SUPERIOR UNIFORM GROUP INC

FORM 10-K
(Annual Report)

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FORM 10-K

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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

For the fiscal year ended December 31, 2004

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

Commission File Number 1-5869-1

SUPERIOR UNIFORM GROUP, INC.

Incorporated - Florida	**I.R.S. Employer Identification No. 11-1385670**
10055 Seminole Blvd. Seminole, Florida 33772	
Telephone	**(727) 397-9611**

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

Common Shares with a par value of $.001 each	**Listed on American Stock Exchange**

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

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

As of March 1, 2005, 7,450,187 common shares were outstanding, and the aggregate market value of the registrant's common shares held by non-affiliates was approximately $87 million (based on the closing sale price of the registrant's common shares on the American Stock Exchange on the last business day of the registrant's most recently completed second fiscal quarter (June 30, 2004)). Shares of common stock held by each executive officer and director have been excluded in that such persons may be deemed to be affiliates. The determination of affiliate status is not necessarily a conclusive determination for other purposes.

Documents Incorporated by Reference:

Portions of the Registrant's Proxy Statement to be filed on or before March 30, 2005, for its Annual Meeting of Shareholders to be held May 4, 2005, are incorporated by reference to furnish the information required by Items 10, 11, 12,13 and 14 of Part III.

Exhibit index may be found on Page 34.

Table of Contents

PART I

Special Note Regarding Forward-Looking Statements

References in this report to "the Company", "Superior", "we", "our", or "us" mean Superior Uniform Group, Inc. together with its subsidiary, except where the context otherwise requires. Certain matters discussed in this Form 10-K are "forward-looking statements" intended to qualify for the safe harbors from liability established by the Private Securities Litigation Reform Act of 1995. These forward-looking statements can generally be identified as such because the context of the statement will include words such as we "believe," "anticipate"," expect" or words of similar import. Similarly, statements that describe our future plans, objectives, strategies or goals are also forward-looking statements. Such forward-looking statements are subject to certain risks and uncertainties that may materially adversely affect the anticipated results. Such risks and uncertainties include, but are not limited, to the following: general economic conditions in the areas of the United States in which the Company's customers are located; changes in the healthcare, resort and commercial industries where uniforms and service apparel are worn; the impact of competition; our ability to successfully integrate operations following consummation of acquisitions and the availability of manufacturing materials. Shareholders, potential investors and other readers are urged to consider these factors carefully in evaluating the forward-looking statements made herein and are cautioned not to place undue reliance on such forward-looking statements. The forward-looking statements made herein are only made as of the date of this Form 10-K and we disclaim any obligation to publicly update such forward-looking statements to reflect subsequent events or circumstances.

Item 1. Business

Superior Uniform Group, Inc. was organized in 1920 and was incorporated in 1922 as a New York company under the name Superior Surgical Mfg. Co., Inc. In 1998, the Company changed its name to Superior Uniform Group, Inc. and its state of incorporation to Florida.

Superior, through its Signature marketing brands – Fashion Seal ®, Fashion Seal Healthcare ™, Martin's ®, Worklon ®, Universal ®, Sope Creek ® and UniVogue ™ – manufactures and sells a wide range of uniforms, corporate I.D., career apparel and accessories for the hospital and healthcare fields; hotels; fast food and other restaurants; and public safety, industrial, transportation and commercial markets, as well as corporate and resort embroidered sportswear. There are no significant distinct segments or lines of business. Approximately 95% of its business consists of the sale of uniforms and service apparel, and miscellaneous products directly related thereto.

Products

Superior manufactures and sells a wide range of uniforms, corporate I.D., career apparel and accessories for the medical and health fields as well as for the industrial, commercial, leisure, and public safety markets. Its principal products are:

- Uniforms and service apparel for personnel of:
  - Hospitals and health facilities;
  - Hotels, commercial buildings, residential buildings, and food service facilities;
  - General and special purpose industrial uses;
  - Commercial enterprises (career apparel for banks, airlines, etc.);
  - Public and private safety and security organizations;
  - Miscellaneous service uses.
- Miscellaneous products directly related to:
  - Uniforms and service apparel specified above (e.g. operating room masks, boots, and sheets);
  - Linen suppliers and industrial launderers, to whom a substantial portion of Superior's uniforms and service apparel are sold; such products being primarily industrial laundry bags.
  - Corporate and resort embroidered sportswear.

