SCOLR INC
Form 10QSB/A
October 08, 2003

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-QSB/A

Amendment No. 1

x **QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2003**

OR

o **TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

FOR THE TRANSITION PERIOD FROM__TO__

COMMISSION FILE NUMBER 000-24693

**SCOLR, INC.
(EXACT NAME OF SMALL BUSINESS ISSUER AS SPECIFIED IN ITS CHARTER)**

DELAWARE **(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)**	**91-1689591** **(I.R.S. EMPLOYER IDENTIFICATION NO.)**

**8340 154TH AVENUE NORTHEAST
REDMOND, WASHINGTON 98052
(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES, INCLUDING ZIP CODE)**

**(425) 883-9518
(ISSUER S TELEPHONE NUMBER, INCLUDING AREA CODE)**

Number of shares of issuer s common stock outstanding as of August 7, 2003: **21,349,107**

Transitional Small Business Disclosure Format: Yes o No x

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EXPLANATORY NOTE

SCOLR, Inc. is filing this Amendment No. 1 to its Quarterly Report on Form 10-QSB/A for the quarter ended June 30, 2003, which was originally filed with the Securities and Exchange Commission on August 14, 2003, (i) to amend Note 9 of the financial statements included in Part 1, Item 1, (ii) to amend Item 2, and (iii) to add Item 4. The entire Quarterly Report has been restated for clarity and convenience. This Amendment No. 1 continues to speak as of the date of the original filing of the Quarterly Report, and the Company has not updated the disclosures contained therein to reflect any events that occurred at a later date.

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PART I: FINANCIAL INFORMATION

Item 1. Financial Statements

SCOLR, Inc.
BALANCE SHEETS

	June 30, 2003 (Unaudited)	December 31, 2002 (As Restated)
ASSETS		
CURRENT ASSETS		
Cash	$ 3,579,274	$ 257,382
Accounts receivable, less allowance for doubtful accounts of $0 and $12,524, respectively	1,219,565	486,417
Current portion of notes receivable	238,462	166,154
Inventories, net	883,313	493,541
Debt issuance costs	1,169,302	
Prepaid expenses	218,945	138,448
Total current assets	7,308,861	1,541,942
PROPERTY AND EQUIPMENT net	1,359,803	1,494,315
OTHER ASSETS		
Intangible assets net	751,911	818,371
Noncurrent portion of notes receivable		55,385
	$ 9,420,575	$ 3,910,013
LIABILITIES AND STOCKHOLDERS EQUITY		
CURRENT LIABILITIES		
Line of credit	$ 479,993	$ 296,387
Current maturities of long-term obligations	117,270	168,870
Current maturities of capital lease obligations	234,405	215,347
Accounts payable trade	832,525	782,385
Accrued liabilities	180,675	124,645
Deferred revenue	280,109	100,000
Total current liabilities	2,124,977	1,687,634
LONG-TERM OBLIGATIONS, less current maturities	21,204	56,650
CAPITAL LEASE OBLIGATIONS, less current maturities	203,627	327,273
STOCKHOLDER LOAN PAYABLE, less discount on debt of $206,876 and $289,627, respectively	793,124	710,373
CONVERTIBLE LOAN PAYABLE, less discount on debt of $3,634,286	1,665,714	
COMMITMENTS AND CONTINGENCIES		
STOCKHOLDERS EQUITY		
Preferred stock, authorized 5,000,000 shares, $.01 par value, none issued or outstanding		
Common stock, authorized 50,000,000 shares, $.001 par value	21,291	21,199
Additional contributed capital	18,424,005	14,041,051
Accumulated deficit	(13,833,367)	(12,934,167)
Total stockholders equity	4,611,929	1,128,083

	$ 9,420,575	$ 3,910,013

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

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SCOLR, Inc.
STATEMENTS OF OPERATIONS
(Unaudited)

