| <br>  |    |
| Item 6. Exhibits and Reports on Form 8-K.....   | 30 |
| <br>  |    |
| Signatures.....   | 32 |

Item 1. Financial Statements

SL INDUSTRIES, INC.  
CONSOLIDATED BALANCE SHEETS

|  | June 30,<br>2004 |
|--|------------------|
|  | (Unaudited)      |
| <br>                                     |                  |
| ASSETS                                   |                  |
| Current assets:                          |                  |
| Cash and cash equivalents .....          | \$ 4,252,000     |
| Receivables, net .....                   | 18,031,000       |
| Note receivable .....                    | -                |
| Inventories, net .....                   | 13,860,000       |
| Prepaid expenses .....                   | 1,227,000        |
| Deferred income taxes, net .....         | 3,431,000        |
|  | -----            |
| Total current assets .....               | 40,801,000       |
| <br>                                     |                  |
| Property, plant and equipment, net ..... | 8,865,000        |
| Deferred income taxes, net .....         | 2,102,000        |
| Goodwill, net .....                      | 10,303,000       |
| Other intangible assets, net .....       | 922,000          |
| Other assets and deferred costs .....    | 2,009,000        |
|  | -----            |

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|   |               |       |
|---|---------------|-------|
| Total assets .....  | \$ 65,002,000 | ===== |
| <br>LIABILITIES   |               |       |
| Current liabilities:  |               |       |
| Debt, current portion .....   | \$ 559,000    |       |
| Accounts payable .....  | 6,224,000     |       |
| Accrued income taxes .....  | 1,488,000     |       |
| Accrued liabilities:  |               |       |
| Payroll and related costs .....   | 5,800,000     |       |
| Other .....   | 5,909,000     |       |
|   | -----         |       |
| Total current liabilities .....   | 19,980,000    |       |
| <br>Debt, less current portion .....  |               |       |
| Deferred compensation and supplemental retirement benefits .....            | 1,735,000     |       |
| Other liabilities .....   | 3,921,000     |       |
|   | 716,000       |       |
|   | -----         |       |
| Total liabilities .....   | \$ 26,352,000 | ----- |
| <br>Commitments and contingencies (Note 9)                                  |               |       |
| <br>SHAREHOLDERS' EQUITY  |               |       |
| Preferred stock, no par value; authorized, 6,000,000 shares; none issued... | \$ -          |       |
| Common stock, \$.20 par value; authorized, 25,000,000 shares;               |               |       |
| issued, 8,298,000 shares .....  | 1,660,000     |       |
| Capital in excess of par value .....  | 39,076,000    |       |
| Retained earnings .....   | 13,738,000    |       |
| Treasury stock at cost, 2,424,000 and 2,356,000 shares, respectively .....  | (15,824,000)  |       |
|   | -----         |       |
| Total shareholders' equity .....  | 38,650,000    |       |
|   | -----         |       |
| Total liabilities and shareholders' equity .....                            | \$ 65,002,000 | ===== |

See accompanying notes to consolidated financial statements.

SL INDUSTRIES, INC.  
CONSOLIDATED STATEMENTS OF OPERATIONS  
(Unaudited)

|   | Three-Months Ended |               |       |
|---|--------------------|---------------|-------|
|   | June 30,           |               |       |
|   | 2004               | 2003*         |       |
|   | -----              | -----         | ----- |
| Net sales                                 | \$30,508,000       | \$ 26,927,000 | \$ 5  |
| Cost and expenses:                        |                    |               |       |
| Cost of products sold .....               | 19,120,000         | 16,590,000    | 3     |
| Engineering and product development ..... | 2,376,000          | 2,070,000     |       |
| Selling, general and administrative ..... | 6,256,000          | 5,908,000     | 1     |
| Depreciation and amortization .....       | 468,000            | 470,000       |       |
|   | -----              | -----         | ----- |
| Total cost and expenses .....             | 28,220,000         | 25,038,000    | 5     |
|   | -----              | -----         | ----- |

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|   |              |            |       |
|---|--------------|------------|-------|
| Income from operations .....                                | 2,288,000    | 1,889,000  |       |
| Other income (expense):                                     |              |            |       |
| Deferred financing costs .....                              | (112,000)    | (101,000)  |       |
| Interest income .....                                       | 18,000       | 31,000     |       |
| Interest expense .....                                      | (59,000)     | (96,000)   |       |
|   | -----        | -----      |       |
| Income from continuing operations before income taxes ..... | 2,135,000    | 1,723,000  |       |
| Income tax provision .....                                  | 576,000      | 596,000    |       |
|   | -----        | -----      |       |
| Income from continuing operations .....                     | 1,559,000    | 1,127,000  |       |
|   | -----        | -----      |       |
| Income (loss) from discontinued operations (net of tax) ... | 20,000       | (428,000)  |       |
|   | -----        | -----      |       |
| Net income .....  | \$ 1,579,000 | \$ 699,000 | \$    |
|   | =====        | =====      | ===== |
| BASIC NET INCOME (LOSS) PER COMMON SHARE                    |              |            |       |
| Income from continuing operations .....                     | \$ 0.27      | \$ 0.19    | \$    |
| Income (loss) from discontinued operations (net of tax)     | 0.00         | (0.07)     |       |
|   | -----        | -----      |       |
| Net income .....  | \$ 0.27      | \$ 0.12    | \$    |
|   | -----        | -----      |       |
| DILUTED NET INCOME (LOSS) PER COMMON SHARE                  |              |            |       |
| Income from continuing operations .....                     | \$ 0.26      | \$ 0.19    | \$    |
| Income (loss) from discontinued operations (net of tax)     | 0.00         | (0.07)     |       |
|   | -----        | -----      |       |
| Net income .....  | \$ 0.26      | \$ 0.12    | \$    |
|   | -----        | -----      |       |
| Shares used in computing basic net income (loss)            |              |            |       |
| per common share .....                                      | 5,880,000    | 5,898,000  |       |
| Shares used in computing diluted net income (loss)          |              |            |       |
| per common share .....                                      | 5,984,000    | 5,912,000  |       |

\* RECLASSIFIED FOR COMPARATIVE PURPOSES ONLY.

See accompanying notes to consolidated financial statements.

2

SL INDUSTRIES, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
FOR THE SIX MONTHS ENDED JUNE 30, 2004 AND JUNE 30, 2003  
(Unaudited)

OPERATING ACTIVITIES:

|  |  |    |
|--|--|----|
| Net income from continuing operations .....                    |  | \$ |
| Adjustments to reconcile net income from continuing operations |  |    |
| to net cash (used in) provided by operating activities:        |  |    |
| Depreciation .....   |  |    |
| Amortization .....   |  |    |
| Amortization of deferred financing costs .....                 |  |    |
| Provisions for losses on accounts receivable .....             |  |    |

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|   |  |
|---|--|
| Issuance of common stock options .....  |  |
| Additions to other assets .....   |  |
| Deferred compensation and supplemental retirement benefits .....                        |  |
| Deferred compensation and supplemental retirement benefit payments .....                |  |
| (Increase) decrease in deferred income taxes .....                                      |  |
| Loss/(gain) on sale of equipment .....  |  |
| Changes in operating assets and liabilities, excluding effects of business disposition: |  |
| Accounts receivable .....   |  |
| Inventories .....   |  |
| Prepaid expenses .....  |  |
| Accounts payable .....  |  |
| Other accrued liabilities .....   |  |
| Accrued income taxes .....  |  |
| <br>NET CASH (USED IN) PROVIDED BY OPERATING ACTIVITIES .....                           |  |
| <br>INVESTING ACTIVITIES:   |  |
| Proceeds from sale of subsidiary (cash and notes receivable) .....                      |  |
| Purchases of property, plant, and equipment .....                                       |  |
| <br>NET CASH PROVIDED BY INVESTING ACTIVITIES .....                                     |  |
| <br>FINANCING ACTIVITIES:   |  |
| Payments of deferred financing costs .....  |  |
| Net proceeds from Senior Credit Facility .....  |  |
| Payments of term loans .....  |  |
| Payments to Revolving Credit Facility, net .....  |  |
| Proceeds from stock options exercised .....   |  |
| Treasury stock (purchases) sales .....  |  |
| <br>NET CASH USED IN FINANCING ACTIVITIES .....   |  |
| <br>NET CASH PROVIDED BY DISCONTINUED OPERATIONS .....                                  |  |
| <br>NET CHANGE IN CASH AND CASH EQUIVALENTS .....                                       |  |
| CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD .....                                  |  |
| <br>CASH AND CASH EQUIVALENTS AT END OF PERIOD .....                                    |  |

Supplemental disclosures of cash flow information:

Cash paid during the year for:

|                    |  |
|--------------------|--|
| Interest .....     |  |
| Income taxes ..... |  |

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See accompanying notes to consolidated financial statements.

SL INDUSTRIES, INC.

Notes to Consolidated Financial Statements (Unaudited)

1. BASIS OF PRESENTATION

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The accompanying unaudited consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions for Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, the accompanying financial statements contain all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation. Operating results for interim periods are not necessarily indicative of the results that may be expected for the year ending December 31, 2004. These financial statements should be read in conjunction with the Company's audited financial statements and notes thereon included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003. The statements of operations and cash flows for the applicable periods ended June 30, 2003 and certain footnotes have been reclassified to reflect the effect of discontinued operations.

### LIQUIDITY

On January 6, 2003, the Company entered into a three-year senior secured credit facility (the "Senior Credit Facility") with LaSalle Business Credit LLC. The Senior Credit Facility provides for a revolving loan and two term loans, up to a maximum indebtedness of \$20,000,000. The revolving loan of up to \$16,810,000 is based upon eligible receivables and inventory, as well as an overadvance amount of \$1,500,000. The overadvance amount was fully paid down on April 7, 2004. The two term loans of \$2,350,000 and \$840,000 are being paid down over a three-year term. The Senior Credit Facility restricts investments, acquisitions, capital expenditures and dividends. The Senior Credit Facility also contains financial covenants relating to minimum levels of net worth, fixed charge coverages, levels of earnings before interest, taxes, depreciation and amortization and maximum levels of capital expenditures, as defined. The Company is in compliance with all of the restrictions and covenants of the Senior Credit Facility.