Uniforms and service apparel account for approximately 95% of total sales and revenues; no other single class of product listed above accounts for more than 10% of total sales and revenues.

Competition

Superior competes with national and regional manufacturers and also with local firms in most major metropolitan areas. Superior competes with more than three dozen firms including divisions of larger corporations. The nature and degree of competition varies with the customer and market where it occurs. Industry statistics are not available, but we believe that Superior is one of the leading suppliers of garments to hospitals and industrial clean rooms, hotels and motels, food service establishments and uniforms to linen suppliers. Superior experiences competition primarily in the areas of product development, styling and pricing.

Customers

Superior has a substantial number of customers, the largest of which accounted for no more than 5% of its 2004 sales.

Backlog

Although Superior at all times has a substantial backlog of orders, we do not consider this significant since our backlog of orders at any time consists primarily of recurrent firm orders being processed and filled.

Superior normally completes shipments of orders from stock between 1 and 2 weeks after their receipt. As of March 5, 2005, the backlog of all orders that we believe to be firm was approximately $8,857,000, compared to approximately $5,947,000 a year earlier.

Inventory

Superior markets itself to its customers as a “stock house”. Therefore, Superior at all times carries substantial inventories of raw materials (principally piece goods) and finished garments which requires substantial working capital. In 2004, 2003 and 2002 approximately 70%, 75% and 65%, respectively of the Company’s products were obtained from suppliers located in Central America. Any inability by the Company to continue to obtain its products from Central America could significantly disrupt the Company’s business. Because the Company manufactures and sources products in Central America, the Company is affected by economic conditions in those countries, including increased duties, possible employee turnover, labor unrest and lack of developed infrastructure. Superior’s principal raw materials are textile products, generally available from a number of sources.

Intellectual Property

While Superior owns and uses several trademarks, its mark “Fashion Seal Uniforms” (presently registered until August 7, 2007, subject to renewal) is important since more than 50% of Superior’s products are sold under that name.

Environmental Matters

In view of the nature of our business, compliance with federal, state, or local laws regulating the discharge of materials into the environment, or otherwise relating to the protection of the environment, has had no material effect upon our operations or earnings and we do not expect it to have a material impact in the future.

Employees

Superior employed 887 persons as of December 31, 2004.

Item 2. Properties

The Company has an ongoing program designed to maintain and improve its facilities. Generally, all properties are in satisfactory condition. The Company’s properties are currently fully utilized (except as otherwise noted), and have aggregate productive capacity to meet the Company’s present needs as well as those of the foreseeable future. The material manufacturing locales are rented for nominal amounts due to cities providing incentives for manufacturers to locate in their area - all such properties may be purchased for nominal amounts. As a result, it is believed that the subject lease expirations and renewal terms thereof are not material. Set forth below are the locations of our facilities:

- Seminole, Florida – Plant of approximately 60,000 square feet owned by the registrant; used as principal administrative office and for warehousing and shipping, as well as the corporate design center.
- Eudora, Arkansas – Plant of approximately 217,000 square feet, partially leased from the City of Eudora under lease requiring payment of only a nominal rental; used for manufacturing, warehousing, and shipping.
- Tampa, Florida – Plant of approximately 111,000 square feet, owned by the registrant; used for warehousing, shipping and small retail operation.
- Miami, Florida – Plant of approximately 5,000 square feet, leased from private owners under a lease expiring in 2005; used for regional sales office, warehousing, shipping, and small retail operation.
- McGehee, Arkansas – Plant of approximately 26,000 square feet, leased from the City of McGehee under lease requiring payment of only a nominal rental; used for manufacturing.
- Marietta, Georgia – Plant and warehouse of approximately 33,000 square feet leased from private owners.
- Portland, Oregon – Plant and warehouse of approximately 35,800 square feet leased from private owners under a lease expiring in 2005.
- Miscellaneous – Atlanta, Georgia, warehouse and sales office - leased; Lexington, Mississippi, used for manufacturing – owned; Dallas, TX, sales office - leased.

