ARISTOTLE CORP
Form 10-Q
May 13, 2004

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON MAY 12, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(MARK ONE)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE

ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2004

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE

ACT OF 1934

FOR THE TRANSITION PERIOD FROM ___________________ TO _____________

COMMISSION FILE NUMBER 0-14669

THE ARISTOTLE CORPORATION

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

DELAWARE	06-1165854
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NO.)

96 CUMMINGS POINT ROAD, STAMFORD, CONNECTICUT

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

06902

(ZIP CODE)

(203) 358-8000

(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

Indicate by check mark whether registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes [X] No [ ]

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

Yes [ ] No [X]

As of May 1, 2004, 17,111,354 shares of Common Stock, 1,096,622 shares of Series I Preferred Stock and 10,984,971 shares of Series J Preferred Stock were outstanding.

THE ARISTOTLE CORPORATION

INDEX OF INFORMATION CONTAINED IN FORM 10-Q FOR THE

QUARTERLY PERIOD ENDED MARCH 31, 2004

PART I - FINANCIAL INFORMATION

PART I

ITEM 1. FINANCIAL INFORMATION

THE ARISTOTLE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

Assets		March 31, 2004 (unaudited)	December 31, 2003	March 31, 2003 (unaudited)
Current assets:				
Cash and cash equivalents	$	1,766	5,566	4,960
Accounts receivable, net		15,082	11,881	14,192
Inventories		31,718	29,157	29,942
Prepaid expenses and other		5,564	5,598	7,722

Refundable income taxes		326	344	-
Deferred income taxes		8,184	8,184	7,251
Total current assets		62,640	60,730	64,067
Property, plant and equipment, net		17,038	17,340	11,556
Goodwill		11,466	11,509	7,008
Deferred income taxes		13,612	15,081	20,729
Other assets		427	454	426
Total assets	$	105,183	105,114	103,786
Liabilities and Stockholders' Equity				
Current liabilities:				
Current installments of long-term debt	$	3,584	1,415	9,143
Trade accounts payable		6,720	5,874	6,216
Accrued expenses		4,583	4,537	3,507
Accrued dividends payable		-	2,154	-
Income taxes		-	-	137
Total current liabilities		14,887	13,980	19,003
Long-term debt, less current installments		29,369	31,290	29,154
Stockholders' equity:				
Preferred stock, Series I, convertible, voting, 11% cumulative, $6.00 stated value; $.01 par value; 2,400,000 shares authorized, 1,096,622, 1,068,622 and 1,046,716 shares issued and outstanding at March 31, 2004, December 31, 2003				

and March 31, 2003, respectively		6,580	6,412	6,280
Preferred stock, Series J, non-voting, 12% cumulative, $6.00 stated value; $.01 par value; 11,200,000				
shares authorized, 10,984,971 shares				
issued and outstanding		65,760	65,760	65,760
Common stock, $.01 par value; 20,000,000 shares authorized, 17,111,354, 17,082,354 and 17,031,687				
17,031,687 shares issued and outstanding at March				
31, 2004, December 31, 2003 and March 31, 2003, respectively		171	171	170
Additional paid-in capital		1,060	860	382
Accumulated deficit		(12,375)	(13,257)	(16,822)
Accumulated other comprehensive loss		(269)	(102)	(141)
Total stockholders' equity		60,927	59,844	55,629
Total liabilities and stockholders' equity	$	105,183	105,114	103,786

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

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THE ARISTOTLE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS

(in thousands, except share and per share data)

(Unaudited)

Three Months Ended

March 31,

		2004	2003
Net sales	$	39,020	35,441
Cost of sales		23,831	22,203
Gross profit		15,189	13,238
Selling and administrative expense		9,876	9,786
Earnings from operations		5,313	3,452
Other expense (income):			
Interest expense		313	308
Other, net		30	(49)
		343	259
Earnings before income taxes		4,970	3,193
Income taxes:			
Current		456	209
Deferred		1,469	1,032
		1,925	1,241
Net earnings		3,045	1,952
Preferred dividends		2,163	2,150
Net earnings (loss) applicable to common stockholders	$	882	(198)
Earnings (loss) per common share:			
Basic	$	.05	(.01)
Diluted	$	.05	(.01)

Weighted average common shares outstanding:		
Basic	17,099,002	17,031,687
Diluted	17,280,043	17,031,687

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

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THE ARISTOTLE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

