

ARISTOTLE CORP
Form 10-Q
August 11, 2005

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON AUGUST 11, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Form 10-Q

(MARK ONE)

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

ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2005

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
(STATE OR OTHER JURISDICTION OF
INCORPORATION OR ORGANIZATION)

06-1165854
(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 August 5, 2005, 17,163,329 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

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 QUARTERLY PERIOD ENDED JUNE 30, 2005

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PART I

ITEM 1. FINANCIAL INFORMATION

THE ARISTOTLE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

| Assets | June 30, 2005 (unaudited) | December 31, 2004 | June 30, 2004 (unaudited) |
|---|---------------------------------|----------------------|---------------------------------|
| Current assets: | | | |
| Cash and cash equivalents | \$ 2,169 | 2,143 | 4,477 |
| Investments | 5,919 | 4,058 | - |
| Accounts receivable, net | 19,857 | 12,592 | 17,651 |
| Inventories | 39,281 | 33,356 | 36,241 |
| Prepaid expenses and other | 4,231 | 6,665 | 3,889 |
| Refundable income taxes | - | 49 | - |
| Deferred income taxes | 9,825 | 9,825 | 8,184 |
| Total current assets | 81,282 | 68,688 | 70,442 |
| Property, plant and equipment, net | 18,343 | 17,405 | 17,065 |
| Goodwill | 13,634 | 13,707 | 11,393 |
| Deferred income taxes | 6,793 | 10,594 | 11,806 |
| Other assets | 439 | 511 | 409 |
| Total assets | \$ 120,491 | 110,905 | 111,115 |
| Liabilities and Stockholders' Equity | | | |
| Current liabilities: | | | |
| Current installments of long-term debt | \$ 115 | 114 | 3,548 |
| Trade accounts payable | 11,015 | 7,192 | 11,048 |
| Accrued expenses | 5,736 | 5,833 | 5,067 |
| Accrued dividends payable | 2,158 | 2,158 | 2,158 |
| Income taxes | 124 | - | 16 |
| Total current liabilities | 19,148 | 15,297 | 21,837 |
| Long-term debt, less current installments | 26,855 | 24,948 | 26,799 |
| Stockholders' equity: | | | |
| Preferred stock, Series I, convertible, voting, 11% cumulative, \$6.00 | | | |
| stated value; \$.01 par value; 2,400,000 shares authorized, | | | |

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| | | | |
|--|------------|---------|----------|
| 1,096,622 shares issued and outstanding | 6,580 | 6,580 | 6,580 |
| 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, 17,157,829, 17,142,779 and 17,112,354 shares issued and outstanding at June 30, 2005, December 31, 2004 and June 30, 2004, respectively | 172 | 171 | 171 |
| Additional paid-in capital | 2,655 | 2,310 | 1,184 |
| Accumulated deficit | (664) | (4,331) | (10,775) |
| Accumulated other comprehensive earnings (loss) | (15) | 170 | (441) |
| Total stockholders' equity | 74,488 | 70,660 | 62,479 |
| Total liabilities and stockholders' equity | \$ 120,491 | 110,905 | 111,115 |

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 June 30, | | Six Months Ended June 30, | |
|------------------------------------|--------------------------------|--------|------------------------------|--------|
| | 2005 | 2004 | 2005 | 2004 |
| Net sales | \$ 50,185 | 44,612 | 91,933 | 83,632 |
| Cost of sales | 30,938 | 27,781 | 56,623 | 51,612 |
| Gross profit | 19,247 | 16,831 | 35,310 | 32,020 |
| Selling and administrative expense | 11,155 | 10,409 | 21,788 | 20,285 |
| Earnings from operations | 8,092 | 6,422 | 13,522 | 11,735 |
| Other expense (income): | | | | |
| Interest expense | 362 | 289 | 653 | 602 |
| Interest income | (12) | (1) | (12) | (1) |

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| | | | | |
|--|------------|------------|------------|------------|
| Other, net | (73) | (8) | (143) | 22 |
| | 277 | 280 | 498 | 623 |
| Earnings before income taxes | 7,815 | 6,142 | 13,024 | 11,112 |
| Income taxes: | | | | |
| Current | 757 | 578 | 1,222 | 1,034 |
| Deferred | 2,263 | 1,806 | 3,819 | 3,275 |
| | 3,020 | 2,384 | 5,041 | 4,309 |
| Net earnings | 4,795 | 3,758 | 7,983 | 6,803 |
| Preferred dividends | 2,158 | 2,158 | 4,316 | 4,321 |
| Net earnings applicable to common stockholders | \$ 2,637 | 1,600 | 3,667 | 2,482 |
| Earnings per common share: | | | | |
| Basic | \$.15 | .09 | .21 | .15 |
| Diluted | \$.15 | .09 | .21 | .14 |
| Weighted average common shares outstanding: | | | | |
| Basic | 17,154,032 | 17,111,607 | 17,149,538 | 17,105,304 |
| Diluted | 17,394,146 | 17,289,123 | 17,399,309 | 17,284,349 |

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

THE ARISTOTLE CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

| | Six Months Ended June 30, | |
|---|------------------------------|---------|
| | 2005 | 2004 |
| Cash flows from operating activities: | | |
| Net earnings | \$ 7,983 | 6,803 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | |
| Depreciation and amortization | 890 | 860 |
| Stock option compensation | 289 | 246 |
| Loss on sale of property, plant and equipment | 1 | 7 |
| Earnings in equity method investment | (161) | - |
| Deferred income taxes | 3,819 | 3,275 |
| Change in assets and liabilities: | | |
| Accounts receivable | (7,265) | (5,770) |
| Inventories | (5,925) | (7,084) |
| Prepaid expenses and other | 2,434 | 1,709 |
| Other assets | 145 | 161 |
| Trade accounts payable | 3,823 | 5,174 |
| Accrued expenses and other liabilities | (43) | 763 |
| Net cash provided by operating activities | 5,990 | 6,144 |
| Cash flows from investing activities: | | |
| Purchases of property, plant and equipment | (1,901) | (838) |
| Proceeds from the sale of property, plant and equipment | - | 2 |
| Purchases of investments | (1,700) | - |
| Net cash used in investing activities | (3,601) | (836) |
| Cash flows from financing activities: | | |
| Proceeds from issuance of long-term debt | 6,000 | 2,500 |
| Principal payments on long-term debt | (4,092) | (4,742) |
| Proceeds from issuance of stock under stock option plans | 45 | 162 |
| Preferred dividends paid | (4,316) | (4,317) |
| Net cash used in financing activities | (2,363) | (6,397) |
| Net increase (decrease) in cash and cash equivalents | 26 | (1,089) |
| Cash and cash equivalents at beginning of period | 2,143 | 5,566 |
| Cash and cash equivalents at end of period | \$ 2,169 | 4,477 |