Item 3. Legal Proceedings

We are a party to certain lawsuits in the ordinary course of business. We do not believe that these proceedings, individually or in the aggregate, will have a material adverse effect on our financial position, results of operations or cash flows.

Item 4. Submission of Matters to a Vote of Security Holders

(a) None

PART II

Item 5. Market Price of and Dividends on Superior's Common Equity and Related Stockholder Matters.

The principal market on which Superior's common shares are traded is the American Stock Exchange; said shares have also been admitted to unlisted trading on the Midwest Stock Exchange.

The table below presents, for our common shares, dividend information and the quarterly high and low sales prices as reported in the consolidated transaction reporting system of the American Stock Exchange.

	QUARTER ENDED							
	2004				2003			
	Mar. 31	June 30	Sept. 30	Dec. 31	Mar. 31	June 30	Sept. 30	Dec. 31
Common Shares:								
High	$16.90	$16.70	$15.85	$14.95	$12.48	$11.45	$14.80	$16.93
Low	$14.00	$14.50	$12.81	$13.65	$10.20	$10.45	$11.00	$13.20
Dividends (total for 2004-$.54; 2003-$.54)	$ .135	$ .135	$ .135	$ .135	$ .135	$ .135	$ .135	$ .135

Our long-term debt agreements include covenants that, among other things, restrict dividends payable by us. Under the most restrictive debt agreement, retained earnings of approximately $7,916,000 were available at December 31, 2004 for declaration of dividends. We have declared cash dividends of $.135 per share in each of the quarters for the fiscal years ending December 31, 2003 and 2004. We expect that, so long as earnings and business conditions warrant, we will continue to pay dividends and that the amount thereof, as such conditions permit, and as the Directors approve, will increase from time to time.

On March 1, 2005, registrant had 262 shareholders of record and the closing price for registrant's common shares on the American Stock Exchange was $13.86 per share.

Equity Compensation Plan Information

The following table provides information about our common stock that may be issued upon the exercise of options, warrants, rights and restricted stock under all our existing equity compensation plans as of December 31, 2004, including the 1993 Incentive Stock Option Plan and the 2003 Incentive Stock and Awards Plan:

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
	(a)	(b)	(c)
Equity compensation Plans approved by Security holders	709,825	$ 12.03	2,199,125
Equity compensation Plans not approved by Security holders	—	—	—
Total	709,825	$ 12.03	2,199,125

The table below sets forth the information with respect to purchases made by or on behalf of Superior Uniform Group, Inc. or any "affiliated purchaser" (as defined in Rule 10b-18(a)(3) under the Exchange Act), of our common shares during the three months ended December 31, 2004.

ISSUER PURCHASES OF EQUITY SECURITIES

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs (1)
Month #1 (October 1, 2004 to October 31, 2004) Month #2 (November 1, 2004 to November 30, 2004) Month #3 (December 1, 2004 to December 31, 2004)	84,050	$ 13.91	84,050	604,050
TOTAL	84,050	$ 13.91	84,050	604,050

(1) In July 2002, the Company's Board of Directors approved a program to repurchase up to 750,000 shares of the Company's outstanding shares of common stock. There is no expiration date or other restriction governing the period over which the Company can make share repurchases under the program

The following selected data are derived from our consolidated financial statements. This data should be read in conjunction with the consolidated financial statements and notes thereto incorporated into Item 8, and with Item 7 - Management's Discussion and Analysis of Financial Condition and Results of Operations.