Three Months Ended

		March 31,	
		2004	2003
Cash flows from operating activities:			
Net earnings	$	3,045	1,952
Adjustments to reconcile net earnings to net cash			
provided by (used in) operating activities:			
Depreciation and amortization		416	410
Stock option compensation		125	131
(Gain) loss on sale of property, plant and equipment		(2)	17
Deferred income taxes		1,469	1,032
Change in assets and liabilities:			
Accounts receivable		(3,201)	(1,740)
Inventories		(2,561)	(2,001)
Prepaid expenses and other		34	44
Other assets		70	4
Trade accounts payable		846	694
Accrued expenses and other liabilities		29	(1,362)
Net cash provided by (used in) operating activities		270	(819)
Cash flows from investing activities:			
Purchases of property, plant and equipment		(278)	(2,833)
Proceeds from the sale of property, plant and equipment		2	3
Net cash used in investing activities		(276)	(2,830)
Cash flows from financing activities:			

Proceeds from issuance of long-term debt		2,500	1,637
Principal payments on long-term debt		(2,136)	(27)
Proceeds from issuance of stock under stock option plans		159	-
Preferred dividends paid		(4,317)	(4,300)
Net cash used in financing activities		(3,794)	(2,690)
Net decrease in cash and cash equivalents		(3,800)	(6,339)
Cash and cash equivalents at beginning of period		5,566	11,299
Cash and cash equivalents at end of period	$	1,766	4,960
Supplemental cash flow information			
Cash paid during the period for:			
Interest	$	334	306
Income taxes	$	357	1,077

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

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THE ARISTOTLE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2004

(Unaudited)

1. Organization

The Aristotle Corporation ("Aristotle") and its subsidiaries (together with Aristotle, the "Company"), founded in 1986, and headquartered in Stamford, CT, is a leading manufacturer and global distributor of educational, health, medical technology and agricultural products. A selection of over 80,000 items is offered, primarily through catalogs carrying the brand of Nasco (founded in 1941), as well as those bearing the brands of Life/Form®, Whirl-Pak®, Simulaids, Triarco, Summit Learning, Hubbard Scientific, Scott Resources, Spectrum Educational Supplies, Haan Crafts and To-Sew. Products include educational materials and supplies for substantially all K-12 curricula, molded plastics, biological materials and items for the agricultural, senior care and food industries. In addition, the Company offers simulation kits and manikins used for training in cardiopulmonary resuscitation and the fire and emergency rescue and patient care fields. The Company markets proprietary product lines that provide exclusive distribution rights throughout all of its catalogs. The proprietary product lines are developed internally through the Company's research and development efforts and acquired externally through licensing rights from third parties.

- Financial Statement Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with

accounting principles generally accepted in the United States of America ("GAAP") for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, the Condensed Consolidated Financial Statements do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three months ended March 31, 2004 are not necessarily indicative of results that may be expected for any other interim period or for the year ending December 31, 2004. For further information, refer to the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2003.

- Principles of Consolidation

All significant intercompany balances and transactions have been eliminated in consolidation.

- Recently Issued Accounting Pronouncements

In December 2003, the Financial Accounting Standards Board issued a revised Interpretation No. 46, *Consolidation of Variable Interest Entities* ("Interpretation 46R"), which addresses how a business enterprise should evaluate whether it has a controlling financial interest in an entity through means other than voting rights and accordingly should consolidate the entity. Interpretation 46R replaces Interpretation No. 46, *Consolidation of Variable Interest Entities*, which was issued in January 2003. The Company will be required to apply Interpretation 46R to interests in variable interest entities ("VIE") created after December 31, 2003. For variable interests in VIEs created before January 1, 2004, the interpretation will be applied beginning on January 1, 2005. For any VIEs that must be consolidated under Interpretation 46R that were created before January 1, 2004, the assets, liabilities and noncontrolling interests of the VIE initially would be measured at their carrying amounts with any difference between the net amount added to the balance sheet and any previously recognized interest being recognized as the cumulative effect of an accounting change. If determining the carrying amounts is not practicable, fair value at the date Interpretation 46R first applies may be used to measure the assets, liabilities and noncontrolling interest of the VIE. The adoption of Interpretation 46R did not have a material impact on the Company's financial statements for the three months ended March 31, 2004.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2004

(Unaudited)

- Business Combinations

On May 31, 2003, Aristotle purchased 100% of the outstanding capital stock of Haan Crafts Corporation ("Haan"). Haan is a manufacturer and catalog distributor of sewing kits used in middle school and junior high school family and consumer science classrooms. The acquisition has complemented the Company's current product lines in the educational segment. The results of Haan's operations have been included in the Company's consolidated financial statements since the date of such acquisition. The aggregate purchase price, net of cash acquired, was $5.3 million, including $3.5 million of cash and $1.8 million in seller financing, which was subsequently retired by the Company. The purchase price allocation resulted in goodwill of $3.9 million attributable to the educational segment. In connection with the acquisition of Haan, Aristotle entered into a $1.2 million capital lease with the seller on a building facility ("Haan Building Facility"). On February 12, 2004, the Company settled the capital lease on the Haan Building Facility for $1.1 million.