Supplemental cash flow information

Cash paid during the period for:

| | | |
|--------------|----------|-----|
| Interest | \$ 633 | 648 |
| Income taxes | \$ 1,062 | 597 |

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

June 30, 2005

(Unaudited)

• 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 more than 45 separate catalogs carrying the brand of Nasco (founded in 1941), as well as those bearing the brands of Life/Form®, Whirl-Pak®, Simulaids, Triarco, Spectrum Educational Supplies, Hubbard Scientific, Scott Resources, Haan Crafts, To-Sew, CPR Prompt®, Ginsberg Scientific and Summit Learning. Products include educational materials and supplies for substantially all K-12 curricula, molded plastics, biological materials, medical simulators 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 also 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 by licensing rights from third parties. The Company's inventories primarily consist of finished goods and catalog merchandise.

Geneve Corporation ("Geneve"), a privately-held diversified financial holding company, and its affiliated entities held greater than 90% of Aristotle's voting power at June 30, 2005 and 2004.

• Financial Statement Presentation

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

U.S. generally accepted accounting principles ("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 of financial position as of June 30, 2005 and 2004, results of operations for the three and six months ended June 30, 2005 and 2004 and cash flows for the six months ended June 30, 2005 and 2004, as applicable, have been made. Operating results for the three and six months ended June 30, 2005 are not necessarily indicative of results that may be expected for any other interim period or for the

year ending December 31, 2005. 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, 2004.

- Principles of Consolidation

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

- Recently Issued Accounting Pronouncements

In March 2005, the Financial Accounting Standards Board (the "FASB") issued Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* ("FIN 47"). FIN 47 clarifies that an entity must record a liability for a "conditional" asset retirement obligation if the fair value of the obligation can be reasonably estimated. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005. The adoption of FIN 47 is not expected to have a material impact on the Company's financial statements.

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THE ARISTOTLE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2005

(Unaudited)

In December 2004, the FASB issued a revised Statement of Financial Accounting Standards ("SFAS") No. 123, *Share-Based Payment* ("SFAS 123R"), which establishes standards for the accounting for transactions in which an entity exchanges its equity instruments for goods or services and incurs liabilities in exchange for goods or services. SFAS 123R requires a company to measure the cost of employee services received in exchange for an award of equity instruments, such as stock options, based on the grant-date fair value of the award and to recognize these awards as an expense in the statement of earnings over the requisite service period. The grant-date fair value of employee stock options and similar instruments will be estimated using option-pricing models adjusted for unique characteristics of those instruments unless observable market prices for the same or similar instruments are available. SFAS 123R replaces SFAS No. 123, *Accounting for Stock-Based Compensation* ("SFAS 123"), which was issued in October 1995. SFAS 123R is effective for all awards granted, modified, repurchased, or cancelled after the beginning of the first annual reporting period beginning after June 15, 2005. SFAS 123R provides for methods of applying this statement to existing awards during the transitional period. The adoption of SFAS 123R is not expected to have a material impact on the Company's financial statements.

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs: an amendment of ARB No. 43* ("SFAS 151"), which clarifies that abnormal costs of idle facility expense, freight, handling costs and wasted material should

be recognized as current period expenses. SFAS 151 also requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. SFAS 151 is effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of SFAS 151 is not expected to have a material impact on the Company's financial statements.

In December 2003, the FASB 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 is required to apply Interpretation 46R to interests in variable interest entities ("VIE") created after December 31, 2003. For variable interests in a VIE created before January 1, 2004, the interpretation will be applied beginning on January 1, 2005. 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 and six months ended June 30, 2005.

June 30, 2005

(Unaudited)

- Business Combinations

On September 17, 2004, Aristotle purchased certain assets of the science product line of Ginsberg Scientific Company and GSC International, Inc. (collectively referred to as "Ginsberg") for \$1.8 million. Ginsberg is a manufacturer and distributor of products and kits designed to demonstrate certain science concepts for students in grades 5-12. The Ginsberg offerings complement the science product lines manufactured and distributed by the Company in the educational segment. The results of Ginsberg's operations have been included in the Company's consolidated financial statements since the date of such acquisition. The purchase price allocation resulted in goodwill of \$1.0 million attributable to the educational segment.

On August 11, 2004, Aristotle purchased certain assets of the CPR Prompt product line from Cardiac Science, Inc. for \$1.9 million. The CPR Prompt product line is comprised of a number of products, primarily training manikins, used in the instruction of cardiopulmonary resuscitation. The CPR Prompt product line complements product lines manufactured and distributed by the Company in the educational segment. The results of CPR Prompt's operations have been included in the Company's consolidated financial statements since the date of such acquisition. The purchase price allocation resulted in goodwill of \$1.0 million attributable to the educational segment.

- Earnings per Common Share

Basic earnings per common share is calculated by dividing net earnings applicable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per common share is calculated by dividing net earnings 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 shares of Series I Preferred Stock outstanding at June 30, 2005 and 2004, were not dilutive and, therefore, have not been included in the computations of diluted earnings per common share amounts for the periods then ended.

- Investments

Prior to February 2005, the Company invested in a limited partnership, the general partner

of which is an affiliate of the Company. In February 2005, the balance of the investment, approximately \$4.1 million, was transferred to another limited partnership, the general partner of which is an affiliate of the Company. The assets of this limited partnership are managed exclusively by a non-affiliate of the Company. The purpose of the limited partnership in which the Company is currently invested is to manage a diversified investment portfolio. The Company invested \$1.7 million during the three and six months ended June 30, 2005. No amounts were invested during the three and six months ended June 30, 2004. The Company's investment is accounted for under the equity method of accounting, which equates the carrying value of the investment to the Company's equity in the partnership's underlying book value. The Company's equity earnings or loss is credited or charged, as appropriate, to other income within the Condensed Consolidated Statements of Earnings. Equity earnings amounted to \$.1 million for the three months ended June 30, 2005. Equity earnings amounted to \$.2 million for the six months ended June 30, 2005. No amounts were earned for the three and six months ended June 30, 2004.