### 2. RECEIVABLES

Receivables at June 30, 2004 and December 31, 2003 consisted of the following:

|   | June 30,<br>2004   | December 31,<br>2003 |
|---|--------------------|----------------------|
| -----<br>(in thousands)                   |                    |                      |
| Trade receivables .....                   | \$ 17,884          | \$ 12,656            |
| Less allowances for doubtful accounts.... | (415)              | (365)                |
|   | -----<br>17,469    | -----<br>12,291      |
| Recoverable income taxes .....            | 137                | 406                  |
| Other .....                               | 425                | 367                  |
|   | -----<br>\$ 18,031 | -----<br>\$ 13,064   |
|   | =====              | =====                |

### 3. INVENTORIES

Inventories at June 30, 2004 and December 31, 2003 consisted of the following:

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|                         | June 30,<br>2004 | December 31,<br>2003 |
|-------------------------|------------------|----------------------|
| -----<br>(in thousands) |                  |                      |
| Raw materials.....      | \$ 10,699        | \$ 8,384             |
| Work in process.....    | 4,097            | 3,769                |
| Finished goods.....     | 2,019            | 1,494                |
|                         | -----            | -----                |
|                         | 16,815           | 13,647               |
| Less allowances.....    | (2,955)          | (2,638)              |
|                         | -----            | -----                |
|                         | \$ 13,860        | \$ 11,009            |
|                         | =====            | =====                |

4. INCOME PER SHARE

The Company has presented net income per common share pursuant to Financial Accounting Standards Board Statement of Financial Accounting Standard ("SFAS") No. 128, "Earnings per Share." Basic net income per common share is computed by dividing reported net income available to common shareholders by the weighted average number of shares outstanding for the period. Diluted net income per common share is computed by dividing reported net income available to common shareholders by the weighted average shares outstanding for the period, adjusted for the dilutive effect of common stock equivalents, which consist of stock options, using the treasury stock method.

The table below sets forth the computation of basic and diluted net income per share:

|  | Three Months Ended June 30,<br>2004 |        |                     |               |
|--|-------------------------------------|--------|---------------------|---------------|
| -----<br>(in thousands, except per share amount) |                                     |        |                     |               |
|  | Net<br>Income                       | Shares | Per Share<br>Amount | Net<br>Income |
|  | -----                               | -----  | -----               | -----         |
| Basic net income per common share                | \$1,579                             | 5,880  | \$ 0.27             | \$ 699        |
| Effect of dilutive securities                    | -                                   | 104    | -                   | -             |
|  | -----                               | -----  | -----               | -----         |
| Diluted net income per common share              | \$1,579                             | 5,984  | \$ 0.26             | \$ 699        |
|  | =====                               | =====  | =====               | =====         |

Six Months Ended June 30,  
2004

-----  
(in thousands, except per share amount)

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|                                     | Net<br>Income | Shares | Per Share<br>Amount | Net<br>Income |
|-------------------------------------|---------------|--------|---------------------|---------------|
| Basic net income per common share   | \$4,720       | 5,909  | \$ 0.80             | \$ 885        |
| Effect of dilutive securities       | -             | 98     | -                   | -             |
| Diluted net income per common share | \$4,720       | 6,007  | \$ 0.79             | \$ 885        |

For the six-month periods ended June 30, 2004 and June 30, 2003, common stock options of 473,501 and 492,475, respectively, were excluded from the diluted computations because the option exercise prices were greater than the average market price of the Company's common stock during these periods.

STOCK BASED COMPENSATION

In December 2002, the Financial Accounting Standards Board ("FASB") issued SFAS No. 148, "Accounting for Stock Based Compensation-Transition and Disclosure" ("SFAS No. 148"), an amendment of SFAS No. 123 "Accounting for Stock-Based Compensation" ("SFAS No. 123"). SFAS No. 148 provides alternative methods for a voluntary change to the fair value method of accounting for stock-based employee compensation and amends the disclosure requirements of SFAS No. 123. The Company has elected to continue to account for its stock-based employee compensation plans under APB Opinion 25, "Accounting for Stock Issued to Employees" ("APB No. 25") and related interpretations. The following disclosures are provided in accordance with SFAS No. 148.

As permitted by the FASB, the Company has elected to follow APB No. 25 and related interpretations in accounting for its stock option plans. Under APB Opinion No. 25, compensation expense is measured as the excess, if any, of the fair value of the Company's common stock at the date of the grant over the amount a grantee must pay to acquire the stock. The Company's stock option plans enable the Company to grant options with an exercise price not less than the fair value of the Company's common stock at the date of the grant. However, the Company has recognized approximately \$184,000 and \$428,000 in the three month period ended June 30, 2004 and the six month period ended June 30, 2004, respectively, in compensation expense related to certain stock based compensation arrangements.

6

The exercise price of all stock options generally equals the market price of the Company's common stock on the date of grant. Compensation cost has been recognized for the Company's stock option plans as noted in the table below. Had compensation cost for the Company's stock option plans been determined based upon the fair value at the grant date for awards under these plans, consistent with the methodology prescribed under SFAS No. 123, the Company's net income and net income per common share would have been as follows:

|  | Three Months Ended June 30,<br>2004 | 2003   |
|--|-------------------------------------|--------|
|  | (in thousands, except per s         |        |
| Net income, as reported                | \$ 1,579                            | \$ 699 |
| Add: Stock-based employee compensation |                                     |        |



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|   |          |         |
|---|----------|---------|
| expense included in reported net income, net of related tax effects   | \$ 112   | \$ 15   |
|   | -----    | -----   |
|   | \$ 1,691 | \$ 714  |
| Deduct: Total stock-based employee compensation expense determined under fair value based method for awards granted, modified, or settled, net of related tax effects | (191)    | (185)   |
|   | -----    | -----   |
| Pro forma net income  | \$ 1,500 | \$ 529  |
|   | =====    | =====   |
| Earnings per common share:  |          |         |
| Basic - as reported   | \$ 0.27  | \$ 0.12 |
| Basic - pro forma   | \$ 0.26  | \$ 0.09 |
| Diluted - as reported   | \$ 0.26  | \$ 0.12 |
| Diluted - pro forma   | \$ 0.25  | \$ 0.09 |

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option-pricing model with the following weighted average assumptions:

|                                 | Six Months Ended<br>June 30,<br>2004 | Six Months Ended<br>June 30,<br>2003 |
|---------------------------------|--------------------------------------|--------------------------------------|
|                                 | -----                                | -----                                |
| Expected dividend yield         | 0.0%                                 | 0.0%                                 |
| Expected stock price volatility | 61.29%                               | 61.61%                               |
| Risk-free interest rate         | 2.81%                                | 2.69%                                |
| Expected life of stock option   | 5 years                              | 5 years                              |

The fair value of the above stock-based compensation costs were determined using the Black-Scholes option valuation model. The Black-Scholes option valuation model was developed for use in estimating the fair value of traded options, which have no vesting restrictions, are fully transferable and do not include a discount for large block trades. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility, expected life of the option and other estimates. Because the Company's employee stock options have characteristics significantly different from those of traded options and because changes of the subjective input assumptions can materially affect the fair value estimate, in the Company's opinion, the existing models do not necessarily provide a reliable single measure of the fair value of its employee stock options.

5. RECENT AND PROPOSED ACCOUNTING PRONOUNCEMENTS

In December 2003, the FASB revised Statement No. 132 "Employers' Disclosures about Pensions and Other Postretirement Benefits." The FASB's revision of Statement No. 132 requires new annual disclosures about the types of plan assets, investment strategy, measurement date, plan obligations and cash flows, as well as the components of the net periodic benefit cost recognized in interim periods. In addition, companies are now required to disclose their estimates of contributions to their plans during the next fiscal year and the components of

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the fair value of total plan assets by type (i.e., equity securities, debt securities, real estate and other assets). The Company adopted the provisions of Statement No. 132 (revised), except for expected future benefit payments, which must be disclosed for fiscal years ending after June 15, 2004.

On March 31, 2004, the FASB issued an exposure document entitled "Share-Based Payment - an amendment of Statements No. 123 and 95 (Proposed Statement of Financial Accounting Standards)." The Proposed Statement would eliminate the ability to account for share-based compensation transactions using Accounting Principles Board ("APB") Opinion No. 25, "Accounting for Stock Issued to Employees" and generally would require that such transactions be accounted for using a fair-value-based method. This accounting treatment, if approved, could result in significant compensation expense for the Company. The Proposed Statement currently contemplates its provisions being applied to public entities prospectively for fiscal years beginning after December 15, 2004, as if all share-based compensation awards granted, modified, or settled after December 15, 1994, had been accounted for using the fair-value method of accounting. Retrospective application of the Proposed Statement is not permitted.

### 6. INTANGIBLE ASSETS

Intangible assets consist of the following:

|                               | June 30, 2004  |                             |           |             |
|-------------------------------|----------------|-----------------------------|-----------|-------------|
|                               | Gross Value    | Accumulated<br>Amortization | Net Value | Gross Value |
|                               | (in thousands) |                             |           |             |
| Goodwill                      | \$12,167       | \$ 1,864                    | \$10,303  | \$12,167    |
| Other Intangible Assets:      |                |                             |           |             |
| Patents                       | 946            | 630                         | 316       | 946         |
| Covenant Not To Compete       | 110            | 110                         | -         | 110         |
| Trademarks                    | 922            | 338                         | 584       | 922         |
| Other                         | 501            | 479                         | 22        | 501         |
| Total Other Intangible Assets | 2,479          | 1,557                       | 922       | 2,479       |
|                               | \$14,646       | \$ 3,421                    | \$11,225  | \$14,646    |

The other intangible assets are all amortizable and have original estimated useful lives as follows: patents are amortized over approximately 13 years and trademarks over approximately 25 years. Amortization expense for intangible assets for each of the three-month periods of fiscal 2004 and 2003 were \$28,000; and for the six-month periods of fiscal 2004 and 2003 were \$58,000 and \$56,000, respectively. Amortization expense for intangible assets subject to amortization in each of the next five fiscal years is estimated to be \$116,000 per year.