On May 31, 2003, Aristotle acquired 100% of the outstanding ownership interests in NHI, LLC ("NHI") from Nasco Holdings, Inc. ("Holdings"), a subsidiary of Geneve Corporation ("Geneve"), a privately-held diversified financial services company. Geneve and Holdings together held greater than 90% of Aristotle's outstanding voting stock at March 31, 2004. The sole purpose of NHI is the ownership and management of warehouse and office facilities, which had been leased to Aristotle. In connection with the purchase of NHI, Aristotle paid to Holdings an amount equal to the book value of NHI, which includes a $3.6 million mortgage related to the properties held by NHI.

- Earnings (Loss) per Common Share

Basic earnings (loss) per common share is calculated by dividing net earnings (loss) applicable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings (loss) per common share is calculated by dividing net earnings (loss) applicable to common stockholders by the weighted average number of common shares outstanding during the period and including each share that would have been outstanding assuming the issuance of common shares for all dilutive potential common shares outstanding during the period.

Shares of Common Stock available for issue upon conversion of the 1,096,622 and 1,046,716 shares of Series I Preferred Stock outstanding at March 31, 2004 and 2003, respectively, and 135,258 shares related to stock options outstanding at March 31, 2003 were not dilutive and, therefore, have not been included in the computations of diluted earnings (loss) per common share amounts for the periods then ended.

- Stockholders' Equity and Comprehensive Earnings

Changes in stockholders' equity for the three months ended March 31 are as follows (in thousands):

		2004	2003
Balance at January 1	$	59,844	55,718

Net earnings		3,045	1,952
Exercise of stock options		159	-
Tax benefit on exercise of stock options		84	-
Stock option compensation		125	131
Other comprehensive loss:			
Foreign currency translation adjustment		(167)	(22)
Preferred dividends		(2,163)	(2,150)
Balance at March 31	$	60,927	55,629

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THE ARISTOTLE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2004

(Unaudited)

Comprehensive earnings for the three months ended March 31 is as follows (in thousands):

		2004	2003
Net earnings	$	3,045	1,952
Foreign currency translation adjustment		(167)	(22)
Comprehensive earnings	$	2,878	1,930

- Stock Options

The Company accounts for its stock options under the fair value-based recognition and measurement provisions of Statement of Financial Accounting Standards ("SFAS") No.123, *Accounting for Stock-Based Compensation* ("SFAS 123"), which requires the fair value of stock options granted to employees to be measured at the date of grant and recognized as an expense over the service period, which is usually the vesting period of the grant. Under SFAS 123, the Company recognizes the fair value of stock options as an expense within its Condensed Consolidated Statements of Earnings.

The Company has a 1997 Employee and Director Stock Plan ("1997 Plan") and 2002 Employee, Director and Consultant Stock Plan ("2002 Plan"). The Company does not currently intend to grant any additional options under the 1997 Plan. No stock options were granted during the three months ended March 31, 2004. The total fair value of the options granted under the 2002 Plan during the three months ended March 31, 2003 was $.4 million. The total fair value of options granted under the 2002 Plan is generally recognized as non-cash compensation expense over the three year vesting period for such options. The Company recorded compensation expense related to granted stock options of approximately $.1 million for the three months ended March 31, 2004 and 2003. The expected annual impact on 2004 earnings before income taxes of the options granted to date is a reduction of approximately $.5 million.

- Defined Benefit Pension Plan

The Company has noncontributory defined benefit pension plans covering substantially all salaried and hourly employees. No contributions were made to the pension plans for the three months ended March 31, 2004. The Company contributed $.1 million to the pension plans for the three months ended March 31, 2003. The Company expects to contribute a total of $.9 million to the pension plans in 2004.

