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REGENCY AFFILIATES INC
Form 10-Q
May 20, 2002

UNITED STATES SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d)
--- OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2002

OR

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

For the transition period from _____ to _____

COMMISSION FILE NUMBER 1-7949

REGENCY AFFILIATES, INC.
(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of
incorporation or organization)

72-0888772

(IRS Employer Identification Number)

729 SOUTH FEDERAL HIGHWAY, SUITE 307, STUART, FLORIDA 34994

(Address of principal executive offices) (Zip Code)

Registrant's Telephone Number, including Area Code (561) 220-7662

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 X No

As of May 20, 2002 there were 1,939,874 shares of the \$.01 Par Value Common Stock

REGENCY AFFILIATES, INC. AND SUBSIDIARIES
INDEX TO THE FINANCIAL STATEMENTS

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REGENCY AFFILIATES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	March 31, 2002		December 31, 2001
	-----		-----
Assets			
Current Assets			
Cash and Cash Equivalents	\$ 295,191	\$	310,093
Accounts receivable, net of allowance	361,251		495,160
Income taxes receivable	8,988		8,988
Inventory	929,289		953,909
Other current assets	320,194		309,663
	-----		-----

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Total current assets	1,914,913	2,077,813
Property, Plant and Equipment, Net	2,313,966	2,192,695
Investment in partnerships	31,565,704	30,183,346
Other Assets		
Aggregate inventory	834,194	834,194
Goodwill, net of amortization	514,617	484,312
Debt issuance costs, net of amortization	315,053	362,311
Accrued interest receivable - related party	55,084	-
Other	3,150	5,205
	-----	-----
Total other assets	1,722,098	1,686,022
	\$37,516,681	\$ 36,139,876
	=====	=====

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

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REGENCY AFFILIATES, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS

	March 31, 2002	December 2001
	-----	-----
Current Liabilities		
Current portion of long-term debt	\$ 112,060	\$ 238
Notes Payable - Banks	930,370	906
Accounts payable	458,368	366
Accrued expenses	1,232,598	1,043
Taxes payable	180,000	180
	-----	-----
Total current liabilities	2,913,396	2,734
Long term debt, net of current portion	14,017,647	13,495
Minority interest in consolidated subsidiaries	26,251	31
Shareholders' equity		
Serial preferred stock not subject to mandatory redemption (maximum liquidation preference \$24,975,312 in 2002 and 2001, Respectively	1,052,988	1,052
Common stock, par value \$.01 authorized 25,000,000 shares; issued and outstanding 1,939,874 shares in 2002 and 2001	19,399	7,759
Additional paid-in capital	8,337,404	597
Readjustment resulting from quasi-reorganization at December 31, 1987	(1,670,596)	(1,670)
Retained earnings	15,270,885	14,589
Note receivable - related party	(2,440,000)	(2,440)
Treasury stock, 405,283 shares in 2002 and 2001	(10,693)	(10)

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Total shareholders' equity	----- 20,559,387 -----	----- 19,878 -----
	=====	=====
	\$37,516,681	\$ 36,139

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

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REGENCY AFFILIATES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF OPERATIONS
THREE MONTHS ENDED MARCH 31, 2002 AND 2001
(UNAUDITED)

	2002	2001
	-----	-----
Net Sales	\$ 502,883	\$3,385,072
	-----	-----
Costs and expenses		
Costs of goods sold	397,884	2,572,388
Selling and administrative	635,271	1,187,923
	-----	-----
	1,033,155	3,760,311
	-----	-----
(Loss) from operations	(530,272)	(375,239)
Income from equity investment in partnerships	1,486,660	1,225,396
Other income, net	62,393	24,583
Interest expense	(343,058)	(314,345)
	-----	-----
Income before income tax expense, and minority interest	675,723	560,395
Income tax expense	-	(68,923)
Minority interest	5,490	(37,460)
	-----	-----
Net income	\$ 681,213	\$ 454,012
	=====	=====
Net income per common share:		
Basic	\$ 0.35	\$ 0.26
	=====	=====
Diluted	\$ 0.35	\$ 0.26
	=====	=====
	-----	-----
Weighted average number of common shares outstanding	1,939,874	1,725,162

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

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REGENCY AFFILIATES, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
THREE MONTHS ENDED MARCH 31, 2002 AND 2001
(UNAUDITED)