### 7. DEBT

Debt consists of the following:

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|                           | June 30,<br>2004 | December 31,<br>2003 |
|---------------------------|------------------|----------------------|
| -----<br>(in thousands)   |                  |                      |
| Revolving lines of credit | \$ -             | \$ 327               |
| Term loan A               | 1,795            | 1,992                |
| Term loan B               | 499              | 583                  |
|                           | -----            | -----                |
|                           | 2,294            | 2,902                |
| Less current portion      | (559)            | (887)                |
|                           | -----            | -----                |
| Long-term debt            | \$ 1,735         | \$ 2,015             |
|                           | =====            | =====                |

The Company's Senior Credit Facility bears interest ranging from the prime rate plus fifty basis points to the prime rate plus 2%. The Senior Credit Facility is secured by all of the Company's assets. The Senior Credit Facility also provides for certain reserves for outstanding letters of credit and other contingencies, which have reduced the Company's availability under the revolving loan portion of the Senior Credit Facility. At June 30, 2004, the outstanding revolving loan balance was \$0 and the outstanding term loan balances were \$1,795,000 and \$499,000, or a total of \$2,294,000 and bore interest of 4.5%. Availability under the Senior Credit Facility at June 30, 2004 was \$13,205,000.

The schedule of payments on long-term debt is as follows:

|                         | June 30  |
|-------------------------|----------|
| -----<br>(in thousands) |          |
| 2005                    | 559      |
| 2006                    | 1,735    |
| 2007                    | -        |
|                         | -----    |
|                         | 2,294    |
| Less current portion    | (559)    |
|                         | -----    |
| Total long-term debt    | \$ 1,735 |
|                         | =====    |

9

8. ACCRUED LIABILITIES AND OTHER

Accrued liabilities and other consists of the following:

|   | June 30,<br>2004 | December 31,<br>2003 |
|---|------------------|----------------------|
| -----<br>(in thousands)                 |                  |                      |
| Taxes (other than income) and insurance | \$ 901           | \$1,062              |

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|                                       |          |         |
|---------------------------------------|----------|---------|
| Commissions                           | 447      | 484     |
| Accrued litigation and legal fees     | 1,511    | 1,109   |
| Other professional fees               | 211      | 269     |
| Environmental                         | 1,019    | 957     |
| Warranty                              | 992      | 915     |
| Other                                 | 1,428    | 1,206   |
| Reclassified to long-term liabilities | (600)    | (600)   |
|                                       | -----    | -----   |
|                                       | \$ 5,909 | \$5,402 |
|                                       | =====    | =====   |

The Company's warranty reserve, which is included in accrued liabilities and other above, for the period ended June 30, 2004 is as follows:

|   |                  |
|---|------------------|
|   | June 30,<br>2004 |
|   | -----            |
|   | (in thousands)   |
| Liability, beginning of year                        | \$ 915           |
| Expense for new warranties issued                   | 246              |
| Expense related to accrual revisions for prior year | 20               |
| Warranty claims                                     | (189)            |
|   | -----            |
| Liability, end of period                            | \$ 992           |
|   | -----            |

9. COMMITMENTS AND CONTINGENCIES

LITIGATION

In the ordinary course of its business, the Company is subject to loss contingencies pursuant to foreign and domestic federal, state and local governmental laws and regulations and is also party to certain legal actions, which may occur in the normal operations of the Company's business. It is management's opinion that the impact of these legal actions will not have a material adverse effect on the consolidated financial position or results of operations of the Company.

The Company's subsidiary, SL Montevideo Technology, Inc. ("SL-MTI"), defended a cause of action, brought against it in the fall of 2000, in the United States District Court for the Western District of Michigan. The lawsuit was filed by a customer, Eaton Aerospace, Inc. ("Eaton"), alleging breach of contract and warranty in the defective design and manufacture of a high precision motor and demanding compensatory damages of approximately \$3,900,000. On November 7, 2002, after a full trial of the facts, a jury awarded Eaton damages of \$650,000, which when combined with pre-trial interest brings the total claim to \$780,000. The full amount of the jury award and pre-trial interest is fully reserved. Eaton is appealing the decision.

The Company's subsidiary SLW Holdings, Inc., formerly known as SL Waber, Inc., is the defendant in a cause of action brought in Superior Court of the State of Illinois. This case was initiated by a former independent sales representative of SL Waber, Inc. claiming wrongful termination. On August 9, 2004, the Company reached an agreement with the plaintiff to settle all disputes in consideration for \$235,000 payable in cash.

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Substantially all of the assets of SL Waber, Inc., including its corporate name were sold by the Company in August 2001.

In 1997, the Company, through a wholly owned subsidiary, commenced a patent infringement action against American Power Conversion Corporation ("APC") in the United States District Court for the Southern District of New Jersey. The complaint alleged that APC infringed a patent held by the subsidiary, and sought damages resulting from APC's infringement. On February 3, 2004, the Company and APC executed a Settlement Agreement that provided, among other things, for the release of all claims against APC and the granting to APC a paid-up license, in return for the payment to the Company of \$4,000,000. The Settlement Agreement was conditioned on the dismissal with prejudice of the lawsuit. On March 5, 2004, the District Court dismissed the lawsuit with prejudice and the settlement fee was paid to the Company. A third party has threatened certain claims against the Company relating to this matter for a portion of the payment. The Company disputes such claims and intends to defend against them vigorously.

On June 12, 2002, the Company and its wholly owned subsidiary, SL Surface Technologies, Inc. ("SurfTech"), were served with notice of a class action complaint filed in Superior Court of New Jersey for Camden County. (Substantially all of the operating assets of SurfTech were sold in November 2003). The Company and SurfTech are currently two of approximately 39 defendants in this action. The complaint alleges, among other things, that the plaintiffs suffered personal injuries as a result of consuming water distributed from the Puchack Wellfield in Pennsauken, New Jersey (which supplied Camden, New Jersey).

This case arises from the same factual circumstances as current administrative actions involving the Puchack Wellfield, to which the Company is a party. The administrative actions are discussed below. The administrative actions and the class action lawsuit both allege that SurfTech and other defendants contaminated ground water through the disposal of hazardous substances at industrial facilities in the area. SurfTech once operated a chrome-plating facility in Pennsauken, New Jersey (the "SurfTech Site").

As with the administrative actions, the Company believes it has significant defenses against the class action plaintiffs' claims and intends to pursue them vigorously. Technical data generated as part of remedial activities at the SurfTech Site have not established offsite migration of contaminants and there are several other technical factors and defenses available to the Company. Based on the foregoing, the Company has been advised by its outside counsel that it has a strong defense against the claims alleged in the class action plaintiffs' complaint, as well as the environmental administrative actions.

It is management's opinion that the impact of legal actions brought against the Company and its operations will not have a material adverse effect on its financial position or results of operations. However, the ultimate outcome of these matters, as with litigation generally, is inherently uncertain, and it is possible that some of these matters may be resolved adversely to the Company. The adverse resolution of any one or more of these matters could have a material adverse effect on the business, operating results, financial condition or cash flows of the Company.

### ENVIRONMENTAL

Loss contingencies include potential obligations to investigate and eliminate or mitigate the effects on the environment of the disposal or release of certain chemical substances at various sites, such as Superfund sites and other

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facilities, whether or not they are currently in operation. The Company is currently participating in environmental assessments and cleanups at a number of sites under these laws and may in the future be involved in additional environmental assessments and cleanups. Based upon investigations completed by the Company and its independent engineering-consulting firms to date, management has provided an estimated accrual for all known costs believed to be probable in the amount of \$1,019,000. However, it is in the nature of environmental contingencies that other circumstances might arise, the costs of which are indeterminable at this time due to such factors as changing government regulations and stricter standards, the unknown magnitude of defense and cleanup costs, the unknown timing and extent of the remedial actions that may be required, the determination of the Company's liability in proportion to other responsible parties, and the extent, if any, to which such costs are recoverable from other parties or from insurance. Although these contingencies could result in additional expenses or judgments, or off-sets thereto, at present such expenses or judgments are not expected to have a material effect on the consolidated financial position or results of operations of the Company. Substantially all of the Company's environmental costs relate to discontinued operations and all such costs have been recorded in discontinued operations.

The Company is the subject of various other lawsuits and actions relating to environmental issues, including an administrative action in connection with the SurfTech Site, which could subject the Company to, among other things, \$9,266,000 in collective reimbursements (with other parties) to the New Jersey Department of Environmental Protection (the "NJDEP"). Technical data generated as part of remedial activities at the SurfTech site have not established offsite migration of contaminants and there are other technical factors and defenses available to the Company. Based on the foregoing, the Company has been advised by its outside counsel that it has significant defenses against all or any part of the claim and that any material impact is unlikely.

The Company has reported a ground water contamination plume on its property in Camden, New Jersey. In January 2003, the Company submitted to the NJDEP a plan to remediate the site, which is currently under review. Based upon the preliminary evidence, the Company was advised that the cost to remediate the site could amount to \$500,000. The Company recorded a provision for this amount during the first quarter of 2002.

The Company is investigating soil and ground water contamination on SL-MTI's property in Montevideo, Minnesota. The Company has submitted to the Minnesota Department of Environmental Protection a plan to remediate the site, which is currently under review. At this date, it is too early to estimate the costs of remediation.

The Company filed claims with several of its insurers seeking reimbursement for past and future environmental costs. In settlement of its claims, the Company received aggregate cash payments of \$2,800,000 prior to fiscal 2001 and contingent commitments from three insurers to pay for a portion of environmental costs associated with the SurfTech Site of 15% of costs up to \$300,000, 15% of costs up to \$150,000 and 20% of costs up to \$400,000, respectively. On May 14, 2004, the Company received \$138,000 from one insurer as payment of part of its contingent commitment, which is recorded in discontinued operations. As of June 30, 2004 and December

12

31, 2003, the remaining environmental accruals of \$1,019,000 and \$957,000, respectively, have been included in "Accrued liabilities and other" (Note 8).

10. SEGMENT INFORMATION

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The Company currently operates under four business segments: Condor D.C. Power Supplies, Inc. ("Condor"), Teal Electronics Corp. ("Teal"), RFL Electronics Inc. ("RFL") and SL Montevideo Technology, Inc. ("SL-MTI"). In the second quarter of 2003, management decided to combine Condor and Teal into one business unit classified as the Power Electronics Group. Accordingly, for the periods presented, the Company's reportable segments consisted of Condor and Teal (the "Power Electronics Group"), SL-MTI and RFL.