	Three months ended June 30,		Six months ended June 30,	
	2003	**2002**	**2003**	**2002**
Net revenues	$2,120,354	$2,119,239	$3,825,615	$ 3,553,272
Cost of revenues	1,419,712	1,668,013	2,528,037	2,784,177
Gross profit	700,642	451,226	1,297,578	769,095
Operating expenses				
Marketing and selling	184,600	102,502	269,498	196,466
Research and development	93,122	123,443	165,202	203,843
General and administrative	704,994	589,019	1,246,880	1,142,969
	982,716	814,964	1,681,580	1,543,278
Operating loss	(282,074)	(363,738)	(384,002)	(774,183)
Other income (expense)				
Interest expense	(251,186)	(68,024)	(368,339)	(134,103)
Severance costs			(157,448)	(159,152)
Other	1,189	(33,453)	10,589	(73,805)
	(249,997)	(101,477)	(515,198)	(367,060)
NET LOSS	$ (532,071)	$ (465,215)	$ (899,200)	$(1,141,243)
Net loss per share, basic and dilutive	$ (0.03)	$ (0.02)	$ (0.04)	$ (0.06)

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

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SCOLR, Inc.
STATEMENTS OF CASH FLOWS
Six Months ended June 30,
(Unaudited)

	2003	2002
Increase (Decrease) in Cash		
Cash flows from operating activities:		
Net loss	$ (899,200)	$(1,141,243)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	240,203	242,103
Loss on the sale of equipment		36,207
Allowance for uncollectible notes receivable		5,528
Amortization of discount on debt	176,414	
Gain on sale of intangible assets	(5,670)	
Amortization of debt issuance costs	44,750	
Impairment of available-for-sale security		36,190
Changes in assets and liabilities		
Accounts receivable	(733,148)	(309,878)
Notes receivable	(16,923)	92,385
Inventories	(391,791)	132,768
Prepaid expenses	(80,497)	(156,329)
Accounts payable	50,140	137,179
Accrued liabilities and deferred revenue	236,139	76,421
Net cash used in operating activities	(1,379,583)	(848,669)
Cash flows from investing activities:		
Proceeds from sale of intangible assets	130,000	
Purchase of equipment and furniture	(12,995)	(38,005)
Proceeds from sale of equipment		49,488
Patent and technology rights expenditures	(148,547)	(38,645)
Net cash used in investing activities	(31,542)	(27,162)
Cash flows from financing activities:		
Payments on long-term obligations and capital lease obligations	(233,910)	(261,693)
Payments on bridge note payable	(550,000)	
Proceeds from long-term obligations	42,276	124,940
Proceeds from convertible note payable, net of issuance costs	4,716,408	
Proceeds from bridge note payable	505,250	
Net borrowings (repayments) on line of credit	183,606	(441,397)
Net proceeds from issuance of common stock, net of costs	69,387	1,464,440
Net cash provided by financing activities	4,733,017	886,290
Net increase in cash	3,321,892	10,459
Cash at beginning of period	257,382	93,082
Cash at end of period	$ 3,579,274	$ 103,541
Cash paid during the year for:		
Interest	$ 75,971	$ 134,103

Noncash investing and financing activities:		
Purchase of equipment under capital lease obligations	$	$ 87,842

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	2003	2002
Issuance of warrants for debt issuance costs	$ 585,710	$
Issuance of warrants with debt and beneficial conversion feature	$3,727,949	$

The accompanying notes are an integral party of these financial statements.

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SCOLR, Inc.

NOTES TO FINANCIAL STATEMENTS (UNAUDITED)

NOTE 1 FINANCIAL STATEMENTS

The unaudited financial statements of SCOLR, Inc. (the Company) have been prepared by the Company pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to such rules and regulations. The results of operations for interim periods are not necessarily indicative of the results to be expected for the entire fiscal year ending December 31, 2003. The accompanying unaudited financial statements and related notes should be read in conjunction with the audited financial statements and the Form 10-KSB of the Company for its fiscal year ended December 31, 2002.

NOTE 2 INVENTORIES

Inventories are stated at lower of cost or market; cost is determined by the first-in, first-out method. Inventories consist of the following:

	June 30, 2003 (unaudited)	**December 31, 2002**
Raw materials	$237,235	$270,165
Work in progress	490,653	206,386
Finished goods	192,914	52,467
	920,802	529,018
Less allowance for obsolete and slow moving Items	37,489	35,477
	$883,313	$493,541

NOTE 3 SEPARATION AGREEMENT

The Company entered into a separation agreement with its former Chief Scientific Officer and a separation agreement with its former Vice President of Administration, Secretary and Treasurer, both of which became fully binding on the parties on March 31, 2001 and effective as of January 15, 2001. For the six months ended June 30, 2003 and 2002, the Company recorded severance costs totaling $157,448 and $159,152, respectively.

