

SCOTTS LIQUID GOLD INC

Form 10-Q

November 14, 2011

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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

WASHINGTON, D.C. 20549

**FORM 10-Q**

**QUARTERLY REPORT UNDER SECTION 13 OF THE**  
**SECURITIES EXCHANGE ACT OF 1934**

FOR THE QUARTERLY PERIOD ENDED September 30, 2011

Commission File No. 001-13458

**SCOTT S LIQUID GOLD-INC.**

(exact name of registrant as specified in its charter)

Colorado  
(State or other jurisdiction of

84-0920811  
(I.R.S. Employer

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Incorporation)

4880 Havana Street

Identification No.)

Denver, CO 80239

(Address of principal executive offices)

Phone: 303-373-4860

(Registrant's telephone number, including area code)

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 has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes  No

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes  No

As of November 14, 2011, the Registrant had 10,898,500 of its \$0.10 par value common stock outstanding.

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## PART I. FINANCIAL INFORMATION

## Item 1. Financial Statements

**SCOTT S LIQUID GOLD-INC. & SUBSIDIARIES****Consolidated Statements of Operations (Unaudited)**

|  | Three Months Ended<br>September 30, |              | Nine Months Ended<br>September 30, |               |
|--|-------------------------------------|--------------|------------------------------------|---------------|
|  | 2011                                | 2010         | 2011                               | 2010          |
| Net sales                                    | \$ 4,071,400                        | \$ 3,494,000 | \$ 11,936,600                      | \$ 10,544,200 |
| Operating costs and expenses:                |                                     |              |                                    |               |
| Cost of sales                                | 2,275,300                           | 1,946,700    | 6,302,100                          | 5,649,000     |
| Advertising                                  | 82,300                              | 78,600       | 330,700                            | 321,500       |
| Selling                                      | 1,103,000                           | 1,017,700    | 3,261,300                          | 3,076,800     |
| General and administrative                   | 601,000                             | 609,200      | 1,813,700                          | 1,827,100     |
|  | 4,061,600                           | 3,652,200    | 11,707,800                         | 10,874,400    |
| Income (loss) from operations                | 9,800                               | (158,200)    | 228,800                            | (330,200)     |
| Rental and other income                      | 39,700                              | 30,600       | 121,700                            | 97,900        |
| Interest expense                             | (59,200)                            | (68,900)     | (183,400)                          | (207,900)     |
|  | (9,700)                             | (196,500)    | 167,100                            | (440,200)     |
| Income tax expense                           |                                     |              |                                    |               |
| Net income (loss)                            | \$ (9,700)                          | \$ (196,500) | \$ 167,100                         | \$ (440,200)  |
| Net income (loss) per common share (Note 2): |                                     |              |                                    |               |
| Basic  | \$ 0.00                             | \$ (0.02)    | \$ 0.02                            | \$ (0.04)     |
| Diluted                                      | \$ 0.00                             | \$ (0.02)    | \$ 0.01                            | \$ (0.04)     |
| Weighted average shares outstanding:         |                                     |              |                                    |               |
| Basic  | 10,898,500                          | 10,795,000   | 10,898,500                         | 10,795,000    |
| Diluted                                      | 10,898,500                          | 10,795,000   | 12,207,750                         | 10,795,000    |

See accompanying notes to consolidated financial statements.

**Table of Contents****SCOTT S LIQUID GOLD-INC. & SUBSIDIARIES****Consolidated Balance Sheets**

|  | September<br>30,<br>2011<br>(Unaudited) | December<br>31,<br>2010 |
|--|---|-------------------------|
| <b><u>ASSETS</u></b>   |   |                         |
| <b>Current assets:</b>   |   |                         |
| Cash and cash equivalents  | \$ 637,600                              | \$ 480,700              |
| Trade receivables, net of allowance of \$62,000 and \$61,300, respectively, for doubtful accounts  | 1,232,800                               | 836,400                 |
| Inventories, net   | 2,323,800                               | 1,681,500               |
| Prepaid expenses   | 185,000                                 | 205,000                 |
| <b>Total current assets</b>  | <b>4,379,200</b>                        | <b>3,203,600</b>        |
| Property, plant and equipment, net   | 10,711,500                              | 11,062,400              |
| Other assets   | 73,400                                  | 91,000                  |
| <b>TOTAL ASSETS</b>  | <b>\$ 15,164,100</b>                    | <b>\$ 14,357,000</b>    |
| <b><u>LIABILITIES AND SHAREHOLDERS' EQUITY</u></b>   |   |                         |
| <b>Current liabilities:</b>  |   |                         |
| Obligations collateralized by receivables  | \$ 785,500                              | \$ 340,900              |
| Accounts payable   | 1,406,000                               | 983,300                 |
| Accrued payroll and benefits   | 686,100                                 | 583,100                 |
| Accrued property taxes   | 168,200                                 | 208,500                 |
| Other accrued expenses   | 130,300                                 | 231,900                 |
| Current maturities of long-term debt   | 338,100                                 | 330,200                 |
| <b>Total current liabilities</b>   | <b>3,514,200</b>                        | <b>2,677,900</b>        |
| Long-term debt, net of current maturities  | 3,449,700                               | 3,704,100               |
| <b>TOTAL LIABILITIES</b>   | <b>6,963,900</b>                        | <b>6,382,000</b>        |
| <b>Shareholders' equity:</b>   |   |                         |
| Common stock; \$.10 par value, authorized 50,000,000 shares; issued and outstanding 10,898,500 shares, and 10,898,500 shares, respectively | 1,089,900                               | 1,089,900               |
| Capital in excess of par   | 5,431,200                               | 5,373,100               |
| Retained earnings  | 1,679,100                               | 1,512,000               |
| <b>Shareholders' equity</b>  | <b>8,200,200</b>                        | <b>7,975,000</b>        |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>  | <b>\$ 15,164,100</b>                    | <b>\$ 14,357,000</b>    |

See accompanying notes to consolidated financial statements.

**Table of Contents****SCOTT S LIQUID GOLD-INC. & SUBSIDIARIES****Consolidated Statements of Cash Flows (Unaudited)**

|   | <b>Nine Months Ended<br/>September 30,</b> |              |
|---|--|--------------|
|   | <b>2011</b>                                | <b>2010</b>  |
| <b>Cash flows from operating activities:</b>  |  |              |
| Net income (loss)   | \$ 167,100                                 | \$ (440,200) |
| Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities: |  |              |
| Depreciation and amortization   | 374,400                                    | 385,500      |
| Stock-based compensation  | 58,100                                     | 66,000       |
| Gain on sale of securities  |  | (300)        |
| Changes in assets and liabilities:  |  |              |
| Proceeds from sale of receivables   | 1,949,900                                  |              |
| Trade receivables, net  | (2,346,300)                                | 10,900       |
| Inventories   | (642,300)                                  | (262,800)    |
| Prepaid expenses and other assets   | 20,000                                     | 48,400       |
| Accounts payable and accrued expenses   | 383,800                                    | 463,300      |
| Total adjustments to net income (loss)  | (202,400)                                  | 711,000      |
| Net Cash Provided (Used) by Operating Activities  | (35,300)                                   | 270,800      |
| <b>Cash flows from investing activities:</b>  |  |              |
| Proceeds from sale of securities  |  | 4,300        |
| Real estate brokerage costs   |  | (41,200)     |
| Purchase of property, plant & equipment   | (5,900)                                    | (1,500)      |
| Net Cash Used by Investing Activities   | (5,900)                                    | (38,400)     |
| <b>Cash flows from financing activities:</b>  |  |              |
| Net proceeds (payments) on obligations collateralized by receivables                            | 444,600                                    | (21,900)     |
| Principal payments on long-term borrowings  | (246,500)                                  | (238,600)    |
| Net Cash Provided (Used) by Financing Activities  | 198,100                                    | (260,500)    |
| Net Increase (Decrease) in Cash and Cash Equivalents  | 156,900                                    | (28,100)     |
| Cash and Cash Equivalents, beginning of period  | 480,700                                    | 654,100      |
| Cash and Cash Equivalents, end of period  | \$ 637,600                                 | \$ 626,000   |
| Supplemental disclosures:   |  |              |
| Cash paid during period for:  |  |              |
| Interest  | \$ 183,800                                 | \$ 208,400   |

See accompanying notes to consolidated financial statements.