THE ARISTOTLE CORPORATION AND SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2005

(Unaudited)

• Stockholders' Equity and Comprehensive Earnings

Changes in stockholders' equity for the six months ended June 30 are as follows (in thousands):

| | 2005 | 2004 |
|---|-----------|---------|
| Balance at January 1 | \$ 70,660 | 59,844 |
| Net earnings | 7,983 | 6,803 |
| Exercise of stock options, including related tax benefit | 57 | 246 |
| Stock option compensation | 289 | 246 |
| Other comprehensive loss: | | |
| Foreign currency translation adjustment | (185) | (339) |
| Preferred dividends | (4,316) | (4,321) |
| Balance at June 30 | \$ 74,488 | 62,479 |

Comprehensive earnings for the three and six months ended June 30 is as follows (in thousands):

| | Three Months Ended | | Six Months Ended | |
|---|--------------------|-------|------------------|-------|
| | June 30, | | June 30, | |
| | 2005 | 2004 | 2005 | 2004 |
| Net earnings | \$ 4,795 | 3,758 | 7,983 | 6,803 |
| Foreign currency translation adjustment | (147) | (172) | (185) | (339) |
| Comprehensive earnings | \$ 4,648 | 3,586 | 7,798 | 6,464 |

• Stock Options

The Company accounts for its stock options under the fair value-based recognition and measurement provisions of 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 under the 2002 Plan during the three and six months ended June 30, 2005. The total fair value of the options granted under the 2002 Plan during the three and six months ended June 30, 2004 was less than \$.1 million. The total estimated 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 pre-tax compensation expense related to granted stock options of approximately \$.2 million and \$.1 million for the three months ended June 30, 2005 and 2004, respectively. The Company recorded pre-tax compensation expense related to granted stock options of approximately \$.3 million and \$.2 million for the six months ended June 30, 2005 and 2004, respectively. The expected annual impact of the options granted to date on 2005 earnings before income taxes is a reduction of approximately \$.4 million.

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THE ARISTOTLE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2005

(Unaudited)

- Defined Benefit Pension Plan

Prior to September 10, 2004, the Company had two noncontributory defined benefit pension plans covering a substantial number of employees. On September 10, 2004, the Company merged both of its defined benefit pension plans with a defined benefit pension plan of an affiliate.

The Company contributed \$.2 million to the pension plan for the three and six months ended June 30, 2005.

No contributions were made to the pension plans for the three and six months ended June 30, 2004. The Company expects to contribute a total of \$1.3 million to the pension plan in 2005.

The following table presents the components of net periodic benefit cost for the three and six months ended June 30 (in thousands):

| | Three Months Ended | | Six Months Ended | |
|------------------------------------|--------------------|-------|------------------|-------|
| | June 30, | | June 30, | |
| | 2005 | 2004 | 2005 | 2004 |
| Service cost | \$ 173 | 155 | 345 | 312 |
| Interest cost | 208 | 203 | 417 | 406 |
| Expected return on plan assets | (237) | (212) | (475) | (424) |
| Amortization of transition asset | - | (6) | - | (13) |
| Amortization of prior service cost | - | - | (1) | (1) |
| Recognized net actuarial loss | 71 | 54 | 142 | 108 |
| Net periodic benefit cost | \$ 215 | 194 | 428 | 388 |

- 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 ARISTOTLE CORPORATION AND SUBSIDIARIES

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

June 30, 2005

(Unaudited)

The following table presents segment information for the three and six months ended June 30 (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|----------------------|--------------------------------|--------|------------------------------|---------|
| | 2005 | 2004 | 2005 | 2004 |
| Net sales: | | | | |
| Educational | \$ 42,505 | 37,384 | 76,449 | 68,462 |
| Commercial | 7,680 | 7,228 | 15,484 | 15,170 |
| Net sales | \$ 50,185 | 44,612 | 91,933 | 83,632 |
| Gross profit: | | | | |
| Educational | \$ 16,840 | 14,895 | 30,937 | 28,079 |
| Commercial | 3,113 | 2,918 | 6,019 | 5,776 |
| Other costs of sales | (706) | (982) | (1,646) | (1,835) |
| Gross profit | \$ 19,247 | 16,831 | 35,310 | 32,020 |

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 June 30, 2005, December 31, 2004 and June 30, 2004 (in thousands):

| | | June 30, 2005 | December 31, 2004 | June 30, 2004 |
|------------------------|----|------------------|----------------------|------------------|
| Identifiable assets: | | | | |
| Educational | \$ | 60,181 | 53,900 | 53,010 |
| Commercial | | 5,920 | 4,832 | 5,547 |
| Other corporate assets | | 54,390 | 52,173 | 52,558 |
| | | | | |
| | \$ | 120,491 | 110,905 | 111,115 |

Educational assets include \$13.6 million, \$13.7 million and \$11.4 million of goodwill at June 30, 2005, December 31, 2004 and June 30, 2004, respectively.

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 and six months ended June 30, 2005 as compared to the three and six months ended June 30, 2004. 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 more than 45 separate catalogs.