	2002	2001
	-----	-----
Cash flows from operating activities		
Net income	\$ 681,213	\$ 454,012
Adjustments to reconcile net income to net cash used by operating activities		
Depreciation and amortization	90,589	166,889
Change in deferred income taxes	-	(21,818)
Minority interest	(5,490)	32,460
Income from equity investment in partnerships	(1,382,358)	(1,225,396)
Interest amortization on long-term debt	252,040	210,771
Changes in operating assets and liabilities		
Accounts receivable	133,909	1,143,075
Accrued interest receivable	(55,084)	-
Inventory	24,620	(65,057)
Other current assets	(10,531)	(250,579)
Accounts payable	91,928	(246,997)
Accrued expenses	189,377	1,003,337
	-----	-----
Net cash from (used by) operating activities	10,213	1,200,697
Cash flows from investing activities		
Capital expenditures	(194,907)	(73,017)
Other	2,055	8,601
	-----	-----
Net cash used by investing activities	(192,852)	(64,416)
Cash flows from financing activities		
Net short-term borrowings (payments)	23,393	(89,440)
Net long-term borrowings (payments)	144,344	(741,249)
	-----	-----
Net cash from (used) by financing activities	167,737	(830,689)
Foreign currency translation adjustment		
	-	(28,255)
Increase (decrease) in cash and cash equivalents	(14,902)	277,337
Cash and cash equivalents - beginning	310,093	928,636
	-----	-----
Cash and cash equivalents - ending	\$ 295,191	\$ 1,205,973
	=====	=====

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

REGENCY AFFILIATES, INC. AND SUBSIDIARIES
 CONSOLIDATED STATEMENTS OF CASH FLOWS (CONTINUED)
 THREE MONTHS ENDED MARCH 31, 2002 AND 2001
 (UNAUDITED)

	2002	2001
	-----	-----
Supplemental disclosures of cash flow information:		
Cash paid during the year for:		
Income taxes	\$ -	\$ 86,695
Interest	39,366	6,478

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

REGENCY AFFILIATES, INC. AND SUBSIDIARIES
 NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Bases of Presentation and Summary of Significant Accounting Policies

- A. Basis of Presentation - The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three-month period ended March 31, 2002 are not necessarily indicative of the results that may be expected for the year ended December 31, 2002. For further information, refer to the consolidated financial statements and footnotes thereto included in the Registrant Company and Subsidiaries' annual report on Form 10-K for the year ended December 31, 2001.
- B. Principals of Consolidation and Nature of Business - The consolidated financial statements include the accounts of Regency Affiliates, Inc. (the "Company"), its wholly owned subsidiaries, Rustic Crafts International, Inc. ("Rustic Crafts"), its 80% owned subsidiaries, National Resource Development Corporation ("NRDC"), Transcontinental Drilling Company ("Drilling") and RegTransco, Inc. ("RTI"), its 75% owned subsidiary, Iron Mountain Minerals, Inc. ("IMM") and its 50% owned subsidiary, Glas-Aire Industries Group, Ltd. ("Glas-Aire") from September 23, 1999, the date in which the company achieved an ownership interest greater

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than 50% through October 1, 2001, the date this interest was disposed of. All significant intercompany balances and transactions have been eliminated in consolidation.

- C. Earnings Per Share - Basic earnings per share are computed by dividing net income attributable to common shareholders by the weighted average number of common shares outstanding during the year. Diluted earnings per share computations assume the conversion of Series B, and Junior Series D preferred stock during the period that the preferred stock issues were outstanding. If the result of these assumed conversions is dilutive, the dividend requirements and periodic accretion for the preferred stock issues are reduced. On February 5, 2002 the Company's stockholders approved a one-for ten reverse stock split of the Company's common stock, par value \$0.40 per share, and a decrease in the par value to \$0.01 per share. The computation of basic and diluted EPS have been retroactively adjusted for the period ending March 31, 2001 to reflect this change in capital structure.
- D. Inventory - Inventories are stated at the lower of cost or market using the first-in, first-out (FIFO) method. Inventory is comprised of the following at March 31, 2002:

Raw materials and supplies	\$282,822
Work-in-process	7,144
Finished products	639,323
	\$929,289
	=====