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**SCOTT'S LIQUID GOLD-INC. & SUBSIDIARIES**

**Notes to Consolidated Financial Statements (Unaudited)**

Note 1. Summary of Significant Accounting Policies

(a) Company Background

Scott's Liquid Gold-Inc. (a Colorado corporation) was incorporated on February 15, 1954. Scott's Liquid Gold-Inc. and its wholly-owned subsidiaries (collectively, we or our or the Company) manufacture and market quality household and skin care products, and we fill, package and market our Mold Control 500 product. Since the first quarter of 2001, we have acted as the distributor in the United States for beauty care products contained in individual sachets and manufactured by Montagne Jeunesse. In 2009, we began the distribution of Batiste dry shampoo manufactured by Vivalis. Our business is comprised of two segments—household products and skin care products.

(b) Principles of Consolidation

Our consolidated financial statements include our accounts and those of our wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated.

(c) Basis of Preparation of Financial Statements

We have prepared these unaudited interim consolidated financial statements in accordance with the rules and regulations of the Securities and Exchange Commission. Such rules and regulations allow the omission of certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles as long as the statements are not misleading. In the opinion of management, all adjustments necessary for a fair presentation of these interim statements have been included and are of a normal recurring nature. These interim financial statements should be read in conjunction with our financial statements included in our 2010 Annual Report on Form 10-K. The results of operations for the interim period may not be indicative of the results to be expected for the full fiscal year.

(d) Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Significant estimates include, but are not limited to, realization of deferred tax assets, reserves for slow moving and obsolete inventory, customer returns and allowances, coupon redemptions, bad debts, and stock-based compensation.

(e) Cash Equivalents

We consider all highly liquid investments with an original maturity of three months or less at the date of acquisition to be cash equivalents.

(f) Sale of Accounts Receivable

On November 3, 2008, we established a \$1.2 million factoring line with an asset-based lender, Summit Financial Resources (Summit or Lender), and secured by accounts receivable, inventory, any lease in which we are a lessor, all investment property and guarantees by our active subsidiaries. On March 12, 2009 we entered into the First Amended and Restated Financing Agreement with the Lender and, subsequently, on March 16, 2011 (effective as of March 1, 2011) we entered into the Second Amended and Restated Financing





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Agreement with the Lender (the Summit Financial Agreement). This most recent amendment, among other things, increased our factoring line from \$1.2 million to \$1.5 million and increased the advance rate from 70% to 85% of eligible receivables. Advances under the agreement bear interest at a rate of 1.5% over the prime rate (as published in the Wall Street Journal) for the accounts receivable portion of the advances and 4.0% over the prime rate for the inventory portion, if any, of the borrowings. Consequently, our interest cost adjusts with changes in the prime rate (3.25% as of September 30, 2011). In addition, there are administrative fees of 1.0% of the average monthly balance of outstanding advances on accounts receivable and 1.35% on the average monthly balance of outstanding advances on inventory. The administrative fee with respect to advances against accounts receivable is less costly than the collateral management fee under the previous agreement in which a 0.28% fee was charged on the face value of the receivable (rather than on the advance amount) for each 10-day period that an advance remained outstanding. The administrative fee with respect to advances on inventory is unchanged from the former collateral management fee relative to advances on inventory. The term of the Summit Financial Agreement is eighteen months (expiring September 1, 2012), renewable automatically for additional one-year terms unless either party provides written notice of non-renewal at least 60 days prior to the end of the current financing period. At September 30, 2011, approximately \$714,500 of this credit line was available to the Company assuming sufficient levels of eligible receivables and inventory.

We follow Financial Accounting Standards Board (FASB) authoritative guidance as it relates to distinguishing between transfers of financial assets that are sales from transfers that are secured borrowings. Under this guidance the reporting of the sale of accounts receivable to Summit is treated as a secured borrowing rather than as a sale. As a result, affected accounts receivable are reported under Current Assets within the Company's balance sheet as Trade receivables subject to reserves for doubtful accounts, returns and other allowances. Similarly, the net liability owing to Summit Financial Resources appears as Obligations collateralized by receivables within the Current Liabilities section of the Company's balance sheet. Net Proceeds received from the sale of accounts receivable appear as cash provided or used by financing activities within the Company's Consolidated Statements of Cash Flows.

On March 16, 2011, under a consent agreement from Summit, the Company entered into a financing agreement with Wells Fargo Bank (the Wells Fargo Agreement) for the purpose of further lowering the cost of borrowing associated with the financing of our accounts receivable. Pursuant to this agreement, the Company may sell receivables relating to our largest account at a discount to Wells Fargo; provided, however, that Wells Fargo may reject offers to purchase such receivables in its discretion. Under the Wells Fargo Agreement, the accounts receivable with our largest customer may be purchased by Wells Fargo at a cost to us equal to LIBOR plus 1.15% per annum, the LIBOR rate being dependent upon the days to maturity of the receivable sold, typically ranging from 102 to 105 days (the 104-day LIBOR rate as reported by Wells Fargo was 0.43% as of September 30, 2011). The Wells Fargo Agreement will continue unless terminated by either party upon 30 days written notice. Under this agreement, the Company sold \$1,958,400 of invoices between March 16, 2011 and September 30, 2011 at a discount of \$8,500.

With respect to the Wells Fargo Agreement, we follow FASB authoritative guidance as it relates to distinguishing between transfers of financial

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assets that are sales from transfers that are secured borrowings. These transactions qualify for a sale of assets since (1) we have transferred all of our rights, title and interest in the selected accounts receivable invoices to the Lender, (2) the Lender may pledge, sell or transfer the selected accounts receivable invoices, and (3) we have no effective control over the selected accounts receivable invoices since we are not entitled to nor obligated to repurchase or redeem the invoices before their maturity and we do not have the ability to unilaterally cause the Lender to return the invoices. Under the authoritative guidance, after a transfer of financial assets, an entity recognizes the financial and servicing assets it controls and the liabilities it has incurred, derecognizes financial assets when control has been surrendered, and derecognizes liabilities when extinguished.

**(g) Inventories**

Inventories consist of raw materials and finished goods and are stated at the lower of cost (first-in, first-out method) or market. We record a reserve for slow moving and obsolete products and raw materials. We estimate reserves for slow moving and obsolete products and raw materials based upon historical and anticipated sales.