At December 31, 2002, the Company was comprised of five operating business units. On November 24, 2003, the Company sold the operating assets of SurfTech. SurfTech is classified as discontinued for all periods presented. Of the remaining business segments: Condor produces a wide range of standard and custom power supply products that convert AC or DC power to direct electrical current to be used in customers' end products. Power supplies closely regulate and monitor power outputs, using patented filter and other technologies, resulting in little or no electrical interference. Teal is a leader in the design and manufacture of customized power conditioning and power distribution units. Teal products are developed and manufactured for custom electrical subsystems for original equipment manufacturers of semiconductor, medical imaging, graphics, and telecommunications systems. SL-MTI is a technological leader in the design and manufacture of intelligent, high power density precision motors. New motor and motion controls are used in numerous applications, including aerospace, medical, and industrial products. RFL designs and manufactures teleprotection products/systems that are used to protect utility transmission lines and apparatus by isolating faulty transmission lines from a transmission grid. RFL also provides customer service and maintenance for all electric utility equipment protection systems. The Other segment includes corporate related items, financing activities and other costs not allocated to other reportable segments, which include but are not limited to certain legal, litigation and public reporting charges.

The unaudited comparative results for the three-month and six-month periods in fiscal 2004 and 2003 are as follows:

|                          | Three Months Ended<br>June 30, |           | Six Months Ended<br>June 30, |       |
|--------------------------|--------------------------------|-----------|------------------------------|-------|
|                          | 2004                           | 2003      | 2004                         |       |
|                          | -----                          |           |                              |       |
|                          | (in thousands)                 |           |                              |       |
| NET SALES                |                                |           |                              |       |
| Power Electronics Group: |                                |           |                              |       |
| Condor                   | \$ 11,660                      | \$ 10,587 | \$ 19,523                    | \$    |
| Teal                     | 7,408                          | 5,074     | 14,801                       |       |
|                          | -----                          | -----     | -----                        | ----- |
| Total                    | 19,068                         | 15,661    | 34,324                       |       |
|                          | -----                          | -----     | -----                        | ----- |
| SL-MTI                   | 5,886                          | 5,732     | 11,783                       |       |
| RFL                      | 5,554                          | 5,534     | 11,043                       |       |
|                          | -----                          | -----     | -----                        | ----- |
| Consolidated             | \$ 30,508                      | \$ 26,927 | \$ 57,150                    | \$    |
|                          | =====                          | =====     | =====                        | ===== |

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|                          | June 30,       |          | June 30, |          |
|--------------------------|----------------|----------|----------|----------|
|                          | 2004           | 2003     | 2004     | 2003     |
|                          | -----          |          |          |          |
|                          | (in thousands) |          |          |          |
| INCOME FROM OPERATIONS   |                |          |          |          |
| Power Electronics Group: |                |          |          |          |
| Condor                   | \$ 1,524       | \$ 1,241 | \$ 1,400 | \$ 1,805 |
| Teal                     | 1,094          | 545      | 2,428    | 900      |
|                          | -----          | -----    | -----    | -----    |
| Total                    | 2,618          | 1,786    | 3,828    | 2,705    |
|                          | -----          | -----    | -----    | -----    |
| SL-MTI                   | 619            | 507      | 1,259    | 806      |
| RFL                      | 412            | 525      | 836      | 1,150    |
| Other                    | (1,361)        | (929)    | (2,440)  | (1,717)  |
|                          | -----          | -----    | -----    | -----    |
| Consolidated             | \$ 2,288       | \$ 1,889 | \$ 3,483 | \$ 2,944 |
|                          | =====          | =====    | =====    | =====    |

|                          | June 30,       | December 31, |
|--------------------------|----------------|--------------|
|                          | 2004           | 2003         |
|                          | -----          |              |
|                          | (in thousands) |              |
| TOTAL ASSETS             |                |              |
| Power Electronics Group: |                |              |
| Condor                   | \$15,504       | \$11,439     |
| Teal                     | 12,809         | 9,665        |
|                          | -----          | -----        |
| Total                    | 28,313         | 21,104       |
|                          | -----          | -----        |
| SL-MTI                   | 9,712          | 9,255        |
| RFL                      | 16,828         | 16,512       |
| Other                    | 10,149         | 11,550       |
|                          | -----          | -----        |
| Consolidated             | \$65,002       | \$58,421     |
|                          | =====          | =====        |

|                         | June 30,       | December 31, |
|-------------------------|----------------|--------------|
|                         | 2004           | 2003         |
|                         | -----          |              |
|                         | (in thousands) |              |
| INTANGIBLE ASSETS (NET) |                |              |
| Teal                    | \$ 5,954       | \$ 6,009     |
| SL-MTI                  | 22             | 25           |
| RFL                     | 5,249          | 5,249        |
|                         | -----          | -----        |
| Consolidated            | \$11,225       | \$11,283     |
|                         | =====          | =====        |

11. DISCONTINUED OPERATIONS

SL WABER



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Effective August 27, 2001, substantially all of the assets of SL Waber, Inc. ("SL Waber") and the stock of Waber de Mexico S.A. de C.V. were sold for approximately \$1,053,000. As part of this transaction, the purchaser acquired the rights to the SL Waber name and assumed certain liabilities and obligations of SL Waber. Subsequent to the sale, the Company changed the name of SL Waber to SLW Holdings, Inc. ("SLW Holdings"). The net income or losses of this subsidiary are included in the consolidated statements of operations under discontinued operations for all periods presented. There was no activity from operations of SLW Holdings during the fourth quarter of 2001 and thereafter. In 1997, SL Waber commenced patent infringement litigation against APC, the rights to which were retained by SL Waber after the

14

sale. On February 3, 2004, the Company and APC executed a Settlement Agreement that provided, among other things, for a release of all claims against APC and granted to APC a paid-up license, in return for the payment to the Company of \$4,000,000. The Settlement Agreement was conditioned on the dismissal with prejudice of the lawsuit. On March 5, 2004, the settlement fee was paid to the Company. The settlement fee, net of tax, in the amount of \$2,488,000 is recorded as part of discontinued operations in the Company's consolidated statements of operations and cash flows for the six months ended June 30, 2004.

### ELEKTRO-METALL EXPORT GMBH

On January 6, 2003, the Company sold its wholly-owned, indirect German subsidiary, Elektro-Metall Export GmbH ("EME"). In consideration for 100% of the issued and outstanding capital stock of EME, the purchaser paid \$8,000,000, consisting of cash of \$4,000,000 paid at closing and \$4,000,000 of purchaser notes. In addition, EME made a distribution of \$2,000,000 to the Company prior to closing. The purchaser notes were comprised of a \$3,000,000 secured note that bore interest at the prime rate plus 2%, which was received on March 14, 2003, and a \$1,000,000 unsecured note that bore interest at an annual rate of 12%, which was received on April 2, 2004. All cash proceeds relating to the purchase price for the sale of EME have now been received by the Company.

### SL SURFACE TECHNOLOGIES, INC.

On November 24, 2003, the Company sold the operating assets of SurfTech. The sale included current assets and equipment used by SurfTech. The purchaser paid \$600,000 in cash, plus the assumption of certain liabilities. The Company continues to own the land and building on which SurfTech's operations were conducted, and has entered into a ten-year lease with the buyer. As a result of the sale, the Company recorded an after tax loss of \$442,000 in the fourth quarter of 2003, which included severance, closing costs and liabilities associated with the withdrawal from a multi-employer union pension plan. The Company paid most of the severance and all closing costs related to the sale in the fourth quarter of 2003, but continues to make payments related to its withdrawal liability from the pension plan in which SurfTech was a participant. There has not been any operational activity related to SurfTech since the sale in November 2003. During the three and six month periods ended June 30, 2003, SurfTech had sales of \$517,000 and \$1,025,000, respectively, and a net loss before income taxes of \$126,000 and \$323,000, respectively, which has been reclassified as discontinued operations.

## 12. RETIREMENT PLANS AND DEFERRED COMPENSATION

The Company maintains three defined contribution pension plans covering substantially all employees. The Company's contributions to these plans are based on a percentage of employee elective contributions and, in one plan, plan year gross wages, as defined. Contributions to plans maintained by Teal and RFL are based on a percentage of employee elective contributions. RFL has also made

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a profit sharing contribution annually. Costs incurred under these plans amounted to \$517,000 and \$622,000 during the six months ended June 30, 2004 and 2003, respectively.

The Company has agreements with certain active and retired directors, officers and key employees providing for supplemental retirement benefits. The liability for supplemental retirement benefits is based on the most recent mortality tables available at discount rates ranging from 6% to 12%. The amount charged to income in connection with these agreements amounted to \$225,000 and \$156,000 for the six months ended June 30, 2004 and 2003, respectively.

15

### 13. RELATED PARTY TRANSACTIONS

During the period January 1, 2004 to June 9, 2004, the Company was billed \$81,000 in legal fees for services performed by Olshan Grundman Frome Rosenzweig & Wolosky LLP ("Olshan"), a law firm in which a former director of the Company is a senior partner. This director did not stand for reelection at the Company's Annual Meeting of Shareholders held on June 9, 2004 and therefore is no longer considered a related party. As of June 9, 2004, \$33,000 remains payable for 2004 services. The fees relate to general corporate and securities matters. During the comparable period in 2003, the Company was billed \$297,000 in legal fees for services performed by Olshan.

The compensation committee has approved the payment of certain fees from the Company to Steel Partners, Ltd. ("SPL"), a company controlled by the Chairman of the Board and Chief Executive Officer of the Company, Warren Lichtenstein. These fees are in consideration for the services of Mr. Lichtenstein and the Company's President, Glen Kassan, as well as other assistance provided by SPL from time to time. During the six months ended June 30, 2004, the Company has expensed \$237,000 for SPL services, of which \$40,000 remains payable. The Company expensed \$237,000 for services performed for the six months ended June 30, 2003.