The following is a summary of key events for the three and six months ended June 30, 2005:

- increase in net sales of 12.5% and 9.9% in the three and six months ended June 30, 2005, respectively, as compared to the same periods in 2004;
- increase in gross profit of 14.4% and 10.3% in the three and six months ended June 30, 2005, respectively, as compared to the same periods in 2004; increase in gross profit margin to 38.4% in the second quarter of 2005 from 37.7% in the second quarter of 2004;
- 27.2% and 17.2% increase in earnings before income taxes in the three and six months ended June 30, 2005, respectively, as compared to the same periods in 2004;
- 27.6% increase in net earnings, resulting in a 66.7% increase in basic and diluted earnings per common share to \$.15, in the second quarter of 2005, as compared to the second quarter of 2004; as a percentage of net sales, net earnings amounted to 9.6% in the second quarter of 2005, compared to 8.5% in the second quarter of 2004; 17.3% increase in net earnings, resulting in a 40.0% increase in basic earnings per common share to \$.21, and 50.0% increase in diluted earnings per common share to \$.21, in the six months ended June 30, 2005, as compared to the six months ended June 30, 2004; as a percentage of net sales, net earnings amounted to 8.7% in the six months ended June 30, 2005, compared to 8.2% in the six months ended June 30, 2004;
- increase in cash retained in the Company to \$2.2 million and \$3.8 million in the three and six months ended June 30, 2005, respectively, from \$1.8 million and \$3.3 million in the three and six months ended June 30, 2004, respectively, primarily as a result of the increased current utilization of Federal net operating tax loss carryforwards;
- EBITDA(1) increase of 24.6% to \$8.5 million in the second quarter of 2005, as compared to the same period in 2004; EBITDA increase of 14.4% to \$14.4 million in the six months ended June 30, 2005, as compared to the same period in 2004;
- capital expenditures amounting to \$1.2 million in the first six months of 2005 for the construction of an 80,000 square foot office and warehouse facility for the Company's Simulaids operations, anticipated to be completed in the first quarter of 2006;
- the Company had investments of \$5.9 million at June 30, 2005, as compared to none at June 30, 2004; and
- semi-annual dividend payments (March 31 and September 30) totaling \$4.3 million on the Company's Series I Preferred Stock and Series J Preferred Stock in the six months ended June 30, 2005.

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 making investments and reducing liabilities such as pension and debt, paying dividends on its preferred stock and completing prudent acquisition opportunities. The Company's management believes that examining 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 and six months ended June 30, 2005 and 2004 and (ii) the percentage change in dollars in those reported items from the comparable period in 2004:

| | Three Months Ended June 30, | | | Six Months Ended June 30, | | |
|------------------------------------|-----------------------------|--------|-------------|---------------------------|--------|-------------|
| | 2005 | 2004 | % Change | 2005 | 2004 | % Change |
| Net sales | 100.0% | 100.0% | 12.5% | 100.0% | 100.0% | 9.9% |
| Cost of sales | 61.6 | 62.3 | 11.4 | 61.6 | 61.7 | 9.7 |
| Gross profit | 38.4 | 37.7 | 14.4 | 38.4 | 38.3 | 10.3 |
| Selling and administrative expense | 22.2 | 23.3 | 7.2 | 23.7 | 24.3 | 7.4 |
| Earnings from operations | 16.2 | 14.4 | 26.0 | 14.7 | 14.0 | 15.2 |
| Other expense (income): | | | | | | |
| Interest expense | .7 | .6 | 25.3 | .7 | .7 | 8.5 |
| Interest income | - | - | * | - | - | * |
| Other, net | (.1) | - | * | (.2) | - | * |
| Earnings before income taxes | .6 | .6 | (1.1) | .5 | .7 | (20.1) |
| Income taxes | | | | | | |
| Current | 1.5 | 1.3 | 31.0 | 1.3 | 1.2 | 18.2 |
| Deferred | 4.5 | 4.0 | 25.3 | 4.2 | 3.9 | 16.6 |
| Net earnings | 6.0 | 5.3 | 26.7 | 5.5 | 5.1 | 17.0 |
| Net earnings | 9.6% | 8.5% | 27.6 | 8.7% | 8.2% | 17.3 |

* Not meaningful.

1. "EBITDA," which is considered a non-GAAP financial measure, is defined as earnings before income taxes, interest expense, other income and expense, depreciation and amortization. A non-GAAP financial measure is a numerical measure of a company's historical or future financial performance, financial position or cash flows that either excludes or includes amounts that are normally included or excluded in a comparable measure calculated and presented under GAAP. EBITDA is not presented as an alternative measure of operating results (such as earnings from operations or net earnings) or cash flow from operations, as determined in accordance with GAAP, but is presented because the Company's management believes it is a widely accepted indicator of the Company's current financial performance and ability to incur and service debt. EBITDA does not give effect to cash used for debt service requirements and thus does not reflect funds available for dividends, reinvestment or other discretionary uses. In addition, EBITDA as presented herein may not be comparable to similarly titled measures reported by other companies. The following table provides a reconciliation of net earnings to EBITDA for the three and six months ended June 30 (in thousands):

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| | Three Months Ended | | Six Months Ended | |
|----------------------------------|--------------------|-------|------------------|--------|
| | June 30, | | June 30, | |
| | 2005 | 2004 | 2005 | 2004 |
| Net earnings | \$ 4,795 | 3,758 | 7,983 | 6,803 |
| Add: | | | | |
| Income taxes | 3,020 | 2,384 | 5,041 | 4,309 |
| Interest expense | 362 | 289 | 653 | 602 |
| Other expense (income) | (85) | (9) | (155) | 21 |
| Depreciation and amortization | 461 | 444 | 890 | 860 |
| EBITDA | \$ 8,553 | 6,866 | 14,412 | 12,595 |

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FLUCTUATIONS IN QUARTERLY RESULTS OF OPERATIONS

The Company is subject to seasonal influences with peak levels occurring in the second and third quarters of the fiscal year primarily due to increased educational shipments coinciding with the start of new school years in the Fall. As a result, the Company recognizes approximately 75% of its annual net earnings in the second and third quarters of its fiscal year. Inventory levels increase in March through June in anticipation of the peak shipping season. The majority of shipments are made between June and August and the majority of cash receipts are collected from August through October.

Quarterly results may also be materially affected by the timing of acquisitions, the timing and magnitude of costs related to such acquisitions, variations in costs of products sold, the mix of products sold and general economic conditions. Results for any quarter are not indicative of the results for any subsequent fiscal quarter or for a full fiscal year.