Inventories were comprised of the following at:

|                                    | <b>September 30, 2011</b> | <b>December 31, 2010</b> |
|------------------------------------|---------------------------|--------------------------|
| Finished goods                     | \$ 1,058,300              | \$ 877,100               |
| Raw materials                      | 1,517,000                 | 1,095,600                |
| Inventory reserve for obsolescence | (251,500)                 | (291,200)                |
|                                    | \$ 2,323,800              | \$ 1,681,500             |

**(h) Property, Plant and Equipment**

Property, plant and equipment are recorded at historical cost. Depreciation is provided using the straight-line method over estimated useful lives of the assets ranging from three to 45 years. Building structures and building improvements are estimated to have useful lives of 35 to 45 years and three to 20 years, respectively. Production equipment and production support equipment are estimated to have useful lives of 15 to 20 years and three to 10 years, respectively. Office furniture and office machines are estimated to have useful lives of 10 to 20 and three to five years, respectively. Carpet, drapes and company vehicles are estimated to have useful lives of five to 10 years. Maintenance and repairs are expensed as incurred. Improvements that extend the useful lives of the assets or provide improved efficiency are capitalized.

**(i) Financial Instruments**

Financial instruments which potentially subject us to concentrations of credit risk include cash and cash equivalents, and trade receivables. We maintain our cash balances in the form of bank demand deposits with financial institutions that management believes are creditworthy. We establish an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends and other information. We have no significant financial instruments with off-balance sheet risk of accounting loss, such as foreign exchange contracts, option contracts or other foreign currency hedging arrangements.

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The recorded amounts for cash and cash equivalents, receivables, other current assets, and obligations collateralized by receivables, accounts payable and accrued expenses approximate fair value due to the short-term nature of these financial instruments. Our long-term debt bears interest at a fixed rate that adjusts annually on the anniversary date to a then prime rate. The carrying value of long-term debt approximates fair value as of September 30, 2011 and December 31, 2010.

### **(j) Long-Lived Assets**

We follow FASB authoritative guidance as it relates to the proper accounting treatment for the impairment or disposal of long-lived assets. This guidance requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

As of December 31, 2010, due to changes in the real estate market in Denver, Colorado and the continuing economic downturn, we conducted an evaluation into fair value impairment with regard to our property, plant and equipment with particular attention to our land and buildings ( facilities ), which have an original cost of \$17,485,800 and a depreciated book value at December 31, 2010 of approximately \$10,423,800. For the facilities, we performed an evaluation utilizing an income capitalization model employing rental, vacancy and capitalization rates obtained from independent market data relative to our area of the Denver market as well as the actual rental rate in effect in the current lease of a portion of our office space. This evaluation returned a range of fair value estimates in excess of (a) the carrying value of the facilities and (b) the current listing price for the facilities. We currently have the facilities listed for sale at the price of \$11,500,000 for the improved property plus an unstated amount for an unimproved, adjacent 5.5 acre parcel of land with a value estimated by us at \$1,200,000. Based upon our evaluation, we found there to be no impairment in the carrying values of our long-lived assets at December 31, 2010 and there have been no events or changes in circumstances that indicate the fair value of the facilities has declined in the nine months ended September 30, 2011; however, the valuation of our facilities can be affected by future events including the commercial real estate market in which our facilities are located.

### **(k) Income Taxes**

We follow FASB authoritative guidance for the accounting for income taxes which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective income tax bases. A valuation allowance is provided when it is more likely than not that some portion or all of a deferred tax asset will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the period in which related temporary differences become deductible. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

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Revenue is recognized when an arrangement exists to sell our product, we have delivered such product in accordance with that arrangement, the sales price is determinable, and collectability is probable. Reserves for estimated market development support, pricing allowances and returns are provided in the period of sale as a reduction of revenue. Reserves for returns and allowances are recorded as a reduction of revenue, and are maintained at a level that management believes is appropriate to account for amounts applicable to existing sales. Reserves for coupons and certain other promotional activities are recorded as a reduction of revenue at the later of the date at which the related revenue is recognized or the date at which the sales incentive is offered. At September 30, 2011 and December 31, 2010 approximately \$244,000 and \$303,000, respectively, had been reserved as a reduction of accounts receivable, and approximately \$24,000 and \$73,000, respectively, had been accrued as current liabilities. Co-op advertising, marketing funds, slotting fees and coupons are deducted from gross sales and totaled \$855,700 and \$848,300 in the nine months ended September 30, 2011 and 2010, respectively.

**(m) Advertising Costs**

Advertising costs are expensed as incurred.

**(n) Stock-based Compensation**

Our Board of Directors adopted an amendment to the 2005 Stock Incentive Plan in May 2011 to: (1) limit the aggregate awards to any director or executive officer, both exercised since January 1, 1999 and unexercised, to awards exercisable for no more than 200,000 shares of common stock, except to the extent that such limit has already been exceeded as of the date of the amendment; and (2) require that the minimum exercise price for new awards be not less than the higher of (i) 120% of current market price on the date of grant; or (ii) the average of market price over the prior 30 trading days.

During the first nine months of 2011, we granted 30,000 options for shares of our common stock to a non-employee director at \$0.37 per share. During the first nine months of 2010, we granted 699,000 options for shares of our common stock to four officers, four non-employee directors and twenty-one employees at \$0.22 to \$0.30 per share. The options, which vest ratably over 48 months, or upon a change in control, and which expire after five years, were granted at or above the market value as of the date of grant.

The weighted average fair market value of the options granted in the first nine months of 2011 and 2010 were estimated on the date of grant, using a Black-Scholes option pricing model with the following assumptions:

|  | <b>September 30, 2011</b> | <b>September 30, 2010</b> |
|--|---------------------------|---------------------------|
| Expected life of options (using the simplified method) | 4.5 years                 | 4.5 years                 |
| Risk-free interest rate                                | 0.9%                      | 1.5%                      |
| Expected volatility of stock                           | 98%                       | 87%-121%                  |
| Expected dividend rate                                 | None                      | None                      |

Compensation cost related to stock options recognized in operating results (included in general and administrative expenses) under authoritative

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guidance issued by the FASB was \$58,100 in the nine months ended September 30, 2011. Approximately \$126,500 of total unrecognized compensation costs related to non-vested stock options is expected to be recognized over the next 47 months. In accordance with this same authoritative guidance, there was no tax benefit from recording the non-cash expense as it relates to the options granted to employees, as these were qualified stock options which are not normally tax deductible. With respect to the non-cash expense associated with the options granted to the non-employee directors, no tax benefit was recognized due to the existence of as yet unutilized net operating losses. At such time as these operating losses have been utilized and a tax benefit is realized from the issuance of non-qualified stock options, a corresponding tax benefit may be recognized.

(o) Operating Costs and Expenses Classification

Cost of sales includes costs associated with manufacturing and distribution including labor, materials, freight-in, purchasing and receiving, quality control, internal transfer costs, repairs, maintenance and other indirect costs, as well as warehousing and distribution costs. We classify shipping and handling costs comprised primarily of freight-out and nominal outside warehousing costs as a component of selling expense on the accompanying Consolidated Statement of Operations. Shipping and handling costs totaled \$1,085,800 and \$947,600, for the nine months ended September 30, 2011 and 2010, respectively.