RFL has an investment of \$15,000 in RFL Communications PLC ("RFL Communications"), representing 4.5% of the outstanding equity thereof. RFL Communications is a distributor of teleprotection and communication equipment located in the United Kingdom. It is authorized to sell RFL products in accordance with an international sales agreement. Sales to RFL Communications for the six months ended June 30, 2004 and June 30, 2003 were \$824,000 and \$403,000, respectively. Accounts receivable due from RFL Communications at June 30, 2004 was \$119,000.

### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The Company through its subsidiaries, designs, manufactures and markets power electronics, power motion, power protection equipment, teleprotection and specialized communication equipment that is used in a variety of aerospace, computer, datacom, industrial, medical, telecom, transportation and utility equipment applications. The Company is comprised of four domestic business segments, two of which have significant manufacturing operations in Mexico. Most of the Company's sales are made to customers who are based in the United States. However, the Company has over the years increased its presence in international markets. The Company places an emphasis on high quality, well-built, dependable products and continues its dedication to product enhancement and innovations.

### CRITICAL ACCOUNTING POLICIES

The Company's Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the United States. These

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generally accepted accounting principles require 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 Consolidated Financial Statements and the reported amounts of net sales and expenses during the reporting period.

The Company's significant accounting policies are described in Note 1 in the Notes to Consolidated Financial Statements included in Part IV of the Company's Annual Report on

16

Form 10-K. Not all of these significant accounting policies require management to make difficult, subjective or complex judgments or estimates. However, the following policies could be deemed to be critical, as that term is defined by the Securities and Exchange Commission.

### REVENUE RECOGNITION

Revenue from product sales is recognized at the time the product is shipped, with provisions established for estimated product returns and returns related to one business segment's stock scrap program with distributors. Upon shipment, the Company provides for the estimated cost that may be incurred for product warranties. Rebates and other sales incentives offered by the Company are recorded as a reduction of sales at the time of shipment. Revenue recognition is significant because net sales is a key component of results of operations. In addition, revenue recognition determines the timing of certain expenses, such as commissions and royalties. The Company follows generally accepted guidelines in measuring revenue. However, certain judgments affect the application of its revenue policy. Revenue results are difficult to predict, and any shortfall in revenue or delay in recognizing revenue could cause operating results to vary significantly from quarter to quarter and could result in future operating losses.

### ALLOWANCE FOR DOUBTFUL ACCOUNTS

The Company's estimate for the allowance for doubtful accounts related to trade receivables is based on two methods. The amounts calculated from each of these methods are combined to determine the total amount reserved. First, the Company evaluates specific accounts where it has information that the customer may have an inability to meet its financial obligations (bankruptcy, etc.). In these cases, the Company uses its judgment, based on the best available facts and circumstances, and records a specific reserve for that customer against amounts due to reduce the receivable to the amount that is expected to be collected. These specific reserves are reevaluated and adjusted as additional information is received that impacts the amount reserved. Second, a general reserve is established for all customers based on several factors, including historical write-offs as a percentage of sales. If circumstances change (i.e., higher than expected defaults or an unexpected material adverse change in a major customer's ability to meet its financial obligation), the Company's estimates of the recoverability of amounts due could be reduced by a material amount.

### INVENTORIES

The Company values inventory at the lower of cost or market, and continually reviews the book value of discontinued product lines to determine if these items are properly valued. The Company identifies these items and assesses the ability to dispose of them at a price greater than cost. If it is determined that cost is less than market value, then cost is used for inventory valuation. If market value is less than cost, then related inventory is adjusted to that value.

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If a write down to the current market value is necessary, the market value cannot be greater than the net realizable value, which is defined as selling price less costs to complete and dispose, and cannot be lower than the net realizable value less a normal profit margin. The Company also continually evaluates the composition of its inventory and identifies slow-moving and excess inventories. Inventory items identified as slow-moving or excess are evaluated to determine if reserves are required. If the Company is not able to achieve its expectations of the net realizable value of the inventory at current market value, it adjusts its reserves accordingly.

17

### ACCOUNTING FOR INCOME TAXES

The Company's income tax policy records the estimated future tax effects of temporary differences between the tax basis of assets and liabilities and amounts reported in the accompanying consolidated balance sheets, as well as operating loss and tax credit carryforwards. The Company follows generally accepted guidelines regarding the recoverability of any tax assets recorded on the balance sheet and provides any necessary allowances as required. As part of the process of preparing its consolidated financial statements, the Company is required to estimate its income taxes in each of the jurisdictions in which it operates. This process involves estimating the actual current tax exposure, together with assessing temporary differences resulting from the differing treatment of certain items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included within the consolidated balance sheet. Management must then assess the likelihood that deferred tax assets will be recovered from future taxable income and to the extent it believes that recovery is not likely, the Company must establish a valuation allowance. To the extent it establishes a valuation allowance or increases or decreases this allowance in a period, it must include expense or income, as the case may be, within the tax provision in the consolidated statement of operations.

Significant management judgment is required in determining the provision for income taxes, the deferred tax assets and liabilities and any valuation allowance recorded against deferred tax assets. As of June 30, 2004 and December 31, 2003, the Company had recorded total valuation allowances of \$352,000 for both periods due to uncertainties related to the utilization of some deferred tax assets, primarily consisting of certain loss carryforwards and tax credits before they expire. The valuation allowance is based on estimates of taxable income by jurisdiction in which the Company operates and the period over which deferred tax assets will be recoverable. In the event that actual results differ from these estimates or these estimates are adjusted in future periods, the Company may need to establish an additional valuation allowance that could materially impact its consolidated financial position and results of operations.

The net deferred tax assets as of June 30, 2004 and December 31, 2003 were \$5,533,000 and \$6,255,000, respectively, net of valuation allowances of \$352,000 for both periods. The carrying value of the Company's net deferred tax assets assumes that it will be able to generate sufficient future taxable income in certain tax jurisdictions based on estimates and assumptions. If these estimates and related assumptions change in the future, the Company may be required to record additional valuation allowances against its deferred tax assets resulting in additional income tax expense in the consolidated statement of operations. Management evaluates the recoverability of the deferred tax assets and assesses the need for additional valuation allowances quarterly.

### LEGAL CONTINGENCIES

The Company is currently involved in certain legal proceedings. As discussed in

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Note 9 in the Notes to the Consolidated Financial Statements included in Part I to this Quarterly Report on Form 10-Q, the Company has accrued an estimate of the probable costs for the resolution of these claims. This estimate has been developed after investigation and is based upon an analysis of potential results, assuming a combination of litigation and settlement strategies. Management does not believe these proceedings will have a material adverse effect on the Company's consolidated financial position. It is possible, however, that future results of operations for any particular quarterly or annual period could be materially affected by changes in these assumptions, or the effectiveness of these strategies, related to these proceedings.

18

### IMPAIRMENT OF LONG-LIVED AND INTANGIBLE ASSETS

The Company's long-lived and intangible assets primarily consist of fixed assets, goodwill and other intangible assets. Statement of Financial Accounting Standards No. 142 "Goodwill and Other Intangible Assets" ("SFAS 142") requires that goodwill be tested for impairment at the reporting unit level (operating segment or one level below an operating segment) on an annual basis and between annual tests in certain circumstances. Application of the goodwill impairment test requires judgment, including the identification of reporting units, assigning assets and liabilities to reporting units, assigning goodwill to reporting units, and determining the fair value of each reporting unit. Significant judgments required to estimate the fair value of reporting units include estimating future cash flows, determining appropriate discount rates and other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value for each reporting unit.

### ENVIRONMENTAL EXPENDITURES

The Company is subject to United States and Mexican environmental laws and regulations concerning emissions to the air, discharges to surface and subsurface waters, and generation, handling, storage, transportation, treatment and disposal of waste materials. The Company is also subject to other federal, state and local environmental laws and regulations, including those that require it to remediate or mitigate the effects of the disposal or release of certain chemical substances at various sites, including some where the Company has ceased operations. It is impossible to predict precisely what affect these laws and regulations will have in the future.

Expenditures that relate to current operations are charged to expense or capitalized, as appropriate. Expenditures that relate to an existing condition caused by past operations are expensed and recorded as part of discontinued operations. Expenditures include costs of remediation and legal fees to defend against claims for environmental liability. Liabilities are recorded when remedial efforts are probable and the costs can be reasonably estimated. The liability for remediation expenditures includes, as appropriate, elements of costs such as site investigations, consultants' fees, feasibility studies, outside contractor expenses and monitoring expenses. Estimates are not discounted, and they are not reduced by potential claims for recovery from insurance carriers. The liability is periodically reviewed and adjusted to reflect current remediation progress, prospective estimates of required activity and other relevant factors including changes in technology or regulations.

The above listing is not intended to be a comprehensive list of all of the Company's accounting policies. In many cases, the accounting treatment of a particular transaction is specifically dictated by generally accepted accounting principles with no need for management's judgment in their application. There are also areas in which management's judgment in selecting any available alternatives would not produce a materially different result. See the Company's

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audited Consolidated Financial Statements and Notes thereto included in Part IV of its Annual Report on Form 10-K, which contain accounting policies and other disclosures required by generally accepted accounting principles.

19

### LIQUIDITY AND CAPITAL RESOURCES

|                           | June 30, 2004<br>----- | December 31, 2003<br>----- |
|---------------------------|------------------------|----------------------------|
|                           |                        | (in thousands)             |
| Cash and cash equivalents | \$ 4,252               | \$ 3,501                   |
| Bank debt                 | \$ 2,294               | \$ 2,902                   |
| Working capital           | \$20,821               | \$16,612                   |
| Shareholders' equity      | \$38,650               | \$34,581                   |

At June 30, 2004, the Company maintained a cash balance of \$4,252,000, with outstanding bank debt of \$2,294,000. Availability under the Senior Credit Facility was \$13,205,000. During the six months ended June 30, 2004, the net cash used by operating activities was \$113,000, as compared to net cash provided by operating activities of \$396,000 during the six months ended June 30, 2003. The primary uses of cash from operating activities for the six-month period ended June 30, 2004 were increases in accounts receivable and in inventory. These uses of cash were partially offset by net income from continuing operations and an increase in accrued income taxes payable and accounts payable. In the six-month period of 2003, net cash provided by operating activities was \$396,000. The principal sources of cash were income from continuing operations, decreases in accounts receivable and inventory. These sources of cash were partially offset by reductions in accounts payable, other accrued liabilities and accrued income taxes.