RESULTS OF OPERATIONS - THREE MONTHS ENDED JUNE 30, 2005 AS COMPARED TO THREE MONTHS ENDED JUNE 30, 2004

Net Sales

Net sales for the second quarter of 2005 increased 12.5% to \$50.2 million from \$44.6 million for the comparable period in 2004. The growth in net sales for the second quarter of 2005 is primarily attributable to organic growth of approximately 9.2% and the inclusion of an additional \$1.5 million of net sales from the CPR Prompt and Ginsberg acquisitions which were completed in the third quarter of 2004. Net sales in the educational segment, totaling \$42.5 million, increased 13.7% in the second quarter of 2005 from \$37.4 million in the comparable period in 2004. Excluding the net sales from CPR Prompt and Ginsberg, educational net sales for the second quarter of 2005 increased 9.7% from the second quarter of 2004. The commercial segment recorded net sales of \$7.7 million in the second quarter of 2005 as compared to \$7.2 million in the second quarter of 2004, thereby increasing 6.3%.

Gross Profit

Gross profit for the second quarter of 2005 increased 14.4% to \$19.2 million from \$16.8 million for the comparable period in 2004. The increase in gross profit for the second quarter of 2005 is primarily attributable to the 12.5% increase in net sales including the additional gross profit of \$.6 million contributed by CPR Prompt and Ginsberg. The gross profit margin of 38.4% in the second quarter of 2005 increased from the 37.7% gross profit margin in the comparable period in 2004. The educational segment gross profit for the second quarter of 2005

increased 13.1% to \$16.8 million from \$14.9 million for the comparable period in 2004. The educational segment gross profit margin decreased slightly to 39.6% in the second quarter of 2005 from 39.8% for the comparable period in 2004. The commercial segment gross profit for the second quarter of 2005 increased 6.7% to \$3.1 million from \$2.9 million for the comparable period in 2004. The commercial segment gross profit margin of 40.5% for the second quarter of 2005 remained consistent with the commercial segment gross profit margin in the comparable period in 2004.

Selling and Administrative Expenses

Selling and administrative expenses for the second quarter of 2005 increased 7.2% to \$11.2 million from \$10.4 million in the comparable period in 2004. As a percent of net sales, selling and administrative expenses amounted to 22.2% for the second quarter of 2005, as compared to 23.3% in the second quarter of 2004. Expenses included in this total include advertising and catalog costs, warehouse and shipping activities, customer service and general administrative functions. Selling and administrative expenses for the second quarter of 2005 were impacted by the following: (i) increase in salaries and wages of \$.4 million, or 6.1%, as a result of increases in annual employee compensation and the number of employees; (ii) increase in advertising expenses of \$.1 million; and (iii) increase in group health care costs by 16.2% to \$1.0 million.

The Company recorded \$.2 million and \$.1 million in compensation expense for the second quarters of 2005 and 2004, respectively, related to grants of stock options to certain employees and directors.

The Company incurred expenses of \$.2 million to Geneve for certain administrative services for each of the second quarters of 2005 and 2004.

Interest Expense

Interest expense for the second quarter of 2005 increased 25.3% to \$.4 million from \$.3 million for the second quarter of 2004. The increase in interest expense is primarily due to the increase in the weighted average interest rates during the second quarter of 2005, net of the decrease in the weighted average debt outstanding, compared to the same period in 2004. The weighted average interest rate on the Company's debt increased to 4.6% in the second quarter of 2005 compared to 3.3% in the comparable period in 2004. The decrease in the weighted average debt outstanding during the second quarter of 2005 is the result of the payment of \$3.4 million during the third quarter of 2004 in full settlement of the mortgage related to the properties held by NHI, LLC ("NHI")

The Company's credit agreements assessed interest at a weighted average rate of 4.8%, 4.1% and 3.3% at June 30, 2005, December 31, 2004 and June 30, 2004, respectively.

Income Tax Provision

Aristotle and its qualifying domestic subsidiaries are included in the Federal income tax return and certain state income tax returns of Geneve. The provision for income taxes for the Company is determined on a separate return basis in accordance with the terms of a tax sharing agreement with Geneve, and payments for current Federal and certain state income taxes are made to Geneve.

The income tax provision for the second quarter of 2005 was \$3.0 million compared to \$2.4 million for the comparable period in 2004. These tax provisions reflect effective tax rates of 38.6% and 38.8% for the second quarters of 2005 and 2004, respectively. For the second quarters of 2005 and 2004, the difference between the Federal statutory income tax rate of 35% and the effective income tax rate results principally from foreign and state income taxes. Approximately \$2.2 million of the income tax provision for the second quarter of 2005 relates to the current utilization of the Company's Federal net operating tax loss carryforwards, compared to approximately \$1.8 million in the second quarter of 2004. Although the reported earnings for the second quarters of 2005 and 2004 are shown after-tax, approximately \$2.2 million and \$1.8 million, respectively, of cash from operations was retained in the Company primarily as a result of the current utilization of these Federal net operating tax loss carryforwards. Except for Federal alternative minimum tax obligations arising from limitations on the utilization of Federal net operating tax loss carryforwards in 2005 and future years, the Company anticipates that the utilization of the available Federal net operating tax loss carryforwards to offset future Federal taxable income will result in the Company not having to use its cash resources to pay Federal income taxes for through 2006.

At June 30, 2005, the Condensed Consolidated Balance Sheet contains a net deferred tax asset of \$16.6 million, net of a valuation allowance of \$7.7 million. Substantially all of the net deferred tax asset relates to Federal net operating tax loss carryforwards, which were recognized in applying purchase accounting to the merger with Nasco International, Inc. on June 17, 2002 (the "Merger"). The valuation allowance has been established primarily to reflect the estimate of Federal net operating tax loss carryforwards that are expected to expire unutilized. There were no changes to the valuation allowance during the second quarters of 2005 and 2004.

RESULTS OF OPERATIONS - SIX MONTHS ENDED JUNE 30, 2005 AS COMPARED TO SIX MONTHS ENDED JUNE 30, 2004

Net Sales

Net sales for the six months ended June 30, 2005 increased 9.9% to \$91.9 million from \$83.6 million for the comparable period in 2004. The growth in net sales for the six months ended June 30, 2005 is primarily attributable to organic growth of approximately 6.6% and the inclusion of an additional \$2.8 million of net sales from the CPR Prompt and Ginsberg acquisitions which were completed in the third quarter of 2004. Net sales in the educational segment, totaling \$76.4 million, increased 11.7% in the six months ended June 30, 2005 from \$68.5 million in the comparable period in 2004. Excluding the net sales from CPR Prompt and Ginsberg, educational net sales for the six months ended June 30, 2005 increased 7.5% from the comparable period in 2004. The commercial segment recorded net sales of \$15.5 million in the six months ended June 30, 2005 as compared to \$15.1 million in the six months ended June 30, 2004.