Selling expenses consist primarily of shipping and handling costs, wages and benefits for sales and sales support personnel, travel, brokerage commissions, promotional costs, as well as other indirect costs.

General and administrative expenses consist primarily of wages and benefits associated with management and administrative support departments, business insurance costs, professional fees, office facility related expenses, and other general support costs.

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## Note 2. Earnings per Share

Per share data was determined by using the weighted average number of common shares outstanding. Potentially dilutive securities, including stock options, are considered only for diluted earnings per share, unless considered anti-dilutive. The potentially dilutive securities are comprised of outstanding stock options of 1,963,550 at September 30, 2011. Potentially dilutive securities at September 30, 2010 comprised of outstanding stock options of 1,932,650 were excluded from the computation of weighted average shares outstanding due to their anti-dilutive effect.

A reconciliation of the weighted average number of common shares outstanding for the three and nine months ended September 30, 2011 and 2010, respectively, follows:

|  | <b>2011</b>         |                    |
|--|---------------------|--------------------|
|  | <b>Three Months</b> | <b>Nine Months</b> |
| Common shares outstanding beginning of period                | 10,898,500          | 10,898,500         |
| Stock issued to ESOP   |                     |                    |
| Stock options exercised                                      |                     |                    |
| Weighted average number of common shares outstanding         | 10,898,500          | 10,898,500         |
| Dilutive effect of common share equivalents                  |                     | 1,309,250          |
| Diluted weighted average number of common shares outstanding | 10,898,500          | 12,207,750         |
|  | <b>2010</b>         |                    |
|  | <b>Three Months</b> | <b>Nine Months</b> |
| Common shares outstanding beginning of period                | 10,795,000          | 10,795,000         |
| Stock issued to ESOP   |                     |                    |
| Stock options exercised                                      |                     |                    |
| Weighted average number of common shares outstanding         | 10,795,000          | 10,795,000         |
| Dilutive effect of common share equivalents                  |                     |                    |
| Diluted weighted average number of common shares outstanding | 10,795,000          | 10,795,000         |

At September 30, 2011, there were 50,000,000 authorized shares of our \$.10 par value common stock and 20,000,000 authorized shares of preferred stock issuable in one or more series. None of the preferred stock was issued or outstanding at September 30, 2011.

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## Note 3. Segment Information

We operate in two different segments: household products and skin care products. Our products are sold nationally and internationally (primarily Canada), directly and through independent brokers, to mass merchandisers, drug stores, supermarkets, wholesale distributors and other retail outlets. Management has chosen to organize our business around these segments based on differences in the products sold. The household products segment includes: Scott's Liquid Gold wood care products including a cleaner that preserves as it cleans and a wood wash product; Mold Control 500, a mold remediation product; Clean Screen, a surface cleaner for sensitive electronic televisions and other devices; and Touch of Scent room air fresheners. The skin care segment includes: Alpha Hydrox, alpha hydroxy acid cleansers and lotions; a retinol product; and Diabetic Skin Care, a healing cream and moisturizer developed to address skin conditions of diabetics. In the skin care segment, we also distribute skin care and other sachets of Montagne Jeunesse and certain other products.

The following provides information on our segments for the three and nine months ended September 30:

|                                 | Three Months ended September 30, |                    |                    |                    |
|---------------------------------|----------------------------------|--------------------|--------------------|--------------------|
|                                 | 2011                             |                    | 2010               |                    |
|                                 | Household Products               | Skin Care Products | Household Products | Skin Care Products |
| Net sales to external customers | \$ 1,399,500                     | \$ 2,671,900       | \$ 1,672,600       | \$ 1,821,400       |
| Net income (loss)               | \$ (182,900)                     | \$ 173,200         | \$ (22,700)        | \$ (173,800)       |
| Identifiable assets             | \$ 2,631,200                     | \$ 4,475,300       | \$ 2,755,700       | \$ 3,989,600       |

|                                 | Nine Months ended September 30, |                    |                    |                    |
|---------------------------------|---------------------------------|--------------------|--------------------|--------------------|
|                                 | 2011                            |                    | 2010               |                    |
|                                 | Household Products              | Skin Care Products | Household Products | Skin Care Products |
| Net sales to external customers | \$ 4,497,500                    | \$ 7,439,100       | \$ 5,415,400       | \$ 5,128,800       |
| Net income (loss)               | \$ (393,600)                    | \$ 560,700         | \$ 100             | \$ (440,300)       |
| Identifiable assets             | \$ 2,631,200                    | \$ 4,475,300       | \$ 2,755,700       | \$ 3,989,600       |

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The following is a reconciliation of segment information to consolidated information for the three and nine months ended September 30:

|                                 | Three Months ended<br>September 30, |               | Nine Months ended<br>September 30, |               |
|---------------------------------|-------------------------------------|---------------|------------------------------------|---------------|
|                                 | 2011                                | 2010          | 2011                               | 2010          |
| Net sales to external customers | \$ 4,071,400                        | \$ 3,494,000  | \$ 11,936,600                      | \$ 10,544,200 |
| Net income (loss)               | \$ (9,700)                          | \$ (196,500)  | \$ 167,100                         | \$ (440,200)  |
| Identifiable assets             | \$ 7,106,500                        | \$ 6,745,300  | \$ 7,106,500                       | \$ 6,745,300  |
| Corporate assets                | 8,057,600                           | 8,149,300     | 8,057,600                          | 8,149,300     |
| Consolidated total assets       | \$ 15,164,100                       | \$ 14,894,300 | \$ 15,164,100                      | \$ 14,894,300 |

Corporate assets noted above are comprised primarily of our cash and investments, and property and equipment not directly associated with the manufacturing, warehousing, shipping and receiving activities.



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## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Results of Operations

Our net income was \$167,100 in the first nine months of 2011 versus a net loss of \$440,200 in the same period of 2010. The \$607,300 improvement in our operating results reflects the combination of increased sales (\$11,936,600 in 2011 versus \$10,544,200 in 2010) and an improvement in gross margins for our cosmetics and distributed products offset somewhat by an increase in operating expenses as detailed below.

**Summary of Results as a Percentage of Net Sales**

|  | Year<br>Ended<br>December 31,<br>2010 | Nine Months Ended<br>September 30, |        |
|--|---------------------------------------|------------------------------------|--------|
|  |                                       | 2011                               | 2010   |
| Net sales                              |                                       |                                    |        |
| Scott's Liquid Gold household products | 48.9%                                 | 37.7%                              | 51.4%  |
| Neoteric Cosmetics                     | 51.1%                                 | 62.3%                              | 48.6%  |
| Total Net Sales                        | 100.0%                                | 100.0%                             | 100.0% |
| Cost of Sales                          | 53.9%                                 | 52.8%                              | 53.6%  |
| Gross profit                           | 46.1%                                 | 47.2%                              | 46.4%  |
| Other revenue                          | 1.0%                                  | 1.0%                               | 0.9%   |
|  | 47.1%                                 | 48.2%                              | 47.3%  |
| Operating expenses                     | 48.6%                                 | 45.3%                              | 49.5%  |
| Interest expense                       | 1.9%                                  | 1.5%                               | 2.0%   |
|  | 50.5%                                 | 46.8%                              | 51.5%  |
| Income (loss) before income taxes      | (3.4%)                                | 1.4%                               | (4.2%) |

Our gross margins may not be comparable to those of other entities, because some entities include all of the costs related to their distribution network in cost of sales and others, like us, exclude a portion of them (freight out to customers and nominal outside warehouse costs) from gross margin, including them instead in the selling expense line item. See Note 1(o), Operating Costs and Expenses Classification, to the unaudited Consolidated Financial Statements in this Report.