- E. Aggregate Inventory - Inventory, which consists of 70+ million short tons is stated at lower of cost or market. The Company is also subject to a royalty agreement which requires the payment of certain royalties to a previous owner of the aggregate inventory upon sale of the aggregate. In December 2001 the aggregate inventory was sold to Iron Mountain Minerals, Inc., a 75% owned subsidiary of the Company. The purchase price was \$18,200,000 and is payable, with interest of 2.46% in ninety-six

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REGENCY AFFILIATES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Bases of Presentation and Summary of Significant Accounting Policies
(Continued)

equal payments of principal and interest commencing December 2003. The intercompany gain on this transaction has been eliminated in the consolidation process resulting in the aggregate inventory being carried at it's historical cost. Otherwise, the Company has made only casual sales of the inventory during the periods.

- F. Income Taxes - The Company utilizes Statement of Financial Accounting Standards No. 109 ("SFAS 109"), "Accounting for Income Taxes," which requires an asset and liability approach to financial accounting and reporting for income taxes. The difference between the financial statement and tax basis of

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assets and liabilities is determined annually. Deferred income tax assets and liabilities are computed for those temporary differences that have future tax consequences using the current enacted tax laws and rates that apply to the periods in which they are expected to affect taxable income. In some situations SFAS 109 permits the recognition of expected benefits of utilizing net operating loss and tax credit carryforwards. Valuation allowances are established based upon management's estimate, if necessary. Income tax expense is the current tax payable or refundable for the period plus or minus the net exchange in the deferred tax assets and liabilities.

Note 2. Investment in Partnership

In November 1994, the Company purchased a limited partnership interest in Security Land and Development Company Limited Partnership ("Security"), which owns and operates an office complex. The Company has limited voting rights and is entitled to be allocated 95% of the profit and loss of the Partnership until October 31, 2003 (the lease termination date of the sole tenant of the office complex) and 50% thereafter. The Company is to receive certain limited cash flow after debt service, and a contingent equity build-up depending upon the value of the project upon termination of the lease. The Company is also entitled to receive certain management fees relating to the partnership.

Security was organized to own and operate two buildings containing approximately 717,000 net rentable square feet consisting of a two-story office building and a connected six-story office tower. The building was purchased by Security in 1986 and is located on approximately 34.3 acres of land, which is also owned by Security. The building has been occupied by the United States Social Security Administration's Office of Disability and International Operations for approximately 24 years under a lease between the United States of America, acting by and through the General Services Administration ("GSA"). Effective November 1, 1994, Security and the GSA entered into a nine-year lease (the "Lease") for 100% of the building. Security has received an opinion of the Assistant General Counsel to the GSA that lease payments are not subject to annual appropriation by the United States Congress and the obligations to make such payments are unconditional general obligations of the United States Government.

The Company accounts for the investment in partnership on the equity method, whereby the carrying value of the investment is increased or decreased by the Company's allocable share of income or loss. The investment in partnership included in the Consolidated Balance Sheets at March 31, 2002 is \$31,565,704. The income from the Company's equity investment in the Partnership for the three months ended March 31, 2002 was \$1,436,660.

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Summarized operating data for Security for the three months ended March 31, 2002, and March 31, 2001, is as follows:

	2002	2001
Revenues	\$ 3,387,359	\$ 3,352,823
Operating Expenses	963,540	982,451
Depreciation and Amortization	642,000	716,067
Interest Expense, Net	269,545	364,444
Net Income	\$ 1,512,274	\$ 1,289,861

Effective November 30, 2000 the Company invested \$10,000 for a 5% limited partnership interest in 1500 Wood Lawn Limited Partnership, the general partner of Security.

The Company recognized income of \$50,000 and \$47,317 in 2002 and 2001, respectively, from the Woodlawn Limited Partnership investment.

Note 3. Note and Accrued Interest Receivable - Related Party

On October 15, 2001 the Statesman Group, Inc. (Statesman) exercised in full its option, which had been granted in 1997, to acquire 6,100,000 shares of the Company's common stock. The exercise was made pursuant to an agreement which provided for (1) a purchase price at \$0.40 per share (par value) rather than the formula price in the option, which would have yielded 25% less to the Company, (2) the execution of a note from Statesman to the Company in the principal amount of \$2,440,000 payable in five years with interest to accrue at the prevailing prime rate and (3) the obligation to be collateralized by the 6,100,000 common shares of the Company purchased upon exercise of the option as well as the 20% remaining interest in the Company's 80% owned subsidiary, NRDC. Accrued interest amounted to \$55,084 at March 31, 2002.