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Gross Profit

Gross profit for the six months ended June 30, 2005 increased 10.3% to \$35.3 million from \$32.0 million for the comparable period in 2004. The increase in gross profit for the six months ended June 30, 2005 is primarily attributable to the 9.9% increase in net sales including the additional gross profit of \$1.2 million contributed by CPR Prompt and Ginsberg. The gross profit margin of 38.4% for the six months ended June 30, 2005 remained consistent with the gross profit margin in the comparable period in 2004. The educational segment gross profit for the six months ended June 30, 2005 increased 10.2% to \$30.9 million from \$28.1 million for the comparable period in 2004. The educational segment gross profit margin decreased to 40.5% in the six months ended June 30, 2005 from 41.0% for

the comparable period in 2004. The decrease in the educational segment gross profit margin in the second quarter of 2005 is primarily due to a shift in sales mix and increased fuel costs supporting product distribution. The commercial segment gross profit for the six months ended June 30, 2005 increased 4.2% to \$6.0 million from \$5.8 million for the comparable period in 2004. The commercial segment yielded a gross profit margin of 38.9% in the six months ended June 30, 2005, as compared to 38.1% in the comparable period in 2004. The increase in the commercial segment gross profit margin is primarily due to a shift in sales mix.

Selling and Administrative Expenses

Selling and administrative expenses for the six months ended June 30, 2005 increased 7.4% to \$21.8 million from \$20.3 million in the comparable period in 2004. As a percent of net sales, selling and administrative expenses amounted to 23.7% for the six months ended June 30, 2005, as compared to 24.3% in the comparable period in 2004. Expenses included in this total include advertising and catalog costs, warehouse and shipping activities, customer service and general administrative functions. Selling and administrative expenses for the six months ended June 30, 2005 were impacted by the following: (i) increase in salaries and wages of \$.7 million, or 5.7%, as a result of increases in annual employee compensation and the number of employees; (ii) increase in advertising expenses of \$.2 million; and (iii) increase in group health care costs by 27.2% to \$2.0 million.

The Company recorded \$.3 million and \$.2 million in compensation expense for the six months ended June 30, 2005 and 2004, respectively, related to grants of stock options to certain employees and directors.

The Company incurred expenses of \$.4 million to Geneve for certain administrative services for each of the six months ended June 30, 2005 and 2004.

Interest Expense

Interest expense for the six months ended June 30, 2005 increased 8.5% to \$.7 million from \$.6 million for the comparable period in 2004. The increase in interest expense is primarily due to the increase in the weighted average interest rates during the six months ended June 30, 2005, net of the decrease in the weighted average debt outstanding, compared to the same period in 2004. The weighted average interest rate on the Company's debt increased to 4.4% in the six months ended June 30, 2005 compared to 3.4% in the comparable period in 2004. The decrease in the weighted average debt outstanding during the six months ended June 30, 2005 is the result of the payment of \$3.4 million during the third quarter of 2004 in full settlement of the mortgage related to the properties held by NHI

The Company's credit agreements assessed interest at a weighted average rate of 4.8%, 4.1% and 3.3% at June 30, 2005, December 31, 2004 and June 30, 2004, respectively.

Income Tax Provision

Aristotle and its qualifying domestic subsidiaries are included in the Federal income tax return and certain state income tax returns of Geneve. The provision for income taxes for the Company is determined on a separate return basis in accordance with the terms of a tax sharing agreement with Geneve, and payments for current Federal and certain state income taxes are made to Geneve.

The income tax provision for the six months ended June 30, 2005 was \$5.0 million compared to \$4.3 million for the comparable period in 2004. These tax provisions reflect effective tax rates of 38.7% and 38.8% for the six months ended June 30, 2005 and 2004, respectively. For the six months ended June 30, 2005 and 2004, the difference between the Federal statutory income tax rate of 35% and the effective income tax rate results principally from foreign and state income taxes. Approximately \$3.8 million of the income tax provision for the six months ended June 30, 2005 relates to the current utilization of the Company's Federal net operating tax loss carryforwards, compared to approximately \$3.3 million in the six months ended June 30, 2004. Although the reported earnings for the six months ended June 30, 2005 and 2004 are shown after-tax, approximately \$3.8 million and \$3.3 million, respectively, of cash from operations was retained in the Company primarily as a result of the current utilization of these Federal net operating tax loss carryforwards. Except for Federal alternative minimum tax obligations arising from limitations on the utilization of Federal net operating tax loss carryforwards in 2005 and future years, the Company anticipates that the utilization of the available Federal net operating tax loss carryforwards to offset future Federal taxable income will result in the Company not having to use its cash resources to pay Federal income taxes through 2006.

At June 30, 2005, the Condensed Consolidated Balance Sheet contains a net deferred tax asset of \$16.6 million, net of a valuation allowance of \$7.7 million. Substantially all of the net deferred tax asset relates to Federal net operating tax loss carryforwards, which were recognized in applying purchase accounting to the Merger. The valuation allowance has been established primarily to reflect the estimate of Federal net operating tax loss carryforwards that are expected to expire unutilized. There were no changes to the valuation allowance during the six months ended June 30, 2005 and 2004.

LIQUIDITY AND CAPITAL RESOURCES

At June 30, 2005, the Company had working capital of \$62.1 million, increasing from \$53.4 million at December 31, 2004. At June 30, 2004, the Company had working capital of \$48.6 million. Cash and cash equivalents increased slightly in the six months ended June 30, 2005, ending the period at \$2.2 million. Cash and cash equivalents decreased \$1.1 million in the six months ended June 30, 2004, ending the period at \$4.5 million. This decrease in the use of cash and cash equivalents during the six months ended June 30, 2005 as compared to the same period in 2004 is primarily due to the following activities:

- The Company generated cash of \$6.0 million from operations during the six months ended June 30, 2005 compared to \$6.1 million for the comparable period of 2004.