**Table of Contents****Nine Months Ended September 30, 2011****Compared to Nine Months Ended September 30, 2010****Comparative Net Sales**

|   | Nine Months Ended     |                       | Percentage             |
|---|-----------------------|-----------------------|------------------------|
|   | September 30,<br>2011 | September 30,<br>2010 | Increase<br>(Decrease) |
| Scott's Liquid Gold and other household products  | \$ 4,155,200          | \$ 5,050,200          | (17.7%)                |
| Touch of Scent                                    | 342,300               | 365,200               | (6.3%)                 |
| <b>Total household products</b>                   | <b>4,497,500</b>      | <b>5,415,400</b>      | <b>(16.9%)</b>         |
| Alpha Hydrox and other skin care                  | 2,936,600             | 2,627,000             | 11.8%                  |
| Montagne Jeunesse and other distributed skin care | 4,502,500             | 2,501,800             | 80.0%                  |
| <b>Total skin care products</b>                   | <b>7,439,100</b>      | <b>5,128,800</b>      | <b>45.0%</b>           |
| <b>Total Net Sales</b>                            | <b>\$ 11,936,600</b>  | <b>\$ 10,544,200</b>  | <b>13.2%</b>           |

Consolidated net sales for the first nine months of the current year were \$11,936,600 versus \$10,544,200 for the first nine months of 2010, an increase of \$1,392,400. Average selling prices for the first nine months of 2011 were down by \$14,000 over the same period of 2010 with household products being up by \$98,800, while average selling prices of skin care products were down by \$112,800. The increase in the selling prices of household products primarily reflects greater couponing efforts in 2010 intended to support retailer sell-through of these products. Such couponing efforts in 2011 were redirected toward our effort to expand distribution of those skin care products which we manufacture contributing to the decrease in selling prices of skin care products. Co-op advertising, marketing funds, slotting fees, and coupons paid to retailers are deducted from gross sales, and totaled \$855,700 in the first nine months of 2011 versus \$848,300 in the same period in 2010, an increase of \$7,400 or 0.9%. This increase consisted of an increase in co-op advertising funds of \$12,000, an increase in coupon expense of \$59,000, and a decrease in slotting fee expenses of \$63,600.

From time to time, our customers return product to us. For our household products, we permit returns only for a limited time and generally only if there is a manufacturing defect. With regard to our skin care products, returns are more frequent under an unwritten industry standard that permits returns for a variety of reasons. In the event a skin care customer requests a return of product, the Company will consider the request, and may grant such request in order to maintain or enhance relationships with customers, even in the absence of an enforceable right of the customer to do so. Some retailers have not returned products to us. Return price credit (used in exchanges typically, or rarely, refunded in cash) when authorized is based on the original sale price plus a handling charge of the retailer that ranges from 8-10%. The handling charge covers costs associated with the return and shipping of the product. Additions to our reserves for estimated returns are subtracted from gross sales.

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From January 1, 2008 through September 30, 2011, our product returns (as a percentage of gross revenue) have averaged as follows: household products 0.6%, Montagne Jeunesse and other distributed products 1.7%, and our Alpha Hydrox and other skin care products 1.3%. The level of returns as a percentage of gross revenue for the household products and Montagne Jeunesse and other distributed products have remained fairly constant as a percentage of sales over that period while the Alpha Hydrox and other skin care products return levels have fluctuated. The products returned in the nine months ended September 30, 2011 (indicated as a percentage of gross revenues) were: household products 0.1%, Montagne Jeunesse and other distributed products 0.1%, and our Alpha Hydrox and other skin care products 0.2%. We review our reserve for returns quarterly and we regularly face the risk that the existing conditions related to product returns will change.

During the first nine months of 2011, net sales of skin care products accounted for 62.3% of consolidated net sales compared to 48.6% for the same period of 2010. Net sales of these products for that period were \$7,439,100 in 2011 compared to \$5,128,800 in 2010, an increase of \$2,310,300 or 45.0%. Our increase in net sales of skin care was comprised of an increase of \$2,000,700 in sales of products for which we act as a distributor and an increase of \$309,600 in our manufactured skin care product lines.

Overall, net sales of our line-up of distributed products, including Montagne Jeunesse, totaled \$4,502,500 in the first nine months of 2011 as compared to net sales of \$2,501,800 in the same period of 2010, an increase of \$2,000,700 or 80.0%. This rise in sales is the combined result of increased offerings of the Montagne Jeunesse products with our largest retail customer, increased sales with several other major customers including grocery, drug and mass merchandise and reductions in the level of marketing support in 2011 compared to the prior year.

Similarly, net sales of our Alpha Hydrox and other manufactured skin care products rose \$309,600, or 11.8%, from \$2,627,000 in the first nine months of 2010 to \$2,936,600 for the same period of 2011. This sales increase was attributable primarily to the return of our products to the shelves of a major drugstore chain.

Sales of household products for the first nine months of 2011 accounted for 37.7% of consolidated net sales compared to 51.4% for the same period in 2010. These products are comprised of Scott's Liquid Gold wood care products, Mold Control 500, Clean Screen, and Touch of Scent. During the nine months ended September 30, 2011 sales of household products were \$4,497,500 as compared to \$5,415,400 for the same period in 2010, a decrease of \$917,900, or 17.0%. Sales decreased in 2011 versus 2010 across all major lines led by Scott's Liquid Gold products (which includes Clean Screen) in which sales declined \$818,700 or 16.6%, followed by declines in sales of Mold Control 500 of \$76,300 or 68.9%, and Touch of Scent of \$22,900 or 6.3%. The decrease in sales of Scott's Liquid Gold products is attributable primarily to the continuing economic slowdown in the United States. In addition, Mold Control 500 was discontinued by our largest retail customer for that product. Sales of our Clean Screen products, a surface cleaner for sensitive electronics including HDTV screens, computer monitors and other such devices first introduced in 2009, were approximately \$602,000 in the first nine months of 2011 as compared to \$688,000 for the same period of 2010, a decline of \$86,000 or 12.5%, reflecting discontinuation by our largest customer partially mitigated by new placement with several other customers.

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As sales of a consumer product decline, there is the risk that retail stores will stop carrying the product. The loss of any significant customer for any household or skin care products could have a significant adverse impact on our revenues and operating results.

We also believe that the introduction of successful new products, including line extensions of existing products using our brand names Scott's Liquid Gold or Neoteric, are important in our efforts to maintain or grow our revenue. In the second quarter of 2009, we introduced Clean Screen, a new household product under the Scott's Liquid Gold brand; in the fourth quarter of 2009 we introduced Batiste dry shampoo for distribution in the United States; and in the second quarter of 2011 we began shipping our latest product Neoteric Diabetic Shampoo. We regularly review possible additional products to sell through distribution agreements or to manufacture ourselves. To the extent that we manufacture a new product rather than purchase it from external parties, we are also benefited by the use of existing capacity in our facilities. The actual introduction of additional products, the timing of any additional introductions and any revenues realized from new products is uncertain.