On January 6, 2003, the Company entered into a three-year Senior Secured Credit Facility (the "Senior Credit Facility") with LaSalle Business Credit LLC. The Senior Credit Facility provides for a revolving loan facility and two term loans, up to a maximum indebtedness of \$20,000,000. The revolving loan of up to \$16,810,000 is based upon eligible receivables and inventory, as well as an overadvance amount of \$1,500,000, which was repaid in full on April 7, 2004. The two term loans of \$2,350,000 and \$840,000 are amortized over a three-year term. The Senior Credit Facility restricts investments, acquisitions, capital expenditures and dividends. It contains financial covenants relating to minimum levels of net worth, fixed charge coverage and EBITDA levels, as defined. The Company is currently in compliance with all the restrictions and covenants of the Senior Credit Facility. The Senior Credit Facility bears interest ranging from the prime rate plus fifty basis points to prime rate plus 2%. The Senior Credit Facility is secured by all of the Company's assets.

During the six months ended June 30, 2004, net cash provided by investing activities was \$299,000, primarily generated by the proceeds of \$1,000,000 received by the Company as a final cash payment from the sale of EME. These proceeds were partially offset by \$701,000 in capital expenditures primarily for computers, machinery and equipment. During the six months ended June 30, 2003, net cash provided by investing activities was \$6,437,000, which was primarily generated by the original proceeds of \$7,000,000 from the sale of EME.

During the six months ended June 30, 2004, net cash used in financing activities was \$1,409,000 primarily due to the payment of the fixed portion of debt and the

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overadvance under the Senior Credit Facility. Also during the period the Company purchased treasury stock in the amount of approximately \$821,000 for 83,450 shares at an average price of \$9.84 per share under the Company's repurchase program approved by the Board of Directors on December 12, 2003. During the six months ended June 30, 2003, net cash used in financing activities was \$11,497,000, primarily related to the pay down of the Company's former credit

20

facility in the net amount of \$17,557,000, offset by net borrowing of \$6,824,000 under the Senior Credit Facility.

The Company's current ratio was 2.04 to 1 at June 30, 2004 and 1.98 to 1 at December 31, 2003. The increase in the current ratio at June 30, 2004 is due to increases in cash, receivables and inventory from year-end levels, partially offset by an increase in accounts payable.

As a percentage of total capitalization, consisting of debt and shareholders' equity, total borrowings by the Company were 6% at June 30, 2004 and 8% at December 31, 2003. During the first six months of 2004, total debt decreased by \$608,000.

Capital expenditures of \$701,000 were made during the first six months of 2004. These expenditures primarily related to computer equipment, factory machinery and equipment purchases. Capital expenditures for the period represent a \$138,000 increase from the comparable period in 2003. During the remainder of 2004, the Company anticipates incurring additional capital expenditures of approximately \$600,000. This amount is subject to change depending upon a number of factors, including certain market conditions within the Company's business segments and availability of financing.

During the first six months of 2004, the Company was able to generate adequate amounts of cash to meet its operating needs, reduce total borrowings by \$608,000 and purchase treasury stock in the amount of approximately \$821,000 under the Company's stock repurchase program. During the period, the operating segments had an aggregate negative cash flow of \$503,000, compared to a positive cash flow of \$3,474,000 in the same period of 2003. Condor and Teal, which had increases in accounts receivable and inventory at the end of the second quarter 2004, generated negative cash flow during the 2004 period. Both of these business segments had increased sales in the second quarter of 10% and 46%, respectively, and increases in backlog for the period of 19% and 45%, respectively. All operating business segments are expected to have positive cash flow for the year ending December 31, 2004.

### CONTRACTUAL OBLIGATIONS

The following is a summary of the Company's contractual obligations that existed as of June 30, 2004:

|                  | Less Than<br>1 Year | 1 to 3<br>Years | 4 to 5<br>Years | After 5<br>Years | Total   |
|------------------|---------------------|-----------------|-----------------|------------------|---------|
| -----            |                     |                 |                 |                  |         |
| (in thousands)   |                     |                 |                 |                  |         |
| Operating Leases | \$ 795              | \$1,400         | \$ -            | \$ -             | \$2,195 |
| Debt             | 559                 | 1,735           | -               | -                | 2,294   |
| Capital Leases   | 46                  | 122             | -               | -                | 168     |

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|                            |                           |                        |                        |                           |
|----------------------------|---------------------------|------------------------|------------------------|---------------------------|
| -----<br>\$ 1,400<br>===== | -----<br>\$3,257<br>===== | -----<br>\$ -<br>===== | -----<br>\$ -<br>===== | -----<br>\$4,657<br>===== |
|----------------------------|---------------------------|------------------------|------------------------|---------------------------|

OFF-BALANCE SHEET ARRANGEMENTS

It is not the Company's usual business practice to enter into off-balance sheet arrangements, such as guarantees on loans and financial commitments, indemnification arrangements, and retained

21

interests in assets transferred to an unconsolidated entity for securitization purposes. Consequently, the Company has no off-balance sheet arrangements, except for operating lease commitments disclosed in the table above, that have, or are reasonably likely to have, a material current or future effect on its financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures or capital resources.

Assuming no further significant slowdown of economic activity in the Company's served markets, management believes that cash from operations and funds expected to be available under the Senior Credit Facility will be sufficient to fund the Company's operations and working capital requirements.

RESULTS OF OPERATIONS

THREE MONTHS ENDED JUNE 30, 2004, COMPARED WITH THREE MONTHS ENDED JUNE 30, 2003

The table below shows the comparison of net sales for the quarter ended June 30, 2004 and the quarter ended June 30, 2003:

|                                  | Three Months<br>Ended<br>June 30,<br>2004 | Three Months<br>Ended<br>June 30,<br>2003 | Increase/<br>(Decrease) Over<br>Same Quarter<br>Last Year | Increase<br>(Decrease)<br>Same Quar<br>Last Yea |
|----------------------------------|---|---|---|---|
|                                  | Amount                                    | Amount                                    | Amount  | Percent   |
| -----<br>(in thousands)<br>----- |   |   |   |   |
| Power Electronics Group:         |   |   |   |   |
| Condor                           | \$ 11,660                                 | \$ 10,587                                 | \$ 1,073  |   |
| Teal                             | 7,408                                     | 5,074                                     | 2,334   |   |
|                                  | -----                                     | -----                                     | -----   |   |
| Total                            | 19,068                                    | 15,661                                    | 3,407   |   |
|                                  | -----                                     | -----                                     | -----   |   |
| SL-MTI                           | 5,886                                     | 5,732                                     | 154   |   |
| RFL                              | 5,554                                     | 5,534                                     | 20  |   |
|                                  | -----                                     | -----                                     | -----   |   |
| Total                            | \$ 30,508                                 | \$ 26,927                                 | \$ 3,581  |   |
|                                  | -----                                     | -----                                     | -----   |   |

The table below shows the comparison of income from operations for the quarter ended June 30, 2004 and the quarter ended June 30, 2003:



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|                          | Three Months<br>Ended<br>June 30,<br>2004 | Three Months<br>Ended<br>June 30,<br>2003 | Increase/<br>(Decrease) Over<br>Same Quarter<br>Last Year | Increase<br>(Decrease)<br>Same Qua<br>Last Yea |
|--------------------------|---|---|---|--|
|                          | Amount                                    | Amount                                    | Amount  | Percent  |
| (in thousands)           |   |   |   |  |
| Power Electronics Group: |   |   |   |  |
| Condor                   | \$ 1,524                                  | \$ 1,241                                  | \$ 283  |  |
| Teal                     | 1,094                                     | 545                                       | 549   |  |
| Total                    | 2,618                                     | 1,786                                     | 832   |  |
| SL-MTI                   | 619                                       | 507                                       | 112   |  |
| RFL                      | 412                                       | 525                                       | (113)   |  |
| Other                    | (1,361)                                   | (929)                                     | (432)   |  |
| Total                    | \$ 2,288                                  | \$ 1,889                                  | \$ 399  |  |

22

Consolidated net sales for the three-month period ended June 30, 2004 increased by \$3,581,000, or 13%, compared to the same quarter in 2003. Teal experienced a significant sales increase from 2003 of \$2,334,000, or 46%. Condor also recorded increased sales over 2003 of \$1,073,000, or 10%. SL-MTI and RFL recorded modest sales increases in 2004, compared to 2003.

The Company had income from operations of \$2,288,000 for the three-month period ended June 30, 2004, as compared to income from operations of \$1,889,000 for the corresponding period last year, an increase of \$399,000, or 21%.

Net income from continuing operations was \$1,559,000, or \$0.26 per diluted share, compared to \$1,127,000, or \$0.19 per diluted share in 2003. Net income from continuing operations increased \$432,000, or 38%. The Company's business segments and the components of operating expenses are discussed more fully in the following sections.

The Power Electronics Group, which is comprised of Condor and Teal, recorded a sales increase of \$3,407,000, or 22%, and an increase in income from operations of \$832,000, or 47%. Teal experienced a sales increase of \$2,334,000, or 46%, and an increase in income from operations of \$549,000, or 101%. Condor also experienced an increase in sales of \$1,073,000, or 10%, and an increase in income from operations of \$283,000, or 23%. Teal's sales increase was primarily attributable to significant increases in its medical imaging product line and, to a lesser extent, its semiconductor product line. Teal's increase in income from operations is due to its increase in sales volume. Condor's increase in sales for the quarter is primarily attributable to an increase in sales in its medical and industrial product lines, while sales decreased for its telecommunications product line. Condor's increase in income from operations is primarily due to its increase in sales volume in 2004 as compared to 2003.

SL-MTI's sales increased \$154,000, or 3%, while income from operations increased \$112,000, or 22%. The increase in income from operations is due to an increase in sales and a combination of improved efficiency experienced at its manufacturing facility in Cedro, Mexico, as compared to 2003. These manufacturing efficiencies contributed to improved gross margins in 2004 compared to 2003.

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RFL's sales increased \$20,000 during the second quarter of 2004, compared to 2003; while income from operations decreased by \$113,000, or 22%, for the comparable periods. While RFL has taken steps to contain its cost structure to be in line with its current sales forecast, it has significantly increased its engineering and product development costs. This increase is the principal reason for the reduction in income from operations in 2004 from 2003.