Table of Contents

Item 6. Selected Financial Data

Years Ended December 31,	2004	2003	2002	2001	2000
Net sales	$143,567,473	$137,326,341	$148,106,311	$156,134,944	$171,106,190
Costs and expenses:					
Cost of goods sold	96,279,784	90,334,765	99,859,787	104,967,460	114,912,716
Selling and administrative expenses	38,524,803	37,491,162	39,400,795	39,342,762	42,372,386
Interest expense	624,199	696,504	853,081	1,623,016	2,167,763
	135,428,786	128,522,431	140,113,663	145,933,238	159,452,865
Earnings before taxes on income, and cumulative effect of change in accounting principle	8,138,687	8,803,910	7,992,648	10,201,706	11,653,325
Taxes on income	2,760,000	3,100,000	2,895,000	3,730,000	4,250,000
Earnings before cumulative effect of change in accounting principle	5,378,687	5,703,910	5,097,648	6,471,706	7,403,325
Cumulative effect of change in accounting principle, net of tax benefit of $2,560,000	—	—	(4,504,563)	—	—
Net earnings	$ 5,378,687	$ 5,703,910	$ 593,085	$ 6,471,706	$ 7,403,325
Basic net earnings per common share:					
Earnings before cumulative effect of change in accounting principle	$ 0.72	$ 0.79	$ 0.72	$ 0.91	$ 1.03
Cumulative effect of change in accounting principle, net of tax	—	—	(0.64)	—	—
Basic net earnings per common share	$ 0.72	$ 0.79	$ 0.08	$ 0.91	$ 1.03
Diluted net earnings per common share:					
Earnings before cumulative effect of change in accounting principle	$ 0.71	$ 0.78	$ 0.71	$ 0.91	$ 1.03
Cumulative effect of change in accounting principle, net of tax	—	—	(0.63)	—	—
Diluted net earnings per common share	$ 0.71	$ 0.78	$ 0.08	$ 0.91	$ 1.03
Cash dividends per common share	$ 0.54	$ 0.54	$ 0.54	$ 0.54	$ 0.54
At year end:					
Total assets	$106,279,126	$102,973,933	$ 99,826,952	$112,914,563	$130,039,204
Long-term debt	$ 5,662,569	$ 6,266,047	$ 7,445,068	$ 13,549,147	$ 29,530,239
Working capital	$ 61,255,572	$ 66,212,497	$ 61,688,699	$ 65,117,560	$ 74,360,573
Shareholders' equity	$ 87,068,494	$ 84,884,482	$ 80,110,389	$ 82,762,205	$ 81,641,863

Table of Contents

Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations

OPERATIONS: In 2004 net sales increased 4.5% in comparison to 2003 and in 2003 net sales decreased 7.3% in comparison to 2002. The 2004 increase is primarily attributed to the acquisition of UniVogue during the first quarter of 2004, which was offset by continuing soft demand from existing customers. The 2003 decrease was attributed to the continued economic slowdown as our customers postponed or cancelled orders in an effort to reduce the impact of the slowdown on their own operations.

As a percentage of sales, cost of goods sold were 67.1% in 2004, 65.8% in 2003 and 67.4% in 2002. The percentage increase in 2004 was due to increased freight costs in 2004 of approximately $1,610,000 while the amounts invoiced to customers (included in net sales) for freight and handling charges only increased $651,000. Additionally, competitive pricing pressures in the market contributed to reduced margins in 2004. The percentage decrease in 2003 was attributed to the continued transition of production to offshore sources.

As a percentage of sales, selling and administrative expenses were 26.8% in 2004, 27.3% in 2003, and 26.6% in 2002. The decrease in this percentage in 2004 is attributed to the increase in sales volume, the impact of 2003 staffing and other cost reductions including the consolidation of our Martins division into our corporate offices. Additionally, we experienced a net recovery in bad debts in 2004 of $12,000 versus net bad debt expense of $218,000 in 2003. The impact of these cost savings were offset by approximately $690,000 in outside consulting costs incurred in association with our efforts to prepare for compliance with Section 404 of the Sarbanes-Oxley Act. The increase in this percentage in 2003 is attributed to the overall decline in sales volume more than offsetting the impact of staffing and other cost reductions on selling administrative expenses. Selling and administrative expenses for 2003 included bad debt expense of approximately $218,000 versus $1,165,000 in 2002 due primarily to the write off of one large account in 2002; and during 2002, the Company incurred approximately $360,000 in costs associated with the review of a potential acquisition that we are no longer pursuing.