On a consolidated basis, cost of goods sold was \$6,302,100 during the first nine months of 2011 compared to \$5,649,000 for the same period of 2010, an increase of \$653,100 or 11.6%, against a sales increase of 13.2%. As a percentage of consolidated net sales, cost of goods sold was 52.8% in 2011 versus 53.6% in 2010, a decrease of about 1.5%. Efforts were made in 2010 employing discounts to mitigate the volume lost with the decision in 2009 to discontinue an unprofitable business relationship with a retail chain. Backing off these tactics late in 2010 served to lower cost in goods relative to sales in 2011. The resulting decrease in cost of sales in 2011 was offset in part by increases in petroleum-based raw materials (up nearly 36% from 2010 to 2011) as well as by reduced plant utilization.

**Operating Expenses, Interest Expense and Other Income**

|                                 | Nine Months Ended<br>September 30, |                     | Percentage<br>Increase<br>(Decrease) |
|---------------------------------|------------------------------------|---------------------|--------------------------------------|
|                                 | 2011                               | 2010                |                                      |
| Operating Expenses              |                                    |                     |                                      |
| Advertising                     | \$ 330,700                         | \$ 321,500          | 2.9%                                 |
| Selling                         | 3,261,300                          | 3,076,800           | 6.0%                                 |
| General & Administrative        | 1,813,700                          | 1,827,100           | (0.7%)                               |
| <b>Total operating expenses</b> | <b>\$ 5,405,700</b>                | <b>\$ 5,225,400</b> | <b>3.5%</b>                          |
| Rental and Other Income         | \$ 121,700                         | \$ 97,900           | 24.3%                                |
| Interest Expense                | \$ 183,400                         | \$ 207,900          | (11.8%)                              |

Operating expenses, comprised of advertising, selling and general and administrative expenses, increased by \$180,300 or 3.5% in the first nine months of 2011, when compared to the same period of 2010. The various components of operating expenses are discussed below.

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Advertising expenses for the first nine months of 2011 were \$330,700 compared to \$321,500 for the same period of 2010, an increase of \$9,200 or 2.9%. As in prior quarters, we have limited advertising as part of our cost reduction efforts.

Selling expenses for the first nine months of 2011 were \$3,261,300 compared to \$3,076,800 for the same period of 2010, an increase of \$184,500 or 6.0%. That increase was comprised of a rise in freight expenses of \$139,800, resulting from the increase in sales, an increase in wages and benefits of \$20,700 related to additional personnel to support marketing efforts, an increase in promotional selling expenses of \$9,800, related to increased sales of Montagne Jeunesse displays and a net increase in other selling expenses, none of which by itself is significant, of \$14,200.

General and administrative expenses for the first nine months of 2011 were \$1,813,700 compared to \$1,827,100 for the comparable period of 2010, a decrease of \$13,400 or 0.7%.

Rental and other income for the first nine months of 2011 of \$121,700 included \$115,000 of net rental receipts and \$3,900 in interest earned on our cash reserves as compared to \$91,600 of net rental receipts and \$6,300 in interest earned in the first nine months of 2010. The increase in rental income is the result of leasing of an additional one-half floor of our office building beginning in September 2010 as well as the scheduled escalation in a pre-existing lease.

Interest expense for the first nine months of 2011 was \$183,400 and included \$51,900 in collateral and/or administrative fees incurred relative to the sale of accounts receivable invoices to Summit Financial Resources. Interest expense for the first nine months of 2010 was \$207,900 and included \$75,600 in collateral management fees. The overall decrease in interest expense is the combined result of lower rates incorporated into the second amendment of the Summit agreement and the Wells Fargo agreement, both of which came into effect in March 2011.

**Table of Contents****Three Months Ended September 30, 2011****Compared to Three Months Ended September 30, 2010****Comparative Net Sales**

|   | <b>Three Months Ended<br/>September 30,</b> |                     | <b>Percentage<br/>Increase<br/>(Decrease)</b> |
|---|---|---------------------|---|
|   | <b>2011</b>                                 | <b>2010</b>         |   |
| Scott's Liquid Gold and other household products  | \$ 1,283,600                                | \$ 1,565,500        | (18.0%)                                       |
| Touch of Scent                                    | 115,900                                     | 107,100             | 8.2%  |
| <b>Total household products</b>                   | <b>1,399,500</b>                            | <b>1,672,600</b>    | <b>(16.3%)</b>                                |
| Alpha Hydrox and other skin care                  | 1,046,000                                   | 800,100             | 30.7%   |
| Montagne Jeunesse and other distributed skin care | 1,625,900                                   | 1,021,300           | 59.2%   |
| <b>Total skin care products</b>                   | <b>2,671,900</b>                            | <b>1,821,400</b>    | <b>46.7%</b>                                  |
| <b>Total Net Sales</b>                            | <b>\$ 4,071,400</b>                         | <b>\$ 3,494,000</b> | <b>16.5%</b>                                  |

Consolidated net sales for the third quarter of the current year were \$4,071,400 versus \$3,494,000 for the comparable quarter of 2010, an increase of \$577,400 or 16.5%. Average selling prices for the third quarter of 2011 were down by \$33,700 over the third quarter of 2010 with household products being down by \$20,600 and average selling prices of skin care products down by \$13,100. This decrease in selling prices of both household and skin care products reflects efforts to expand distribution of those products which we manufacture. Co-op advertising, marketing funds, slotting fees, and coupons paid to retailers are deducted from gross sales, and totaled \$299,500 in the third quarter of 2011 versus \$309,300 in the same quarter in 2010, a decrease of \$9,800 or 3.2%. This decrease consisted of decreases in co-op marketing expense of \$4,700 and in slotting fee expense of \$30,800 offset somewhat by an increase in coupon expense of \$25,700.

During the third quarter of 2011, net sales of skin care products accounted for 65.6% of consolidated net sales compared to 52.1% for the same quarter in 2010. Net sales of these products for that period were \$2,671,900 in 2011 compared to \$1,821,400 in 2010, an increase of \$850,500 or 46.7%. Our increase in net sales of skin care products was comprised of an increase of \$604,600 in sales of products for which we act as a distributor, as well as, an increase of \$245,900 in our manufactured skin care product lines.

Overall, net sales of our line-up of distributed products, including Montagne Jeunesse, totaled \$1,625,900 in the third quarter of 2011 as compared to net sales of \$1,021,300 in the same period of 2010, an increase of \$604,600 or 59.2%. This rise in sales is primarily the result of increased offerings of the Montagne Jeunesse products with our largest retail customer, the return of this product line to the shelves of a major drugstore chain, and the steady growth in sales of the Batiste dry shampoo at retail stores.

Additionally, net sales of our Alpha Hydrox and other manufactured skin care products increased \$245,900, or 30.7%, from \$800,100 in the third quarter of 2010 to \$1,046,000 for the same period of 2011. This sales

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increase was primarily attributable to a major drugstore chain in which both our Alpha Hydrox products have returned to the shelves and through whom our Diabetic shampoo product is being introduced.