The following table presents the components of net periodic benefit cost for the three months ended March 31 (in thousands):

		2004	2003
Service cost	$	157	137
Interest cost		203	190
Expected return on plan assets		(212)	(197)
Amortization of transition asset		(7)	(10)
Amortization of prior service cost		(1)	(1)
Recognized net actuarial loss		54	39
Net periodic benefit cost	$	194	158

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THE ARISTOTLE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2004

(Unaudited)

- Segment Reporting

The Company's business activities are organized into two business segments, educational and commercial. The educational segment relates to instructional teaching aids and materials, which are distributed to educational institutions principally in North America, for kindergarten through grade 12 classes, and for nursing school and emergency medical instructors. Products in the educational segment are marketed primarily through catalogs. The growth potential of the educational segment is directly related to school enrollments and the strength of government funding of education. The commercial segment relates to agricultural products, sterile sampling containers and systems, materials for nursing home activities and novelty and gift products. Products in the commercial segment are marketed through catalogs nationwide and through a worldwide dealer network covering more than 60 countries. Market growth in the commercial segment is principally impacted by the general economic conditions of world agriculture, the increasing size of the aged population, as well as increasing global awareness of food and water quality standards. The Company evaluates the performance of these segments based on segment net sales and gross profit.

The following table presents segment information for the three months ended March 31 (in thousands):

			2004	2003
Net sales:				
Educational		$	32,942	29,000
Commercial			7,942	7,728
Intercompany			(1,864)	(1,287)
	Net sales	$	39,020	35,441
Gross profit:				
Educational		$	13,184	11,695
Commercial			2,858	2,817
Other costs of sales			(853)	(1,274)
	Gross profit	$	15,189	13,238

Other costs of sales primarily include freight costs incurred in the procurement of inventories and shipment of customer orders not allocable to a particular segment.

The following table presents segment identifiable asset information as of March 31, 2004, December 31, 2003 and March 31, 2003 (in thousands):

		March 31, 2004	December 31, 2003	March 31, 2003
Identifiable assets:				
Educational	$	49,457	45,606	42,617

Commercial		5,325	4,624	5,000
Other corporate assets		50,401	54,884	56,169
Identifiable assets	$	105,183	105,114	103,786

Educational assets include $11.5 million, $11.5 million and $7.0 million of goodwill at March 31, 2004, December 31, 2003 and March 31, 2003, respectively.

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

GENERAL

This discussion and analysis of financial condition and results of operations reviews the results of operations of the Company, on a consolidated basis, for the three months ended March 31, 2004 as compared to the three months ended March 31, 2003. This discussion and analysis of financial condition and results of operations has been derived from, and should be read in conjunction with, the unaudited Condensed Consolidated Financial Statements and Notes to Condensed Consolidated Financial Statements contained herein.

The Company is a leading manufacturer and global distributor of educational, health, medical technology and agricultural products, primarily offered through catalogs.

The following is a summary of key events for the first quarter of 2004:

- increase in net sales and gross profit of 10.1% and 14.7%, respectively, as compared to the first quarter of 2003;
- 53.9% and 56.0% increase in earnings from operations and net earnings, respectively, as compared to the first quarter of 2003;
- EBITDA(1) increase of 48.3% to $5.7 million from $3.9 million in the comparable quarter in 2003;
- increase in cash retained in the Company to $1.5 million in first quarter of 2004 from $1.0 million in the comparable quarter in 2003 as a result of the increased utilization of Federal net operating tax loss carryforwards; and
- semi-annual payment of $4.3 million of dividends on the Company's Series I Preferred Stock and Series J Preferred Stock.

A key strength of the Company's business is its ability to generate cash consistently. The Board of Directors and management use cash generated as a measure of the Company's performance. The Company uses the cash generated from operations to strengthen the balance sheet, including reducing liabilities such as pensions and debt, and for paying dividends on its preferred stock. The Company's management believes that looking at the ability to generate cash provides investors with additional insight into the Company's performance.

The following table sets forth selected financial data (i) as a percentage of net sales for the three months ended March 31, 2004 and 2003 and (ii) the percentage change in dollars in those reported items from the comparable period in 2003:

	% of Net Sales					
	2004		2003		% Change	
Net sales	100.0	%	100.0	%	10.1	%
Cost of sales	61.1		62.6		7.3	
Gross profit	38.9		37.4		14.7	
Selling and administrative expense	25.3		27.6		.9	
Earnings from operations	13.6		9.8		53.9	
Other expense (income):						
Interest expense	.8		.9		1.6	
Other, net	.1		(.1)		(161.2)	
	.9		.8		32.4	
Earnings before income taxes	12.7		9.0		55.7	
Income taxes						
Current	1.2		.6		118.2	
Deferred	3.8		2.9		42.3	