The changes in current assets and liabilities are typical for the first six months of the fiscal year as the Company is preparing for its peak business cycle, which occurs during the second and third quarters of the fiscal year. For more information on the seasonality of the Company's business, please refer to the "Fluctuations in Quarterly Results of Operations" section above.

- The Company used cash of \$3.6 million for investing activities in the six months ended June 30, 2005, compared to \$.8 million for the comparable period in 2004. In the six months ended June 30, 2005, the Company used cash of \$1.2 million to purchase land and fund a portion of the construction of an approximately 80,000 square foot office and warehouse facility for the Company's Simulaid operations. It is estimated that the construction cost of the facility will be approximately \$4.8 million. The Company anticipates completing construction of the facility in the first quarter of 2006. The Company is funding the construction of the facility through a

one year, \$4.3 million construction loan, with interest payable monthly at the mortgage lender's prime rate. Subsequent to the completion of the facility, the construction loan will convert to a 10-year mortgage on the new facility, with interest payable at the one month LIBOR rate plus a

margin of 1.75 basis points. The Company intends to sell the current Simulaids facility following commencement of operations at the new facility.

Capital expenditures to replace and upgrade existing capital equipment and install new equipment and fixtures to provide additional operating efficiencies totaled \$.7 million and \$.8 million in the six months ended June 30, 2005 and 2004, respectively.

During the six months ended June 30, 2005, the Company invested \$1.7 million in an investment limited partnership, the general partner of which is an affiliate of the Company. The assets of the limited partnership are managed exclusively by a non-affiliate of the Company (see Note 7 of the Notes Condensed Consolidated Financial Statements included in Item 1 of this Form 10-Q). No such investments were made during the six months ended June 30, 2004. The Company had investments of \$5.9 million at June 30, 2005, as compared to none at June 30, 2004.

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- Financing activities used cash of \$2.4 million in the six months ended June 30, 2005, compared to \$6.4 million for the comparable period in 2004. In the six months ended June 30, 2005, the net principal proceeds from debt of \$1.9 million were primarily due to the increase in the amounts outstanding on the Company's primary credit facility due to seasonal working capital requirements and the \$1.2 million of capital expenditures in connection with the new Simulaids facility. In the six months ended June 30, 2004, the net principal payments on debt of \$2.2 million were primarily due to the following: (i) decrease of \$.5 million in the amounts outstanding on the Company's primary credit facility; (ii) payment of \$1.1 million for the settlement of capital lease obligations related to the Haan Building Facility; and (iii) payment in full of the \$.5 million note payable to a related party.

The Company paid dividends of \$4.3 million in each of the six months ended June 30, 2005 and 2004 on its Series I Preferred Stock and Series J Preferred Stock.

On October 15, 2003, the Company entered into a five-year, non-amortizing, \$45.0 million Revolving Credit Facility. The Revolving Credit Facility provides the Company with seasonal working capital, letters of credit and funds for appropriate acquisitions of businesses similar in nature to the Company's current business segments. This debt carries a variable rate of interest that is based on Prime or LIBOR rates plus applicable margins. At June 30, 2005, the weighted average interest rate on this debt was 4.6%. The Revolving Credit Facility currently has a committed weighted average rate of interest (including applicable margins) of approximately 5.1%. Such rate commitments expire on various dates through November 7, 2005. The Company's Revolving Credit Facility is collateralized by certain accounts receivable, inventories and property, plant and equipment, and shares of a certain subsidiary's capital stock outstanding and ownership interests of certain of the Company's limited liability subsidiaries. The Revolving Credit Facility contains various financial and operating covenants, including, among other things, requirements to maintain certain financial ratios and restrictions on additional indebtedness, common stock dividend payments, capital disposals and intercompany management fees. The Company was in compliance with all financial covenants as of June 30, 2005.

In 2005, capital expenditures to replace and upgrade existing equipment and install new equipment and fixtures to provide additional operating efficiencies are expected to approximate \$1.7 million.

Capital resources in the future are expected to be used for the development of catalogs and product lines, to acquire additional businesses and for other investing activities. The Company anticipates that there will be sufficient financial resources to meet projected working capital and other cash requirements for at least the next twelve months. Management of the Company believes it has sufficient capacity to maintain current operations and support a sustained level of future growth.

INFLATION

Inflation has had and is expected to have only a minor effect on the Company's operating results and its sources of liquidity.

SIGNIFICANT ACCOUNTING POLICIES

The preparation of the Condensed Consolidated Financial Statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Condensed Consolidated Financial Statements and notes thereto. Actual results could differ from those estimates. The Company believes the following accounting policies affect the more significant judgments and estimates used in the preparation of the Condensed Consolidated Financial Statements:

Prepaid Catalog Costs and Amortization - The Company accumulates all direct costs, less vendor rebates, incurred in the development, production and circulation of catalogs on the Condensed Consolidated Balance Sheets until the related catalog is mailed, at which time such catalog costs are amortized into selling and administrative expense over the estimated sales realization cycle of one year, using the straight-line method.

Deferred Income Taxes - At June 30, 2005, the Condensed Consolidated Balance Sheet contains a net deferred tax asset of approximately \$16.6 million, net of a valuation allowance of approximately \$7.7 million, related primarily to Federal net operating tax loss carryforwards. The realizability of this asset is dependent upon the Company's generation of sufficient levels of future taxable income and the ability to retain its Federal net operating tax loss carryforward position. Events may limit the use of all or a portion of these Federal net operating tax loss carryforwards, thus potentially resulting in a higher tax liability for the Company in the future. The net deferred tax asset, including the valuation allowance, at June 30, 2005 is subject to future adjustment based upon changes in management's evaluation of the realizability of the deferred tax asset.

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Goodwill - The Company evaluates goodwill for impairment at least annually, or more frequently if events or circumstances indicate that the assets may be impaired, by applying a fair value based test and, if impairment occurs, the amount of impaired goodwill is written off immediately. The Company evaluates goodwill for impairment based on the expected future cash flows or earnings projections. Goodwill is deemed impaired if the estimated discounted cash flows or earnings projections do not substantiate the carrying value. The estimation of such amounts requires significant management judgment with respect to revenue and expense growth rates, changes in working capital and selection of an appropriate discount rate, as applicable. The use of different assumptions would increase or decrease discounted future operating cash flows or earnings projections and could, therefore, change the impairment determination. The Company evaluated its goodwill at December 31, 2004, and determined that there was no impairment of goodwill.