Sales of household products for the third quarter of 2011 accounted for 34.4% of consolidated net sales compared to 47.9% for the same period in 2010. These products are comprised of Scott's Liquid Gold wood care products, Mold Control 500, Clean Screen, and Touch of Scent. During the quarter ended September 30, 2011 sales of household products were \$1,399,500 as compared to \$1,672,600 for the same period in 2010, a decrease of \$273,100, or 16.3%. The continuing economic slowdown in the United States, direct product competition and discontinued distribution by a retail chain are the primary factors that resulted in a sales decline of our Scott's Liquid Gold products (which includes Clean Screen) of \$253,800 or 16.3% in the third quarter of 2011 when compared to the same period of 2010. Sales of our Clean Screen products, a surface cleaner for sensitive electronics including HDTV screens, computer monitors and other such devices first introduced in 2009, has slowed its sales pace in the third quarter of 2011 compared to 2010, off by \$89,000 or 32.8% due primarily to lost placement as a result of competitive products entering the market. Mold Control 500 was discontinued by our largest retail customer for that product in the second quarter of 2010 and contributed to the decision in 2011 to no longer market this product with the intention of discontinuing the product entirely by the end of 2012. Sales of Mold Control 500 were \$11,100 in the third quarter of 2011 as compared to \$39,200 for the same period of 2010, a decrease of \$28,100 or 71.7%. Sales were up by \$8,800 or 8.2% in our Touch of Scent line in the third quarter of 2011 compared to 2010.

On a consolidated basis, cost of goods sold was \$2,275,300 during the third quarter of 2011 compared to \$1,946,700 for the same period of 2010, an increase of \$328,600 or 16.9%, against a sales increase of 16.5% for these periods. As a percentage of consolidated net sales, cost of goods sold was 55.9% in 2011 versus 55.7% in 2010, an increase of about 0.4%. As discussed previously with respect to the nine month results, the cost of goods in 2011 has been unfavorably impacted by both a rise in the cost of petroleum-based raw materials and reduced plant utilization.

**Operating Expenses, Interest Expense and Other Income**

|                                 | Three Months Ended<br>September 30, |                     | Percentage<br>Increase<br>(Decrease) |
|---------------------------------|-------------------------------------|---------------------|--------------------------------------|
|                                 | 2011                                | 2010                |                                      |
| Operating Expenses              |                                     |                     |                                      |
| Advertising                     | \$ 82,300                           | \$ 78,600           | 4.7%                                 |
| Selling                         | 1,103,000                           | 1,017,700           | 8.4%                                 |
| General & Administrative        | 601,000                             | 609,200             | (1.3%)                               |
| <b>Total operating expenses</b> | <b>\$ 1,786,300</b>                 | <b>\$ 1,705,500</b> | <b>4.7%</b>                          |
| Rental and Other Income         | \$ 39,700                           | \$ 30,600           | 29.7%                                |
| Interest Expense                | \$ 59,200                           | \$ 68,900           | (14.1%)                              |

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Operating expenses, comprised of advertising, selling and general and administrative expenses, increased \$80,800 or 4.7% in the third quarter of 2011, when compared to the same period during 2010. The various components of operating expenses are discussed below.

Advertising expenses for the third quarter of 2011 were \$82,300 compared to \$78,600 for the comparable quarter of 2010, an increase of \$3,700 or 4.7%. As in prior quarters, we continue to limit advertising as part of our cost reduction efforts.

Selling expenses for the third quarter of 2011 were \$1,103,000 compared to \$1,017,700 for the comparable three months of 2010, an increase of \$85,300 or 8.4%. That increase was comprised of a rise in freight expenses of \$51,900 resulting from the increase in sales, an increase in wages and benefits of \$26,300 related to additional personnel to support marketing, market research costs of \$11,400 and by a net decrease in other selling expenses, none of which by itself is significant, of \$4,300.

General and administrative expenses for the third quarter of 2011 were \$601,000 compared to \$609,200 for the same period of 2010, a decrease of \$8,200, or 1.3%.

Rental and other income for the third quarter of 2011 of \$39,700 included \$38,400 of net rental receipts and \$1,300 in interest earned on our cash reserves as compared to \$28,900 of net rental receipts and \$1,700 in interest earned in the third quarter of 2010. The increase in rental income is the result of leasing of an additional one-half floor of our office building beginning in September 2010 as well as the scheduled escalation in a pre-existing lease.

Interest expense for the third quarter of 2011 was \$59,200 and included \$17,300 in collateral and/or administrative fees incurred relative to the sale of accounts receivable invoices to Summit Financial Resources. Interest expense for the third quarter of 2010 was \$68,900 and included \$25,400 in collateral management fees. The overall decrease in interest expense is the combined result of lower rates incorporated into the third amendment of the Summit agreement and the Wells Fargo agreement, both of which came into effect in March 2011.

## **Liquidity and Capital Resources**

### *Citywide Loan*

On June 28, 2006, we entered into a loan with a fifteen year amortization with Citywide Banks (the *Bank*) for \$5,156,600 secured by the land, building and fixtures at our Denver, Colorado facilities. Interest on the bank loan (3.25% at September 30, 2011) is at the prime rate as published in *The Wall Street Journal*, adjusted annually each June. This loan requires 180 monthly payments of approximately \$38,200. Monthly payments commenced on July 28, 2006. The loan agreement contains a number of covenants, including the requirement for maintaining a current ratio of at least 1:1 and a ratio of consolidated long-term debt to consolidated net worth of not more than 1:1, the aforementioned ratios to be calculated in accordance with U.S. generally accepted accounting principles. We may not declare any dividends that would result in a violation of either of these covenants. Affirmative covenants in the loan agreement concern, among other things, compliance in all material respects with applicable laws and regulations and compliance



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with our agreements with other parties which materially affect our financial condition. Negative covenants require that we not do any of the following, among other things, without the consent of the Bank: Sell, lease or grant a security interest in assets; engage in any business activity substantially different than those in which we are presently engaged; sell assets out of the ordinary course of business; or purchase another entity or an interest in another entity. The foregoing requirements were met at the end of quarter ending September 30, 2011.

### *Financing Agreements*

On November 3, 2008, effective as of October 31, 2008, we entered into a financing agreement with Summit Financial Resources, an asset-based lender, for the purpose of improving working capital. The Summit Financial Agreement, amended on March 12, 2009 and on March 16, 2011 (effective March 1, 2011) has a term that expires on September 1, 2012, and may be renewed for an additional 12 months unless either party elects to cancel in writing at least 60 days prior to the anniversary date. The Summit Financial Agreement provides for a factoring line up to \$1.5 million and is secured primarily by accounts receivable, inventory, any lease in which we are a lessor, all investment property and guarantees by our active subsidiaries. Under the Summit Financial Agreement, the lender will make loans at our request and in the lender's discretion (a) based on purchases of our Accounts by the lender, with recourse against us and an advance rate of 85% (or such other percentage determined by the lender in its discretion), and (b) based on Acceptable Inventory not to exceed certain amounts, including an aggregate maximum of \$500,000. Advances under the agreement bear interest at a rate of 1.5% over the prime rate (as published in The Wall Street Journal) for the accounts receivable portion of the advances and 4.0% over the prime rate for the inventory portion of the borrowings. Consequently, our interest cost adjusts with changes in the prime rate (3.25% as of September 30, 2011). In addition there are administrative fees of 1.0% per month on the average monthly outstanding loan on the receivable portion of any advance and 1.35% per month on the average monthly outstanding loan on the inventory portion of any advance. The Summit Financial Agreement provides that neither we nor our active subsidiaries may engage in a change in control transaction without the prior written consent of the lender. Events of default include, but are not limited to, the failure to make a payment when due or a default occurring on any indebtedness of ours.