Interest expense as a percentage of sales was 0.4% in 2004, 0.5% in 2003, and 0.6% in 2002. The decreases in 2004 and 2003 are due to lower average borrowings outstanding and lower interest rates.

The effective income tax rate in 2004 was 33.9%; in 2003 it was 35.2%; and in 2002 it was 36.2%. The decreases are primarily attributed to decreases in state income taxes.

In 2004, the Company reported earnings before cumulative effect of change in accounting principle of 3.7% of sales with a return of 6.3% on average shareholders' equity. In 2003, the Company reported earnings before cumulative effect of change in accounting principle of 4.2% of sales with a return of 6.9% on average shareholders' equity. In 2002, the Company reported earnings before cumulative effect of change in accounting principle of 3.4% of sales with a return of 6.3% on average shareholders' equity.

The cumulative effect of change in accounting principle charge in the amount of $4,504,563, net of tax benefit of $2,560,000 was recognized in 2002 as a result of the Company's adoption of FAS No. 142. The Company completed its transitional impairment testing of goodwill during 2002 and determined that its goodwill for certain reporting units was impaired.

In 2004, the Company reported net income of 3.7% of sales with a return of 6.3% on average shareholders' equity. In 2003, the Company reported net income of 4.2% of sales with a return of 6.9% on average shareholders' equity. In 2002, the Company reported net income of 0.4% of sales with a return of 0.7% on average shareholders' equity.

LIQUIDITY AND CAPITAL RESOURCES: The Company uses a number of standards for its own purposes in measuring its liquidity, such as: working capital, profitability ratios, long-term debt as a percentage of long-term debt and equity, and activity ratios.

Accounts receivable increased 3.5% from $24,419,287 on December 31, 2003 to $25,263,744 as of December 31, 2004. This increase is primarily attributed to the increase in sales in the current period.

Inventories increased 25.7% from $36,380,470 on December 31, 2003 to $45,741,410 as of December 31, 2004. This increase is attributed to the acquisition of UniVogue inventories of $2,065,444 in the first quarter of 2004, a conscious effort by management to increase inventories in the Company's core styles to better service customer needs and to the increase in the amount of product being sourced in Asia during 2004.

Management's Discussion and Analysis of Financial Condition and Results of Operations (con't)

Accounts payable increased 32.9% from $5,400,401 on December 31, 2003 to $7,177,596 on December 31, 2004 primarily due to the higher inventory levels discussed above.

Other current liabilities decreased 25.9% from $5,078,982 on December 31, 2003 to $3,761,660 on December 31, 2004. The Company is in a net refund position at December 31, 2004 for income taxes as a result of estimated tax payments in excess of the current year liability, whereas the Company had an accrued balance payable of $699,000 at December 31, 2003. The current year prepaid balance of approximately $476,000 is included in prepaid expenses and other current assets at December 31, 2004. Additionally, the current year accrued liabilities decreased by $426,000 as a result of improvements in the current year funded status of the Company's defined benefit plans and a reduction of $317,000 in the accrued liability related to the Company's interest rate swap agreement.

The working capital of the Company at December 31, 2004 was approximately $61,256,000 and the working capital ratio, 5.9:1; for 2003, it was approximately $66,213,000 and the working capital ratio, 6.7:1. The Company has operated without hindrance or restraint with its present working capital, believing that income generated from operations and outside sources of credit, both trade and institutional, are more than adequate to fund the Company's operations.

In 2004, the Company's percentage of total debt to total debt and equity was 7.7% and in 2003 it was 8.1%. The decrease is attributed primarily to decreased borrowings under the Company's borrowing agreements as a result of scheduled repayments in 2004 offset by $990,000 of new borrowings in 2004.

The Company has an on-going capital expenditure program designed to maintain and improve its facilities. Capital expenditures were approximately $6,162,000, $2,051,000, and $2,820,000, in the years 2004, 2003, and 2002, respectively. The significant increase in 2004 was primarily attributed to an upgrade of the Company's central warehouse distribution system in Eudora, Arkansas. This project was completed in January of 2005. Total capitalized expenditures for this project in 2004 were approximately $5,237,000. Additionally, in 2004, the Company purchased certain software for approximately $990,000 that was 100% financed via long-term debt. The Company at all times evaluates its capital expenditure programs in light of prevailing economic conditions.