Defined Benefit Plans

- The Company accounts for the benefits under its defined benefit pension plan using actuarial models required by SFAS No. 87, "Employers' Accounting for Pensions." These models use an attribution approach that generally spreads individual events over the service lives of the employees in the plan. Examples of "events" are plan amendments and changes in actuarial assumptions such as discount rate, expected return on plan assets and rate of compensation increases. The principle underlying the required attribution approach is that employees render service over their service lives on a relatively consistent basis and, therefore, pension benefits are earned in, and should be expensed in, the same pattern.

In calculating net periodic benefit cost and the related benefit obligation, the Company is required to select certain actuarial assumptions. These assumptions include discount rate, expected return on plan assets and rate of compensation increase. The discount rate assumptions reflect the prevailing market rates for long-term, high-quality, fixed-income debt instruments that, if the obligation was settled at the measurement date, would provide the necessary future cash flows to pay the benefit obligation when due. The Company uses long-term historical actual return experience with consideration of the expected investment mix of the plan's assets, as well as future estimates of long-term investment returns, to develop its assumptions of the expected return on plan assets. The rate of compensation increase is based on historical experience and the Company's long-term plans for such increases.

Revenues - Customarily applying FOB-shipping point terms, the Company recognizes revenue upon shipment of products to its customers, which corresponds to the time when risk of ownership transfers. The point of shipment is typically from one of the Company's distribution centers or, on occasion, a vendor's location as a drop shipment. All drop shipment sales are recorded at gross selling price.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's financial instruments include cash and cash equivalents, investments, accounts receivable, accounts payable, accrued liabilities and debt. As described below, credit risk and interest rate risk are the primary sources of market risk in the Company's accounts receivable and debt.

QUALITATIVE

Credit Risk: The Company provides credit in the normal course of business to its customers, which are primarily educational institutions or distributors. No single customer accounted for more than 10% of the Company's sales in the six months ended June 30, 2005 and 2004. The Company performs ongoing credit evaluations of its customers, maintains allowances for potential credit losses and generally does not require collateral to support its accounts receivable balances.

Interest Rate Risk: Changes in interest rates can potentially impact the Company's profitability and its ability to realize assets and satisfy liabilities. Interest rate risk is resident primarily in debt, which typically has variable interest rates based on Prime or LIBOR rates. Assuming no other change in financial structure, an increase of 1% in the Company's variable interest rate for debt would decrease pre-tax earnings for 2005 by approximately \$.3 million. This amount is determined by considering the impact of a 1% increase in interest on the average debt estimated to be outstanding in 2005.

QUANTITATIVE

The Company's debt as of June 30, 2005 is as follows (in millions, except percentage data):

| | MATURITY LESS THAN ONE YEAR | MATURITY GREATER THAN ONE YEAR |
|--------------------------------|--------------------------------------|---|
| Amount | \$.1 | \$ 26.9 |
| Weighted average interest rate | 6.0% | 4.8% |
| Fair market value | \$.1 | \$ 26.9 |

The fair market value of debt equals the face amount of debt outstanding because the underlying rate of interest on substantially all of the Company's debt is variable based upon Prime or LIBOR rates.

ITEM 4. CONTROLS AND PROCEDURES

The President and Chief Financial Officer of the Company (its principal executive officer and principal financial officer, respectively) have concluded, based on their evaluation as of the end of the period covered by this Report, that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports filed or submitted by it under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including the President and Chief Financial Officer, as appropriate, and allow timely decisions regarding required disclosure.

There have not been any changes in the Company's internal control over financial reporting during the fiscal quarter ended June 30, 2005 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

FORWARD-LOOKING STATEMENTS

The Company believes that this Quarterly Report on Form 10-Q may contain forward-looking statements within the meaning of the "safe-harbor" provisions of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on management's current expectations and are subject to a number of uncertainties and risks that could cause actual results to differ materially from those projected or suggested in such forward-looking statements. The Company cautions investors that there can be no assurance that actual results or business conditions will not differ materially from those projected or suggested in such forward-looking statements as a result of various factors including, but not limited to, the following: (i) the ability of the Company to obtain financing and additional capital to fund its business strategy on acceptable terms, if at all; (ii) the ability of the Company on a timely basis to find, prudently negotiate and consummate additional acquisitions; (iii) the ability of the Company to manage any to-be acquired businesses; (iv) there is not an active trading market for the Company's securities and the stock prices thereof are highly volatile, due in part to the relatively small percentage of the Company's securities which is not held by the Company's majority stockholder and members of the Company's Board of Directors and/or management; (v) the ability of the Company to retain and utilize its Federal net operating tax loss carryforward position; and (vi) other factors identified in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, "Forward-Looking Statements," contained in the Company's Annual Report on

Form 10-K for the year ended December 31, 2004. As a result, the Company's future development efforts involve a high degree of risk. For further information, please see the Company's filings with the SEC, including its Forms 10-K, 10-Q and 8-K.

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PART II

ITEM 6. EXHIBITS

The following exhibits are filed as part of this report:

| EXHIBIT NUMBER | DESCRIPTION |
|-------------------|---|
| 10.10 | AIA Document A191-Standard Form of Agreement Between Owner and Design/Builder dated as of May 16, 2005 by and between Simulaids, Inc. and Kingston Equipment Rental, Inc. |
| 10.20 | Building Loan Agreement dated as of July 1, 2005 by and between Simulaids, Inc. and M&T Real Estate Trust. |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certifications. |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certifications. |
| 32.1 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2 | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 11, 2005

/s/ Steven B. Lapin

Steven B. Lapin

President and Chief Operating

Officer

(Principal Executive Officer)

Date: August 11, 2005

/s/ Dean T. Johnson

Dean T. Johnson

Vice President and Chief

Financial Officer

(Principal Financial and

Accounting Officer)

EXHIBIT INDEX

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|-------------------|--|
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| <u>31.2</u> | <u>Rule 13a-14(a)/15d-14(a) Certifications.</u> |
| <u>32.1</u> | <u>Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |
| <u>32.2</u> | <u>Certification Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.</u> |