Statesman is controlled by The Statesman Irrevocable Trust dated April 15, 1991, a trust for the benefit of William R. Ponsoldt, Jr. (a director of the Company) and two other children of William R. Ponsoldt, Sr., the Company's President and Chief Executive Officer.

Note 4. Note Payable

The Company's subsidiary, Rustic Crafts, has established a \$1,000,000 line of credit with PNC Bank. The line of credit expires on May 18, 2002, (with an extension of approximately 90 days) is renewable annually and bears interest at the Bank's prime rate minus one-half percent (5.25% at March 31, 2002). The accounts receivable, inventory and other assets, such as property and equipment, of Rustic Crafts have been pledged as collateral to secure the line of credit. The line of credit is guaranteed by the Company. At March 31, 2002, the amount outstanding under the line of credit was \$930,370.

Note 5. Long-Term Debt

KBC Bank Loan - On June 24, 1998, the Company refinanced the

long-term debt previously outstanding with Southern Indiana Properties, Inc. ("SIPI") and entered into a Loan Agreement (the "Loan") with KBC Bank N.V. ("KBC"). Under the terms of the Loan

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Agreement, KBC advanced \$9,383,320. The due date of the Loan is November 30, 2003 with interest at the rate of 7.5% compounded semi-annually on each June 1 and December 1, commencing December 1, 1998. The interest may be paid by the Company in cash on these semi-annual dates or the Company may elect to add the interest to the principal of the Loan then outstanding. The loan is secured by the Company's interest in the partnership. As of March 31, 2002, the amount outstanding under the Loan is \$12,409,507, including \$252,040 of interest for the three months ended March 31, 2002.

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REGENCY AFFILIATES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 5. Long-Term Debt (Continued)

The Company purchased a residual value insurance policy which secures the repayment of the outstanding principal and interest when due with a maximum liability of \$14 million. The costs related to the insurance along with legal fees and other costs associated with obtaining the Loan have been capitalized as debt issuance costs and are being amortized over the life of the Loan using the effective interest method.

Mortgage Loan - On March 25, 1998, Rustic Crafts purchased a

building of 126,000 square feet located in Scranton, Pennsylvania. The purchase of this facility was funded in part by a first mortgage term loan in the amount of \$960,000. The first mortgage term loan is payable in consecutive monthly installments over 10 years with a 20 year amortization.

Equipment Loans - In connection with the purchase of the Rustic

Crafts building, PNC Bank loaned the Company a total of \$767,000 to finance the acquisition of new equipment and to install such equipment in the facility. Principal payments on one loan of \$604,000 began March 2000 for 120 months in amounts sufficient to amortize the outstanding balance over twenty years from March 2000. In March 2000 the interest rate was changed to the average weekly yield on U.S. Treasury Bills, plus 200 basis points. The remaining loan in the original amount of \$163,500 is payable in equal monthly installments of \$2,518.

Miscellaneous Loan - In June 1999, Rustic Crafts obtained an

additional loan from PNC Bank for the purpose of funding additional equipment purchases and working capital in the amount of \$156,000. The loan is payable in equal monthly installments, including principal and interest, of \$3,153.

The interest rates on the mortgage loan, the equipment loan and the miscellaneous loan range from 7.52% to 8.25% at March 31, 2002. The outstanding balance on these loans is \$1,608,140 at March 31, 2002.

Rustic Craft's real and personal property, equipment, accounts receivable, inventory and other general intangibles are pledged

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as security for the loans. The loans are also guaranteed by the Company. The security agreement requires Rustic Crafts to maintain certain financial ratios. Rustic Crafts was in compliance with such ratios at March 31, 2002.

Note 6. Income Taxes

As referred to in Note 1, the Company utilizes SFAS 109, "Accounting for income Taxes." The deferred taxes are the result of long-term temporary differences between financial reporting and tax reporting for depreciation, earnings from the Company's partnership investment in Security Land and Development Company Limited Partnership related to depreciation and amortization and the recognition of income tax carryforward items.

For regular federal income tax purposes, the Company has remaining net operating loss carryforwards of approximately \$7,507,000. These losses can be carried forward to offset future taxable income and, if not utilized, will expire in varying amounts beginning in the year 2002.