During the years ended December 31, 2004 and 2003, the Company paid cash dividends of approximately $4,015,000 and $3,895,000, respectively, on a quarterly dividend of $.135 per share. In July 2002, our Board of Directors reset the common stock repurchase program authorization so that the Company may make future repurchases of up to 750,000 of its common shares. The Company reacquired and retired 94,950 and 35,000 of its common shares in the years ended December 31, 2004 and 2003, respectively, with costs of $1,312,000 and $366,000, respectively. At December 31, 2004, we had approximately 604,000 shares remaining on our common stock repurchase authorization. Shares purchased under our share repurchase program are constructively retired and returned to unissued status. We consider several factors in determining when to make share repurchases, including among other things, our cost of equity, our after-tax cost of borrowing, our debt to total capitalization targets and our expected future cash needs. There is no expiration date or other restriction governing the period over which we can make our share repurchases under the program. The Company anticipates that it will continue to pay dividends and that it will repurchase additional shares of its common stock in the future as financial conditions permit.

In 2004, cash and cash equivalents decreased by $14,765,000. This decrease is attributed to approximately $3,578,000 in cash provided from operations, offset by approximately $13,497,000 utilized in investing activities and approximately $4,846,000 utilized in financing activities. Investing activities consisted primarily of $6,272,000 utilized in the acquisition of UniVogue in the first quarter of 2004 and $6,162,000 utilized for fixed asset additions, primarily for the central warehouse distribution system.

In 2003, cash and cash equivalents increased by $7,444,000. This increase is attributed to approximately $12,826,000 in cash provided from operations, offset by approximately $2,688,000 utilized in investing activities and approximately $2,693,000 utilized in financing activities.

On March 26, 1999, the Company entered into a 3-year credit agreement with Wachovia Bank that made available to the Company up to $15,000,000 on a revolving credit basis. Interest is payable at LIBOR plus 0.60% based upon the one-month LIBOR rate for U.S. dollar based borrowings (3.0% at December 31, 2004). The Company pays an annual commitment fee of 0.15% on the average unused portion of the commitment. The available balance under the credit agreement is reduced by outstanding letters of credit. As of December 31, 2004, approximately $552,000 was outstanding under letters of credit. On March 27, 2001, and again on April 27, 2004, the Company entered into

Management's Discussion and Analysis of Financial Condition and Results of Operations (con't)

agreements with Wachovia Bank to extend the maturity of the revolving credit agreement. The revolving credit agreement matures on June 30, 2007. At the option of the Company, any outstanding balance on the agreement at that date will convert to a one-year term loan. The remaining terms of the original revolving credit agreement remain unchanged. The Company also entered into a $12,000,000 10-year term loan on March 26, 1999 with the same bank. The term loan is an amortizing loan, with monthly payments of principal and interest, maturing on April 1, 2009. The term loan carries a variable interest rate of LIBOR plus 0.80% based upon the one-month LIBOR rate for U.S. dollar based borrowings. Concurrent with the execution of the term loan agreement, the Company entered into an interest rate swap with the bank under which the Company receives a variable rate of interest on a notional amount equal to the outstanding balance of the term loan from the bank and the Company pays a fixed rate of 6.75% on a notional amount equal to the outstanding balance of the term loan to the bank.

The credit agreement and the term loan with Wachovia Bank contain restrictive provisions concerning debt to net worth ratios, other borrowings, capital expenditures, rental commitments, tangible net worth ($76,378,000 at December 31, 2004); working capital ratio (2.5:1), fixed charges coverage ratio (2.5:1), stock repurchases and payment of dividends. At December 31, 2004, under the most restrictive terms of the debt agreements, retained earnings of approximately $7,916,000 were available for declaration of dividends. The Company is in full compliance with all terms, conditions and covenants of the various credit agreements.