NOTE 4 SALE OF PRODUCT LINE AND RELATED INTANGIBLE ASSETS

In February 2003, the Company sold its feed additive product line for $230,000, net of certain royalties, to a third party for $130,000 cash payment and an executed purchase order of inventory for the remaining $100,000. The assets sold included inventories of $2,019 and related intellectual property of $122,311 resulting in a net gain of $5,670.

NOTE 5 STOCK OPTIONS

The Company has stock-based employee compensation plans. The Company applies APB Opinion 25, *Accounting for Stock Issued to Employees*, and related Interpretations in accounting for its plans. Because the exercise price of the Company s common stock options equals the market price of the underlying stock on the date of the grant, no corresponding compensation expense has been recognized.

The following table illustrates the effect on net loss and loss per share if the Company had applied the fair value recognition provisions of SFAS 123 to its stock-based awards for the periods ended June 30:

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	Three months ended June 30, 2003	2002	Six Months ended June 30, 2003	2002
Net loss, as reported	$(532,071)	$(465,215)	$ (899,200)	$(1,141,243)
Total stock-based compensation expense determined under fair-value-based method	$(148,344)	$ (31,773)	$ (178,996)	$ (63,546)
Pro forma net loss	$(680,415)	$(496,988)	$(1,078,196)	$(1,204,789)
Basic and diluted loss per share: As reported	$ (0.03)	$ (0.02)	$ (0.04)	$ (0.06)
Pro forma net loss per share	$ (0.03)	$ (0.02)	$ (0.05)	$ (0.06)

NOTE 6 EARNINGS (LOSS) PER SHARE

Basic earnings (loss) per share is based on the weighted average number of shares outstanding during the quarter and income available to common shareholders. Earnings (loss) per share assuming dilution is based on the assumption that outstanding stock options and warrants were exercised. The weighted average shares for computing basic earnings (loss) per share were 21,233,210 and 20,288,726 for the three months ended June 30, 2003 and 2002, respectively and 21,216,174 and 19,698,252 for the six months ended June 30, 2003 and 2002, respectively. At June 30, 2003, there were 9,305,117 shares of potentially issuable common stock. Because of the net loss for the three months and six months ended June 30, 2003 and 2002, potentially issuable common stock was not included in the calculation of diluted loss per share as their inclusion would be anti-dilutive.

NOTE 7 FINANCING EVENTS

Convertible Notes Payable

On June 25, 2003 the Company completed a private placement and issued $5.3 million of Convertible Notes due June 25, 2006. The transaction provided the Company with approximately $4.7 million in net proceeds. Interest accrues on the notes at 6% and is payable quarterly. Of the $5.3 million of notes issued, $75,000 were issued to Herbert L. Lucas, a director of the Company. The principal balance is convertible into shares of the Company s common stock at a conversion price equal to $1.05 per share, subject to certain anti-dilution adjustments. Such adjustments include the issuance, sale or distribution of shares of common stock at a price less than $1.05 per share; and the issuance of options, warrants or other rights to purchase common stock that are exercisable at, or convertible into or exchangeable for common stock at a price less than $1.05 per share. Despite the foregoing, such anti-dilution adjustments are not triggered by the following: (1) the grant or exercise of options to employees or directors or stock purchase plans; (2) shares or options issued in connection with an acquisition of another entity or in connection with a licensing transaction; (3) the exercise of any options, warrants or other rights to purchase common stock that were outstanding as of April 30, 2003; or (4) the issuance, sale or distribution by the Company of up to 750,000 shares of common stock regardless of the price. The Company has the right to force conversion of all the notes into shares of the Company s common stock at any time, provided its common stock trades at $2.10 or higher for 20 trading days within a 30-consecutive day trading period.

In accordance with EITF 98-5, *Accounting for Convertible Securities with Beneficial Conversion Features or Contingently Adjustable Conversion Ratios*, and EITF 00-27, *Application of Issue No. 98-5 to Certain Convertible Instruments*, an embedded beneficial conversion feature should be recognized and measured by allocating a portion of the proceeds of the note equal to the intrinsic value of that feature to additional paid-in capital. That amount should be calculated at the commitment date as the difference between the conversion price and the fair value of the common stock into which the note is convertible, multiplied by the number of shares into which the note is convertible (intrinsic value). The fair value of the Company s common stock on June 25, 2003 was $1.77, resulting in a beneficial conversion feature of $0.72 per share. As a result, the Company recorded a discount on the note for the beneficial conversion feature of approximately $3.6 million, which is being recognized as interest expense over the earlier of the term of the notes (3 years) or upon the conversion of the notes into the Company s common stock. The convertible notes payable totaled $5,300,000 less the discount of $3,634,286 or $1,665,714 at June 30, 2003.