On March 16, 2011, under a consent agreement from Summit, the Company entered into a financing agreement with Wells Fargo Bank (the Wells Fargo Agreement) for the purpose of further lowering the cost of borrowing associated with the financing of our accounts receivable. Pursuant to this agreement, the Company may sell receivables relating to our largest account at a discount to Wells Fargo; provided, however, that Wells Fargo may reject offers to purchase such receivables in its discretion. Under the Wells Fargo Agreement, the accounts receivable with our largest customer may be purchased by Wells Fargo at a cost to us equal to LIBOR plus 1.15% per annum, the LIBOR rate being dependent upon the days to maturity of the receivable sold, typically ranging from 102 to 105 days (the 104-day LIBOR rate as reported by Wells Fargo was 0.43% as of September 30, 2011). The Wells Fargo Agreement will continue unless terminated by either party upon 30 days written notice.

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### *Liquidity*

During the first nine months of 2011, our working capital increased by \$339,300 resulting in a current ratio (current assets divided by current liabilities) of 1.25:1 at September 30, 2011, compared to 1.20:1 at December 31, 2010. The increase in working capital is attributable primarily to net income of \$167,100 coupled with the excess of depreciation expense over fixed asset additions as well as the outlay of cash relative to the reduction in outstanding long-term debt.

At September 30, 2011, trade and other receivables were \$1,232,800 versus \$836,400 at the end of 2010. Obligations collateralized by receivables, accounts payable, accrued payroll and other accrued expenses increased by \$828,400 from the end of 2010 through September of 2011 corresponding with the increase and timing of purchases of inventory over that period. At September 30, 2011 inventories were \$642,300 more than at December 31, 2010, in support of planned production of finished goods inventory as well as to support increased sales volumes in both manufactured and distributed cosmetic product lines. Prepaid expenses decreased from the end of 2010 by \$20,000 primarily related to the advance payment on process oil at December 31, 2010.

We have no significant capital expenditures planned for 2011.

The Summit Financial Resources Agreement and Wells Fargo Agreement are expected to provide working capital which may be necessary to meet the needs of the Company over the next 12 months. The Company, in general, has high quality accounts receivable which may be sold pursuant to these agreements. The Summit Financial Agreement has a term of 18 months which expires September 1, 2012, while the Wells Fargo Agreement only expires upon cancellation by one or both parties.

As a result of the foregoing, we expect that our available cash, projected cash flows from operating activities, and borrowing available under the Summit Financial Agreement and the Wells Fargo Agreement (assuming no cancellation of such agreements) will fund our cash requirements for the 12 months ending September 30, 2012.

In our continual effort to improve our liquidity and our operating results, we continue to pursue the following steps: the sale or lease of all or a portion of our real estate which we have listed with a real estate firm, efforts to improve revenues, a further reduction in our fixed operating expense if needed, and potentially the addition of external financing. In October 2009 we entered into a long-term lease of the third floor of our five-story office building to an established subsidiary of an international company. In September 2010, we entered a two-year lease of an additional one-half of a floor in the same building. In June 2011, we consolidated all officers and employees onto a single floor of the office building so as to make the vacated space immediately available in the event additional tenants are secured.

Our dependence on operating cash flow means that risks involved in our business can significantly affect our liquidity. Any loss of a significant customer, any further decreases in distribution of our skin care or household products, any new competitive products affecting sales levels of our products, or any significant expense not included in our internal budget could result in the need to raise cash. We have no arrangements for any additional external financing of debt or equity, and we are not certain

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whether any such financing would be available on acceptable terms. Any external debt financing could require the cooperation and approval of existing lenders. In order to improve our operating cash flow, we need to achieve profitability.

### Forward-Looking Statements

This report may contain forward-looking statements within the meaning of U.S. federal securities laws. These statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements and our performance inherently involve risks and uncertainties that could cause actual results to differ materially from the forward-looking statements. Factors that would cause or contribute to such differences include, but are not limited to: continued acceptance of each of our significant products in the marketplace; the degree of success of any new product or product line introduction by us; uncertainty of consumer acceptance of recently introduced products; competitive factors; any decrease in distribution of (i.e., retail stores carrying) our significant products; continuation of our distributorship agreement with Montagne Jeunesse; the need for effective advertising of our products; limited resources available for such advertising; new competitive products and/or technological changes; dependence upon third-party vendors and upon sales to major customers; changes in the regulation of our products, including applicable environmental regulations; additional net losses which could affect our liquidity; the loss of any executive officer; and other matters discussed in our Annual Report on Form 10-K for the year ended December 31, 2010 and this Quarterly Report. We undertake no obligation to revise any forward-looking statements in order to reflect events or circumstances that may arise after the date of this Quarterly Report.

Item 3. Quantitative and Qualitative Disclosures About Market Risk  
Not Applicable

Item 4. Controls and Procedures  
Disclosure Controls and Procedures

As of September 30, 2011, we conducted an evaluation, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective as of September 30, 2011.

Changes in Internal Control over Financial Reporting

There was no change in our internal control over financial reporting during the quarter ended September 30, 2011 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II OTHER INFORMATION

Item 5. Other Information

On August 19, 2011, the Company issued to Phil Neri a non-qualified option to acquire 30,000 shares of common stock previously approved as an inducement for joining the Company's Board of Directors. The options vest ratably over 48 months, or upon a change in control, and expire after five years. The exercise price of \$.37 per share for the award was determined as required under the 2005 Incentive Stock Plan, which requires a price of the higher of (i) 120% of current market price on the date of grant; or (ii) the average of market price over the prior 30 trading days.

Item 6. Exhibits

- 3.1 Restated Articles of Incorporation, as amended and restated through May 1, 1996, incorporated by reference to Exhibit 3.1 of our Annual Report on Form 10-KSB for the year ended December 31, 2007.
- 3.2 Amended and Restated Bylaws of the Company, incorporated by reference to Exhibit 99.1 of our Current Report on Form 8-K filed on July 19, 2011.
- 31.1 Rule 13a-14(a) Certification of the Chief Executive Officer
- 31.2 Rule 13a-14(a) Certification of the Chief Financial Officer
- 32.1\*\* Section 1350 Certification
- 101.INS XBRL Instance Document\*\*
- 101.SCH XBRL Taxonomy Extension Schema Document\*\*
- 101.CAL XBRL Taxonomy Extension Calculation Linkbase Document\*\*
- 101.LAB XBRL Taxonomy Extension Label Linkbase Document\*\*
- 101.PRE XBRL Taxonomy Extension Presentation Linkbase Document\*\*

\* Management contract or compensatory plan or arrangement

\*\* Furnished, not filed.

\*\*\* XBRL (Extensible Business Reporting Language) information is furnished and not filed or a part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act of 1933, is deemed not filed for purposes of section 18 of the Securities Exchange Act of 1934, and is otherwise not subject to liability under these sections.

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.

SCOTT'S LIQUID GOLD-INC.

November 14, 2011  
Date

BY: /s/ Mark E. Goldstein  
Mark E. Goldstein  
President and Chief Executive Officer

November 14, 2011  
Date

BY: /s/ Brian L. Boberick  
Brian L. Boberick



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**EXHIBIT INDEX**

| <b>Exhibit No.</b> | <b>Document</b>   |
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