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REGENCY AFFILIATES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 6. Income Taxes (Continued)

For the three months ended March 31, 2002, and 2001, the tax effect of net operating loss carryforwards reduced the current provision for regular Federal income taxes by approximately \$300,000, and \$154,000, respectively. The Company provided \$0 and \$68,923, for Canadian, state income and the alternative minimum tax in the three months ended March 31, 2002 and 2001, respectively.

Note 7. Related Party Transactions

On November 2, 2000, L. J. Horbach, a director of the Company through December 5, 2000 and L. J. Horbach and Associates, of which Mr. Horbach is the sole owner, purchased from Mid City Bank a certain promissory note of the Company for \$71,109, as to which he had been a guarantor. Thereafter, Mr. Horbach filed suit against the Company seeking to collect both the principal amount of the note and accrued interest which amounted to, collectively, \$82,978. In December 2001, the Company filed suit against Mr. Horbach seeking to avoid it's alleged liability and other relief.

Note 8. Segment Information

The Company's operating structure includes operating segments for Automobile Accessories through September 30, 2001 (the operations of Glas-Aire, which was acquired in September 1999), Home Furnishing Accessories (the operations of Rustic Crafts, which was acquired in March 1997), Investment in Partnerships (the investment in Security Land and Development Limited Partnership and 1500 Wood Lawn Limited Partnership (Note 2), and

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Corporate and Other. The Company operates and generates its revenue in the United States, Canada and Japan.

Information about the Company's Operations by segment for the periods presented follows:

	Automobile Accessories	Home Furnishing Accessories	Investment in Partnership	Corporate and Other	Conso
March 31, 2002					

Net sales	\$ -	\$ 502,883	\$ -	\$ -	\$ -
Income from equity investment in partnerships	-	-	1,486,660	-	1
Segment profit/(loss)	-	(177,999)	1,486,660	(627,448)	
March 31, 2001					

Net sales	\$ 2,962,047	\$ 423,025	\$ -	\$ -	\$ 3
Income from equity investment in partnerships	-	-	1,225,396	-	1
Segment profit/(loss)	75,780	(178,304)	1,225,396	(668,860)	

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REGENCY AFFILIATES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

General.

Regency Affiliates, Inc. (the "Company") is the parent company of several subsidiary business operations. The Company is committed to develop and/or monetize these business operations for the benefit of its shareholders and continues to commit both financial and personnel resources to an active merger and acquisition program in order to enhance common stockholder's values. The Company's Shareholders Equity at March 31, 2002 was \$20,559,387 as compared to \$16,501,809 at March 31, 2001, an increase of \$4,057,578 for the twelve months ended March 31, 2002.

Liquidity and Capital Resources.

The investment in Security is estimated to provide the Company with management fees of approximately \$100,000 per annum until 2003. In the period ending March 31, 2002, the Company's income from its equity investment in the Partnership (as well as its interest in the General Partner, 1500 WoodLawn L.P.) was \$1,486,660. These funds, however, are presently committed for the amortization of the outstanding principal balance on Security's real estate mortgage and, while the Company's equity investment in the Partnership has increased to \$31,565,704, neither provides liquidity to the Company in excess of the \$100,000 annual management fee. The Company has, however, been successful in obtaining

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financing with respect to this investment.

On March 15, 1998, Rustic Crafts purchased a building of 126,000 square feet located near the current facility in Scranton, Pennsylvania. The purchase of this facility was funded by new borrowings from PNC Bank in the form of a first mortgage term loan in the amount of \$960,000. Rustic Crafts also obtained financing of approximately \$923,000 from PNC Bank to equip the facility and purchase new equipment. The move to the new facility was completed in 1999 and has significantly increased the operating capacity and enabled Rustic Crafts to more efficiently fill its current orders and increase its customer base. On the date of acquisition of the new facility, a tenant was renting 23,000 square feet of this facility at a base rent of \$17,400 per year plus an allocable share of the real estate taxes. The Company intends to maintain this tenant relationship on an ongoing basis and has rented an additional 28,000 square feet to another tenant at an annual minimum rent of \$71,680.

The Company has had discussions with several companies regarding the possible sale of its interest in IMM The Company is also exploring the possibility of establishing a permanent infrastructure during the year 2002 to commercialize the inventory of previously quarried and stockpiled aggregate at the Groveland Mine in cooperation with an experienced aggregate supply company.