The Company prepaid the balance of its 6.65% note payable to MassMutual, including a prepayment penalty of approximately $285,000, on March 18, 2002 utilizing cash balances on hand as of December 31, 2001 and additional cash generated from operations in the first quarter of 2002. With funds from the credit agreement, anticipated cash flows generated from operations and other credit sources readily available, the Company believes that its liquidity is satisfactory, its working capital adequate and its capital resources sufficient for funding its ongoing capital expenditure program and its operations, including planned expansion for 2005.

The following table summarizes our fixed cash obligations as of December 31, 2004 for the fiscal years ending December 31:

	2005	2006	2007	2008	2009 and thereafter	Total
Variable rate term loans and revolving credit facility	$1,264,000	$1,353,000	$1,448,000	$1,551,000	$650,000	$6,266,000
Other debt arrangements, including capital leases	330,000	330,000	330,000	—	—	990,000
Operating leases	321,000	157,000	156,000	90,000	—	724,000
Total contractual cash obligations	$1,915,000	$1,840,000	$1,934,000	$1,641,000	$650,000	$7,980,000

The Company does not engage in any off-balance sheet financing arrangements. In particular, we do not have any interest in variable interest entities, which include special purpose entities and structured finance entities.

Critical Accounting Policies

Our significant accounting policies are described in Note 1 to the consolidated financial statements included in this Annual Report on Form 10-K. Our discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of the financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate the estimates that we have made. These estimates are based upon our historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Our actual results may differ from these estimates under different assumptions or conditions. We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations (con't)

Revenue Recognition and Allowance for Doubtful Accounts

The Company recognizes revenue in the period in which the product is shipped. Judgments and estimates are used in determining the collectability of accounts receivable. The Company analyzes specific accounts receivable and historical bad debt experience, customer credit worthiness, current economic trends and the age of outstanding balances when evaluating the adequacy of the allowance for doubtful accounts. Management judgments and estimates are used in connection with establishing the allowance in any accounting period. Changes in estimates are reflected in the period they become known. If the financial condition of the Company's customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required.

Inventories

Inventories are stated at the lower of cost or market value. Judgments and estimates are used in determining the likelihood that goods on hand can be sold to customers. Historical inventory usage and current revenue trends are considered in estimating both excess and obsolete inventories. If actual product demand and market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

Insurance

The Company self-insures for certain obligations related to health and workers' compensation programs. The Company also purchases stop-loss insurance policies to protect it from catastrophic losses. Judgments and estimates are used in determining the potential value associated with reported claims and for losses that have occurred, but have not been reported. The Company's estimates consider historical claim experience and other factors. The Company's liabilities are based on estimates, and, while the Company believes that the accrual for loss is adequate, the ultimate liability may be in excess of or less than the amounts recorded. Changes in claim experience, the Company's ability to settle claims or other estimates and judgments used by management could have a material impact on the amount and timing of expense for any period.

Recent Accounting Pronouncements:

In December 2004, the FASB issued FAS No. 123 (revised 2004), *"Shared-Based Payment."* FAS 123(R) addresses the accounting for share-based payment transactions in which an enterprise receives employee services in exchange for (a) equity instruments of the enterprise or (b) liabilities that are based on the fair value of the enterprise's equity instruments or that may be settled by the issuance of such equity instruments. Statement 123(R) requires an entity to recognize the grant-date fair-value of stock options and other equity-based compensation issued to employees in the income statement. The revised Statement generally requires that an entity account for those transactions using the fair-value-based method, and eliminates the intrinsic value method of accounting in APB Opinion No. 25, *"Accounting for Stock Issued to Employees"*, which was permitted under Statement 123, as originally issued.

The revised Statement requires entities to disclose information about the nature of the share-based payment transactions and the effects of those transactions on the financial statements. FAS 123(R) is effective for public companies that do not file as small business issuers as of the beginning of the first interim or annual reporting period that begins after June 15, 2005 (i.e., third quarter 2005 for the Company). All public companies must use either the modified prospective or the modified retrospective transition method. The Company has not yet evaluated the impact of adoption of this pronouncement that must be adopted in the third quarter of our fiscal year 2005.