### COST OF PRODUCTS SOLD

As a percentage of net sales, cost of products sold in 2004 was approximately 63%, compared to 62% in 2003. Although the cost of products sold as a percentage of net sales remained relatively constant for the comparative quarters, the mix within the Company's business segments changed over the two periods. The cost of products sold percentage for the Power Electronics Group remained at approximately 63% for 2004, compared to 2003. Within the Power Electronics Group, Condor's cost of products sold remained constant. Teal's cost of products sold increased approximately 2%, due to an increase in materials costs and an increase in direct labor expenses. Direct labor expenses increased to support the rapid ramp-up in production, as necessary to meet precipitous sales growth. SL-MTI decreased its cost of products sold percentage from 72% in

23

2003, to 69% in 2004. These improved gross margins were due to an increase in sales volume and improved operating efficiencies at its manufacturing facility in Cedro, Mexico. RFL's cost of products sold as a percentage of sales remained relatively constant in 2004, compared to 2003.

### ENGINEERING AND PRODUCT DEVELOPMENT EXPENSES

Engineering and product development expenses for the three month periods ended June 30, 2004 and June 30, 2003 were approximately 8% of net sales. The increase in engineering and product development expenses was \$306,000, or 15% in the current quarter of 2004, as compared to 2003. With the exception of Teal, all of the Company's business segments increased their engineering and product development expenditures in 2004, compared to 2003. Teal's engineering and product development expenditures decreased marginally. SL-MTI and RFL are working on new products and product enhancements at a greater rate in 2004, compared to 2003.

### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses for 2004 and 2003 were 21% and 22% of sales, respectively. These expenses increased by \$348,000, or 6%, largely as the result of a 13% sales increase over the periods. The most significant increases in selling, general and administrative costs were experienced by Condor and Teal, due primarily to corresponding increases in sales volume. The Company also recorded \$184,000 in compensation expense related to certain stock based compensation arrangements with key executives.

### DEPRECIATION AND AMORTIZATION

Depreciation and amortization expenses for the 2004 and 2003 remained relatively constant at 2% of sales.

### AMORTIZATION OF DEFERRED FINANCING COSTS

In connection with entering into the Senior Credit Facility on January 6, 2003, the Company incurred costs of approximately \$1,342,000. These costs have been deferred and are being amortized over the three-year term of the Senior Credit Facility. For the quarters ended June 30, 2004 and June 30, 2003, amortization

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of these deferred financing assets was \$112,000 and \$101,000, respectively.

### INTEREST INCOME (EXPENSE)

Interest income decreased for the current three-month period by \$13,000, as compared to the same period last year. Interest expense for the current three-month period decreased by \$37,000, or 39%, due primarily to the reduction of debt.

### TAXES

The effective tax rate for the three-month period ended June 30, 2004 was approximately 27%. This rate reflects the statutory rate after adjustments for state tax provisions, offset by research and development credits and certain foreign tax credits recorded during the period. The effective tax rate for the comparable period in 2003 was approximately 35%.

### DISCONTINUED OPERATIONS

For the three months ended June 30, 2004, the Company recorded net income from discontinued operations, net of tax, of \$20,000. This amount, net of tax, is primarily attributable to a favorable tax ruling related to EME, in the amount \$330,000 net of expenses and net billings to insurance companies related to the recovery of certain legal fees for environmental matters in the amount of \$172,000, net of tax. These income amounts, net of tax, were offset by current environmental,

24

legal and litigation charges related to discontinued operations. For the three months ended June 30, 2003, the Company recorded a net loss from discontinued operations, net of tax, of \$428,000. This amount consisted primarily of the net loss for SurfTech, net of tax, in the amount of \$131,000 and the cost of environmental and legal charges related to discontinued operations.

### SIX MONTHS ENDED JUNE 30, 2004 COMPARED WITH SIX MONTHS ENDED JUNE 30, 2003

The table below shows the comparison of net sales for the six months ended June 30, 2004 and June 30, 2003:

|                                 | Six Months<br>Ended<br>June 30,<br>2004 | Six Months<br>Ended<br>June 30,<br>2003 | Increase/<br>(Decrease) Over<br>Same Period<br>Last Year | Increase/<br>(Decrease) O<br>Same Perio<br>Last Year |
|---------------------------------|---|---|--|--|
|                                 | Amount                                  | Amount                                  | Amount   | Percent  |
| (in thousands)                  |   |   |  |  |
| <b>Power Electronics Group:</b> |   |   |  |  |
| Condor                          | \$19,523                                | \$20,077                                | (\$ 554)   |  |
| Teal                            | 14,801                                  | 9,388                                   | 5,413  |  |
| Total                           | 34,324                                  | 29,465                                  | 4,859  |  |
| SL-MTI                          | 11,783                                  | 11,129                                  | 654  |  |
| RFL                             | 11,043                                  | 12,043                                  | (1,000)  |  |
| <b>Total</b>                    | <b>\$57,150</b>                         | <b>\$52,637</b>                         | <b>\$ 4,513</b>  |  |

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The table below shows the comparison of income from operations for the six months ended June 30, 2004 and June 30, 2003:

|                          | Six Months<br>Ended<br>June 30,<br>2004 | Six Months<br>Ended<br>June 30,<br>2003 | Increase/<br>(Decrease) Over<br>Same Period<br>Last Year | Increase<br>(Decrease)<br>Same Period<br>Last Year |
|--------------------------|---|---|--|--|
|                          | Amount                                  | Amount                                  | Amount   | Percent  |
| (in thousands)           |   |   |  |  |
| Power Electronics Group: |   |   |  |  |
| Condor                   | \$ 1,400                                | \$ 1,805                                | (\$ 405)   |  |
| Teal                     | 2,428                                   | 900                                     | 1,528  |  |
| Total                    | 3,828                                   | 2,705                                   | 1,123  |  |
| SL-MTI                   | 1,259                                   | 806                                     | 453  |  |
| RFL                      | 836                                     | 1,150                                   | (314)  |  |
| Other                    | (2,440)                                 | (1,717)                                 | (723)  |  |
| Total                    | \$ 3,483                                | \$ 2,944                                | \$ 539   |  |

Consolidated net sales for the six months ended June 30, 2004, compared to the six months ended June 30, 2003 increased \$4,513,000, or 9%. This increase was due mainly to an increase in sales in the Power Electronics Group of \$4,859,000, or 16%. Within the Power Electronics Group, Teal had a significant increase in sales of \$5,413,000, or 58%, while Condor's sales decreased \$554,000, or 3%. Condor's sales decrease was primarily due to

25

delayed shipments from its contract manufacturers in China in the first quarter. SL-MTI had a sales increase of \$654,000, or 6%; and RFL experienced a sales decrease of \$1,000,000, or 8%. The sales decrease at RFL was caused by sluggish demand in its served markets.

The Company recorded income from operations of \$3,483,000 for the six months ended June 30, 2004, compared to income from operations of \$2,944,000 for the corresponding period last year. This change represents an increase of \$539,000, or 18%.

Net income from continuing operations was \$2,244,000, or \$0.37 per diluted share in 2004, compared to \$1,598,000, or \$0.27 per diluted share in 2003. Net income from continuing operations increased by \$646,000, or 40%. The Company's business segments and the components of operating expenses are discussed more fully in the following sections:

The Power Electronics Group recorded a sales increase of \$4,859,000, or 16%, and an increase in income from operations of \$1,123,000, or 42%. Within the Power Electronics Group, Teal reported a sales increase of \$5,413,000, or 58%, and Condor recorded a sales decrease of \$554,000, or 3%. Teal's income from operations increased by \$1,528,000, or 170%, compared to 2003. Teal's increased

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income from operations was due to increased sales volume, which was partially offset by higher related selling and administrative costs. Its medical imaging product line and its semiconductor product line each experienced increased demand throughout the period. Condor experienced a sales decrease of \$554,000 and a decrease in income from operations of \$405,000, primarily due to delays in shipments from contract manufacturers in China.

SL-MTI's sales increased by \$654,000, or 6%, while income from operations increased by \$453,000, or 56%. The increase in sales was primarily due to increased demand for its medical product line in the first quarter of 2004. The increase in income from operations was the result of increased sales volume and operating efficiencies at SL-MTI's manufacturing facility in Cedro, Mexico. These increases were partially offset by increased engineering and product development spending.

RFL's sales decreased by \$1,000,000, or 8%, in 2004, compared to 2003. Income from operations decreased by \$314,000, or 27%, for the comparable periods. All of RFL's product lines experienced decreases in sales. RFL continues to experience inconsistent procurement patterns from electric utility companies, who are the major purchasers of its products. Larger infrastructure expansion projects continue to be deferred in favor of smaller maintenance projects. The Company believes that this pattern will continue until investment incentives are created by the enactment of pending federal energy legislation. RFL has maintained its gross margins, compared to 2003, due to cost containment. Despite lower sales volume, RFL increased its expenditures for engineering and product development by approximately 19%, compared to 2003.

### COST OF PRODUCTS SOLD

Cost of products sold as a percentage of sales for the six months ended June 30, 2004 and June 30, 2003 was approximately 63%. With the exception of SL-MTI, all of the business segments' cost of products sold as a percentage of sales were comparable to 2003. Gross margins at SL-MTI improved by approximately 4%, due to increased volume and improved manufacturing efficiencies, as previously discussed.

26

### ENGINEERING AND PRODUCT DEVELOPMENT EXPENSES

Engineering and product development expenses for the six months ended June 30, 2004 and June 30, 2003 remained at approximately 8% of sales. Engineering and product development expenses increased \$559,000, or 14%, in the six-month period of 2004, as compared to 2003. All of the Company's business segments increased their engineering and product development expenditures in 2004, compared to 2003.

### SELLING, GENERAL AND ADMINISTRATIVE EXPENSES

Selling, general and administrative expenses for the six months ended June 30, 2004 were approximately 21% of sales, compared to 22% of sales in 2003. These expenses increased by \$512,000, or 4%, over the comparative periods. The major reason for the increase was due to the greater sales volume. Another contributing factor to the increase was the recording of \$428,000 in compensation expense related to certain stock based compensation arrangements with key executives, which were non-cash charges for the period.