On April 22, 1999, the Company acquired 513,915 shares (35%) of the outstanding common stock of Glas-Aire ("Glas-Aire") for the issuance of a promissory note of \$650,000 due January 1, 2000, at an interest rate of 7.5% per annum, which note was guaranteed by Mr. William Ponsoldt, Sr., President of the Company and \$1,213,000 in cash. As of September 23, 1999 Regency had acquired 51.3% of the common stock of Glas-Aire. These common stock acquisitions were effected by open market purchases, with the funding provided by an affiliate of Statesman Group, Inc. ("Statesman"), a substantial shareholder of the Company, on an unsecured basis, by direct purchases from Glas-Aire, and by a common stock exchange agreement between the Company and certain shareholders of Glas-Aire. Under the common stock exchange agreement, the Company issued 1,188,000 shares of its restricted common stock in exchange for 288,000 Glas-Aire common shares held by the shareholders.

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REGENCY AFFILIATES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

The Company also sold 2,852,375 shares of its common stock to Glas-Aire for cash of \$1,967,960 and 86,000 shares of Glas-Aire common stock. The proceeds were used to repay the funding provided by an affiliate of Statesman and other general corporate requirements.

Results of Operations

In September 1999, the Company acquired a 51% interest in Glas-Aire which manufacturers automotive accessories. The financial statements for March 31, 2001 include the results of Glas-Aire, but not those for March 31, 2002. The operations of the Company also include the operations of Rustic Crafts, which is engaged in the manufacturing of decorative fireplaces, heater logs and related accessories.

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On October 1, 2001, The Company announced that it had completed a transaction for the disposing of the Company's interest in Glas-Aire. Pursuant to an agreement entered into on September 17, 2001 and amended on October 1, 2001, the Company exchanged 1,215,105 shares of common stock of Glas-Aire, representing approximately 50% of the issued and outstanding shares of Glas-Aire, for \$2,500,000 plus 4,040,375 shares of Regency's common stock, or approximately 23% of the issued and outstanding shares of Regency. As a result of the transaction, neither Regency nor Glas-Aire owns any stock of the other. Glas-Aire generated net sales of \$8,378,202 for the nine-month period ending September 30, 2001. Income before income from equity investment and income tax expense was \$449,040 over the same period. Glas-Aire had been included in Regency's consolidated financial statements effective September 23, 1999 (the date that we acquired 51.3% control of Glas-Aire) through September 30, 2001. Gross margins decreased \$1,273,429 in 2001 over 2000, which is primarily attributable to the disposition of Glas-Aire and its inclusion in the company's financial statements through only September 30, 2001.

During the period that Regency owned it's interest of Glas-Aire, Regency received no cash from the operations of Glas-Aire, so there will be no change in cash flow as a result of the disposition of it's interest.

The Company's current operations do not generate sufficient cash flow to cover corporate operating expenses and thus the Company must rely on external sources to fund these expenses. The Company currently has unused borrowing capacity and is in discussion with additional external sources to provide for additional borrowing capacity to be used if needed.

2002 Compared to 2001

Net sales decreased \$2,882,189 in 2002 over the similar period in 2001, which is largely attributable to the disposition of the Glas-Aire subsidiary. The remaining difference is due to an increase in sales at Rustic Crafts of \$79,858.

Gross margin decreased \$707,685, which is largely attributable to the disposition of the Glas-Aire subsidiary. The remaining decrease is due to increase in gross margin from Rustic Crafts of \$33,810.

Selling and administrative expenses decreased \$552,652 in 2002 as compared to 2001, which decrease is largely attributable to the disposition of Glas-Aire.

Income from equity in partnerships increased \$261,264. This increase is due to a decrease in interest expense of \$161,822 resulting from payment of principal and decreases in operating expenses for the quarter as to Security Land income.

REGENCY AFFILIATES, INC. AND SUBSIDIARIES NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

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

Interest expense increased by \$28,713 and is largely attributable to increased interest expense on the KBC loan.