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In consideration of certain placement services, the Company paid a cash fee of approximately $200,000, issued $300,000 of convertible notes and issued warrants to purchase up to 476,191 shares at $1.155 per share. The fair value of the warrants was determined using the Black-Scholes option pricing model using the following assumptions: volatility of 72%, term of five years, risk-free interest rate of 3.36% and 0% dividend yield. The fair value of the warrants totaled approximately $586,000. The total debt issuance costs of approximately $1,169,300 are being amortized as interest expense over the earlier of the term of the notes (3 years) or upon conversion of the notes into the Company s common stock.

The notes and warrants include registration rights requiring the Company to file a registration statement with the SEC registering, for resale, the shares of common stock issuable upon conversion of the notes or exercise of the warrants. The registration statement is to be filed no later than 60 days after the final closing date (June 25, 2003) with an effective date no later than 150 days after the final closing date. In the event the registration statement is not effective within 150 days after June 25, 2003, the conversion price for the notes will be reduced by the percentage resulting from multiplying 2% by the number of thirty (30) day periods beyond the 150-day period.

Short Term Notes Financing

Between April 30, 2003 and May 6, 2003 the Company issued $550,000 of subordinated notes to a group of accredited investors, including Herbert L. Lucas, a director of the Company, who purchased $75,000 of such subordinated notes. The transaction provided the Company with approximately $505,000 in net proceeds. In conjunction with the sale of these notes the Company granted warrants to purchase 235,722 shares of the Company s common stock (including 32,144 warrants granted to Mr. Lucas) at $1.11 per share exercisable for three years. The notes are unsecured and do not accrue interest until maturity. The notes were paid in full on June 25, 2003 with the proceeds received from the Convertible Note financing discussed above.

The loan was discounted for the relative fair value of the warrants totaling approximately $94,000, which was recognized as interest expense upon payment of the loan. The fair value of warrants was determined using the Black-Scholes option-pricing model with the following assumptions: volatility of 72%, risk-free interest rate of 2.25%, expected life of three years and 0% dividend yield.

For placement services associated with the financing, the Company paid a fee of $23,750 and issued warrants to purchase up to 20,357 shares of the Company s common stock at $1.11 per share exercisable for three years. The fair value of the warrants was valued using the Black-Scholes option pricing model with the same assumptions as the bridge notes discussed above. The total debt issuance costs of approximately $44,750 were recognized as interest expense upon the payment of the notes.

The warrants include registration rights requiring the Company to register the underlying shares of common stock with the Securities and Exchange Commission by December 31, 2003. In the event that the registration is not completed by December 31, 2003, the exercise price of the warrants decreases by 2% and continues to decrease by 2% for each 30-day period that the registration statement is not declared effective. The decrease is limited to 36%.

NOTE 8 RESEARCH AND DEVELOPMENT AGREEMENT

The Company entered into a Letter of Intent with BioNutrics, Inc. during the quarter ended December 31, 2002 that states the Company will sub-license two separate products to BioNutrics and enter into a Research and Development Agreement covering use of the Company s CDT technology in conjunction with certain patented Active Pharmaceutical Ingredients or proprietary formulations owned by BioNutrics. The agreement called for a non-refundable up front fee of $200,000 in the form of a cash payment and note receivable. The cash payment of $100,000 was received in December 2002 and the note agreement was executed during the six months ended June 30, 2003. The note is due nine months after the execution of a license, development and sales agreement. The $200,000 fee is included in deferred revenue and will be recognized when the Company has satisfied its obligations.

NOTE 9 RESTATEMENT OF FINANCIAL INFORMATION

During the three months ended March 31, 2003, the Company determined that certain costs that were incurred during 2002 and deferred as a prepaid expense at December 31, 2002, should have been expensed in the year ended December 31, 2002. These costs totaled approximately $104,000 and were incurred in conjunction with the anticipated sale of its Probiotics business. These costs have been recorded as a prior period adjustment in the period ended March 31, 2003.

The following is a summary of the effects of such restatement on the Company s financial statements as of December 31, 2002 and for the year then ended:

	As Originally Reported	As Restated
Balance Sheet:		
Current assets	$1,645,766	$1,541,942