### DEPRECIATION AND AMORTIZATION

Depreciation and amortization expenses for 2004 and 2003 were approximately 2% of sales, and remained relatively constant in 2004, as compared to 2003.

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### AMORTIZATION OF DEFERRED FINANCING COSTS

Amortization of deferred financing costs was \$224,000 in 2004 and \$201,000 in 2003. These costs were less than 1% of sales in 2004 and 2003.

### INTEREST INCOME (EXPENSE)

Interest income for the six months ended June 30, 2004 decreased by \$35,000, as compared to the same period last year. This decrease is primarily related to the pay down of the purchaser's note, received as part of the sale of EME. Interest expense for the same six-month period decreased by \$120,000, or 45%, due primarily to the reduced debt levels.

### TAXES

The effective tax rate for the six months ended June 30, 2004 was approximately 29%, compared to 38% for the six months ended June 30, 2003. The effective tax rate for the six months ended June 30, 2004 reflects the statutory rate after adjustments for state tax provisions, offset by research and development credits and certain foreign tax credits primarily taken in the first quarter of 2004.

### DISCONTINUED OPERATIONS

For the six months ended June 30, 2004, the Company recorded net income from discontinued operations, net of tax, of \$2,476,000. This amount is primarily related to a settlement fee received by SL Waber, net of tax, in the amount of \$2,488,000 (see Note 11) and the reversal of tax reserves related to EME as previously discussed. These income amounts, net of tax, were partially offset by current environmental, legal and litigation charges related to discontinued operations. For the six months ended June 30, 2003, the Company recorded a net loss from discontinued operations, net of tax, of \$713,000. This amount consisted primarily of the net loss for SurfTech, net of tax, in the amount of \$274,000 and the cost of environmental and legal charges related to discontinued operations.

27

### FORWARD-LOOKING INFORMATION

From time to time, information provided by the Company, including written or oral statements made by representatives, may contain forward-looking information as defined in the Private Securities Litigation Reform Act of 1995. All statements, other than statements of historical facts, contain forward-looking information, particularly statements that address activities, events or developments that the Company expects or anticipates will or may occur in the future, such as expansion and growth of the Company's business, future capital expenditures and the Company's prospects and strategy. In reviewing such information, it should be kept in mind that actual results may differ materially from those projected or suggested in such forward-looking information. This forward-looking information is based on various factors and was derived utilizing numerous assumptions. Many of these factors previously have been identified in filings or statements made by or on behalf of the Company.

Important assumptions and other important factors that could cause actual results to differ materially from those set forth in the forward-looking information include changes in the general economy, changes in capital investment and/or consumer spending, competitive factors and other factors affecting the Company's business in or beyond the Company's control. These factors include a change in the rate of inflation, a change in state or federal legislation or regulations, an adverse determination with respect to a claim in

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litigation or other claims (including environmental matters), the ability to recruit and develop employees, the ability to successfully implement new technology and the stability of product costs. These factors also include the timing and degree of any business recovery in certain of the Company's markets that are currently experiencing a cyclical economic downturn.

Other factors and assumptions not identified above could also cause actual results to differ materially from those set forth in the forward-looking information. The Company does not undertake to update forward-looking information contained herein or elsewhere to reflect actual results, changes in assumptions or changes in other factors affecting such forward-looking information.

Future factors include the effectiveness of cost reduction actions undertaken by the Company; increasing price, products and services competition by U.S. and non-U.S. competitors, including new entrants; rapid technological developments and changes and the Company's ability to continue to introduce and develop competitive new products and services on a timely, cost-effective basis; availability of manufacturing capacity, components and materials; credit concerns and the potential for deterioration of the credit quality of customers; customer demand for the Company's products and services; ability of the Company to continue to finance its operations on satisfactory terms; U.S. and non-U.S. governmental and public policy changes that may affect the level of new investments and purchases made by customers; changes in environmental and other U.S. and non-U.S. governmental regulations; protection and validity of patent and other intellectual property rights; compliance with the covenants and restrictions of bank credit facilities; and outcome of pending and future litigation and governmental proceedings. These are representative of the future factors that could affect the outcome of the forward-looking statements. In addition, such statements could be affected by general industry and market conditions and growth rates, general U.S. and non-U.S. economic conditions, including increased economic uncertainty and instability, and interest rate and currency exchange rate fluctuations and other future factors.

28

For a further description of future factors that could cause actual results to differ materially from such forward-looking statements, see the discussion in the Company's Annual Report on Form 10-K for the year ended December 31, 2003, Part I, Item 1 - Risk Factors.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in quantitative and qualitative market risk from the disclosure contained in Item 7A of the Company's Annual Report on Form 10-K for the year ended December 31, 2003, which is incorporated herein by reference.

### ITEM 4. CONTROLS AND PROCEDURES

The Company, under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the design and operation of the Company's "disclosure controls and procedures," as such term is defined in Rules 13a-15e and 15d-15e promulgated under the Securities Exchange Act of 1934, as amended, (the "Exchange Act") as of this Quarterly Report on Form 10-Q (this "Report"). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer have concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this Report to provide reasonable assurance that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded,

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processed, summarized and reported within the time periods specified in the rules and forms of the Securities and Exchange Commission. There have been no changes in internal controls or in other factors that could significantly affect these controls subsequent to the date of their evaluation, including any corrective actions with regard to significant deficiencies and material weaknesses.

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected.

### PART II - OTHER INFORMATION

#### ITEM 1. LEGAL PROCEEDINGS

See Note 9 to the Consolidated Financial Statements.

#### ITEM 2. CHANGES IN SECURITIES, USE OF PROCEEDS AND ISSUER PURCHASES OF EQUITY SECURITIES

On December 12, 2003, the Company announced that its Board of Directors had authorized the repurchase of up to 10% of the outstanding shares of common stock of the Company. Any repurchases are to be made on the open market or in negotiated transactions. For the six months ended June 30, 2004, the Company had purchased 83,450 shares pursuant to the December 12, 2003 repurchase program and 44,100 shares purchased through deferred compensation plans.

#### ISSUER PURCHASES OF EQUITY SECURITIES

| PERIOD<br>-----       | TOTAL<br>NUMBER OF<br>SHARES<br>PURCHASED<br>----- | AVERAGE<br>PRICE PAID<br>PER SHARE<br>----- | TOTAL NUMBER<br>OF SHARES PURCHASED<br>PART<br>OF PUBLICLY<br>ANNOUNCED PLANS<br>OR PROGRAMS<br>----- |
|-----------------------|--|---|---|
| January 1 - 31, 2004  | 20,600 (1)   | \$9.13                                      | -   |
| February 1 - 29, 2004 | 4,300 (1)  | \$9.41                                      | -   |
| March 1 - 31, 2004    | 4,200 (1)  | \$9.67                                      | -   |
| April 1 - 30, 2004    | 80,250 (2)   | \$9.87                                      | 71,650  |
| May 1 - 31, 2004      | 16,500 (3)   | \$9.88                                      | 11,800  |
| June 1 - 30, 2004     | 1,700 (1)  | \$10.55                                     | -   |
| Total                 | 127,550 (4)  | \$9.74 (5)                                  | 83,450  |

1. The Company purchased these shares other than through a publicly announced plan or program in open market transactions or in negotiated transactions.

2. Of the 80,250 shares purchased, 8,600 shares were purchased by the Company other than through a publicly announced plan or program in open market transactions or in negotiated transactions.

3. Of the 16,500 shares purchased, 4,700 shares were purchased by the Company other than through a publicly announced plan or program in open market transactions or in negotiated transactions.

4. Of the aggregate 127,550 shares purchased, an aggregate of 44,100 shares were



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purchased through deferred compensation plans.

5. The average price per share for purchases made through a publicly announced plan or program was \$9.84 per share for the 83,450 shares purchased.

29

### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

At the Company's Annual Meeting of Shareholders on June 9, 2004, the Company's shareholders re-elected seven incumbent members (J. Dwane Baumgardner, Avrum Gray, James R. Henderson, Glen M. Kassan, Warren G. Lichtenstein, James A. Risher, and Mark E. Schwarz) to the Company's Board of Directors. The votes cast for all nominees were as follows:

| NOMINEES               | FOR       | WITHHOLD AUTHORITY |
|------------------------|-----------|--------------------|
| J. Dwane Baumgardner   | 5,556,887 | 92,796             |
| Avrum Gray             | 5,510,384 | 139,299            |
| James R. Henderson     | 5,584,481 | 65,202             |
| Glen M. Kassan         | 5,585,694 | 63,989             |
| Warren G. Lichtenstein | 5,586,662 | 63,021             |
| James A. Risher        | 5,586,897 | 62,786             |
| Mark E. Schwarz        | 5,449,554 | 200,129            |

The votes cast for, against, and withheld for the ratification of the appointment of Grant Thornton LLP as the Company's independent auditors for the fiscal year ending December 31, 2004 were as follows:

| FOR       | AGAINST | ABSTAIN |
|-----------|---------|---------|
| 5,572,058 | 65,316  | 12,309  |

### ITEM 5. OTHER INFORMATION

Pursuant to Section 10A(i)(2) of the Exchange Act, the Company is responsible for listing the non-audit services approved in the second quarter of 2004 by its Audit Committee to be performed by Grant Thornton, the Company's external auditor. Each of the permitted non-audit services has been pre-approved by the Audit Committee or the Audit Committee's Chairman pursuant to delegated authority by the Audit Committee. During the second quarter of 2004, the Audit Committee pre-approved the following non-audit services anticipated to be performed by Grant Thornton: 1) Review of Forms 1118 and 5471 to be included in the Company's 2003 U.S. Corporation Income Tax Return; and 2) Analysis and consultation in connection with allowable research and development tax credits.

### ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

#### (a) Exhibits

31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

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31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.

30

32.1 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

(b) Reports on Form 8-K  
None.

31

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.

Date: August 9, 2004

SL INDUSTRIES, INC.

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(Registrant)

By: /s/ Warren G. Lichtenstein

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Warren G. Lichtenstein  
Chairman of the Board and  
Chief Executive Officer  
(Principal Executive Officer)

By: /s/ David R. Nuzzo

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David R. Nuzzo  
Chief Financial Officer  
(Principal Accounting Officer)

32