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Net income increased \$227,201 in 2002 compared to 2001. Increased equity earnings from partnerships were offset by the disposition of Glas-Aire

Forward-Looking Statements

Certain statements contained in this Quarterly Report on Form 10-Q, including, but not limited to those regarding the Company's financial position, business strategy, acquisition strategy and other plans and objectives for future operations and any other statements that are not historical facts constitute "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. Such forward-looking statements involve known and unknown risks, uncertainties and other important factors that could cause the actual results, performance or achievements expressed or implied by such forward-looking statements to differ materially from any future results, performance or achievements expressed or implied by such forward-looking statements. Although the Company believes that the expectations reflected in these forward-looking statements are reasonable, there can be no assurance that the actual results or developments anticipated by the Company will be realized or, even if substantially realized, that they will have the expected effect on its business or operations. These forward-looking statements are made based on management's expectations and beliefs concerning future events impacting the Company and are subject to uncertainties and factors (including, but not limited to, those specified below) which are difficult to predict and, in many instances, are beyond the control of the Company. As a result, actual results of the Company may differ materially from those results contemplated by such forward-looking statements which include, but are not limited to:

- (i) The Company's current operations do not generate sufficient cash flow to cover corporate operating expenses and thus the Company must rely on external sources to fund these expenses. The Company's ability to continue in existence is partly dependent upon its ability to generate satisfactory levels of operating cash flow.
- (ii) The Company currently lacks the necessary infrastructure at the site of the Groveland Mine to permit the Company to make more than casual sales of the aggregate.
- (iii) An unsecured default in the Lease or sudden catastrophe to the Security West Building from uninsured acts of God or war could have a materially adverse impact upon the Company's investment in Security Land and Development Company Limited Partnership and therefore its financial position and results of operations.
- (iv) The failure of the Social Security Administration to renew its lease of the Security West Buildings upon its expiration on October 31, 2003 could have a materially adverse impact upon the Company's investment in Security Land and Development Company Limited Partnership.
- (v) The Company has significant tax loss and credit carryforwards and no assurance can be provided that the Internal Revenue Service would not attempt to limit or disallow altogether the Company's use, retroactively and/or prospectively, of such carryforwards, due to ownership changes or any other reason. The disallowance of the utilization of the company's net operating loss would severely impact the Company's financial position and results of operations due to the significant amounts of taxable income (generated by the Company's investment in Security) that have in the past been, and is expected in the

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future to be, offset by the Company's net operating loss carryforwards.

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PART II - OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS.

On February 7, 2002 a complaint naming Regency Affiliates, Inc. as Defendant was filed in the District Court of Douglas County, Nebraska, case number 1012. The Plaintiffs are Larry J. Horbach, individually and L.J. Horbach & Associates and they are demanding payment on a Regency Affiliates loan they purchased from Mid City Bank. The plaintiffs are requesting payment of \$82,512.57 plus accrued interest, costs and attorney fees. We are vigorously defending this litigation and had previously commenced litigation regarding the same subject in December 2001.

On December 14, 2001 we initiated a proceeding in The Circuit Court of the Nineteenth Judicial Circuit in and for Martin County, Florida, case number 01-1087-CA against Larry J. Horbach, individually and L.J. Horbach & Associates. Larry Horbach was a former interim CFO and Board member. We claim that Larry Horbach, without appropriate authority, borrowed \$100,050 from Mid City Bank in the name of Regency. We further claim that Horbach converted all or part of the proceeds from the loan for his benefit.

On September 13, 2001, Glas Aire Industries LTD., Multicorp Holdings Inc., Glas Aire Industries Group Ltd, Craig Grossman, Todd Garrett, Speed.Com, Inc., Regency Affiliates, Inc., William Ponsoldt, and Marc Baldinger were listed as defendants in a proceeding in the Supreme Court of British Columbia with Alex Y. W. Ding as plaintiff. The case number is S015104. Mr. Ding, the former president of Glas-Aire, has asserted that the October 2001 Regency-Glas-Aire transaction is in breach of bank agreements, securities law and fiduciary duties owed to Glas-Aire and its stockholders. While the company has been served, plaintiff has not proceeded on this action and has not filed a statement of claim on a timely basis. Should plaintiff continue with the action, the defendants, including Regency, would vigorously defend this litigation

ITEM 2. CHANGES IN SECURITIES.

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

None.

ITEM 5. OTHER INFORMATION.

None.

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K.

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None.

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SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

REGENCY AFFILIATES, INC.

(Registrant)

Date: May 20, 2002

/s/ Marc H. Baldinger

(Chief Financial Officer and Director)

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