In December 2003, the FASB issued FAS No. 132 (revised 2003), "Employers' Disclosures about Pensions and Other Postretirement Benefits." The provisions of FAS No. 132(R) do not change the measurement and recognition provisions of FAS No. 87, "Employers' Accounting for Pensions" or FAS No. 88, "Employers' Accounting for Settlements and Curtailments of Defined Benefit Plans and Termination Benefits." During the three months ended March 31, 2004, the Company adopted the provisions of FAS No. 132(R), which did not have a material effect on the Company's consolidated financial statements.

In November 2004, the FASB issued FAS No. 151, "Inventory Costs - an Amendment of ARB No. 43, Chapter 4," to provide clarification that abnormal amounts of idle facility expense, freight, handling costs, and wasted material be recognized as current-period charges. In addition, this standard requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions of this standard are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The Company is currently evaluating the impact the standard will have on the Company's consolidated financial statements.

Management's Discussion and Analysis of Financial Condition and Results of Operations (con't)

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities," which establishes criteria to identify variable interest entities ("FIN 46") and the primary beneficiary of such entities. An entity that qualifies as a VIE must be consolidated by its primary beneficiary. All other holders of interests in a VIE must disclose the nature, purpose, size and activity of the VIE as well as their maximum exposure to losses as a result of involvement with the VIE. FIN 46 was revised in December 2003 and is effective for financial statements of public entities that have variable interest entities, as defined, for periods ending after December 15, 2003. For public entities without variable interest entities, it is effective for financial statements for periods ending after March 15, 2004. The Company does not have any variable interest entities, as defined, and accordingly the adoption of FIN 46 did not have a material effect on the Company's consolidated financial statements.

A variety of proposed or otherwise potential accounting standards are currently under study by standard-setting organizations and various regulatory agencies. Because of the tentative and preliminary nature of these proposed standards, management has not determined whether implementation of such proposed standards would be material to the Company's consolidated financial statements.

Item 7a. Quantitative and Qualitative Disclosures About Market Risks

The Company is exposed to market risk from changes in interest rates, which may adversely affect its results of operations and financial condition. The Company seeks to minimize the risks from these interest rates when considered appropriate, through the limited use of derivative financial instruments. The Company's policy is to not use financial instruments for trading or other speculative purposes and is not a party to any leveraged financial instruments. The Company has debt obligations with variable interest rates tied to LIBOR which are described in "Liquidity and Capital Resources" as well as Note 7 of the Notes to Consolidated Financial Statements. The Company estimates that a hypothetical increase in interest rates of 1% would have resulted in an insignificant increase in the Company's interest expense for the year ended December 31, 2004.

The Company has one interest rate swap agreement to hedge against the potential impact on earnings from increases in market interest rates of a variable rate term loan. Under the interest rate swap agreement, the Company receives or makes payments on a monthly basis, based on the differential between a specified interest rate and one month LIBOR. A term loan of $6,266,047 is designated as a hedged item for interest rate swaps at December 31, 2004.

This interest rate swap is accounted for as a cash flow hedge in accordance with FAS 133 and FAS 138. As of the report date, the swap met the effectiveness test, and as such no gains or losses were included in net income during the year related to hedge ineffectiveness and there was no income adjustment related to any portion excluded from the assessment of hedge effectiveness. A gain of $317,000 associated with this interest rate swap agreement was included in other comprehensive income for the year ended December 31, 2004. A gain of $256,000 associated with this interest rate swap agreement was included in other comprehensive income for the year ended December 31, 2003. A loss of $464,000 was included in other comprehensive loss for the year ended December 31, 2002. The fair market values of the interest rate swap of $331,000 and $648,000 are included in accrued expenses in the accompanying consolidated balance sheets as of December 31, 2004 and 2003, respectively. The original term of the contract is ten years.

The Company is also exposed to changes in prevailing market interest rates affecting the return on its investments but does not consider this interest rate market risk exposure to be material to its financial condition or results of operations. The Company invests primarily in highly liquid debt instruments with strong credit ratings and short-term (less than three months) maturities.