

TREECON RESOURCES INC
Form 10-Q
July 26, 2004
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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 March 31, 2004

OR

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 1-9083

TREECON RESOURCES, INC.

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(Exact name of registrant as specified in its charter)

Nevada
(State or other jurisdiction of
incorporation or organization)

23-2708876
(IRS Employer
Identification Number)

6004 South U.S. Highway 59

Lufkin, Texas 75901

(Address of principal executive offices)

(936) 634-3365

(Registrant's telephone number, including area code)

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

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

As of June 14, 2004, there were 18,615,464 shares of the issuer's common stock, \$.01 par value, outstanding.

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FORM 10-Q
QUARTER ENDED MARCH 31, 2004

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TREECON RESOURCES, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

Assets

	March 31,	September
	2004	30,
	(Unaudited)	2003
	(Note 2)	
Current assets:		
Cash	\$ 2,427,932	\$ 2,562,705
Receivables, net of allowance for doubtful accounts of \$527,183 and \$490,800		
Trade accounts	1,781,257	2,190,003
Sales contracts	2,186,117	2,295,723
Notes	2,877,376	2,008,960
Related parties	107,778	716,057
Inventories	9,208,081	9,134,123
Prepaid expenses and other	1,137,792	1,045,110
Total current assets	19,726,333	19,952,681
Property and equipment, at cost		
Land	658,930	658,930
Buildings and improvements	5,162,256	5,083,791
Machinery, equipment and other	2,202,322	2,269,734
	8,023,508	8,012,455
Accumulated depreciation	(3,413,431)	(3,234,682)
	4,610,077	4,777,773
Other assets:		
Noncurrent receivables, net of allowance for doubtful accounts of \$31,200 and \$31,200		
Sales contracts	416,403	441,387
Related parties		338,000
Restricted cash	538,154	537,209
Other	2,269,228	2,507,852
	3,223,785	3,824,448
Total assets	\$ 27,560,195	\$ 28,554,902

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

Table of Contents**TREECON RESOURCES, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS (continued)****Liabilities and Shareholders' Equity**

	March 31,	September 30,
	2004	2003
	(Unaudited)	(Note 2)
Current liabilities:		
Notes payable and accrued interest to related party	\$ 23,499,458	\$ 24,336,841
Accounts payable	1,354,619	845,939
Accrued expenses and other	1,665,719	1,548,934
Current maturities of long-term debt	82,708	284,769
Total current liabilities	26,602,504	27,016,483
Long-term debt, net of current portion	39,560	540,278
Reserve for credit guarantees	538,154	537,209
Total liabilities	27,180,218	28,093,970
Shareholders' equity:		
Common stock, \$0.01 par value, authorized 100,000,000 shares, issued and outstanding 18,615,464 shares	186,155	186,155
Paid-in capital	28,156,204	28,156,204
Accumulated deficit	(27,567,757)	(27,824,802)
Notes receivable from officers and directors	(394,625)	(56,625)
Total stockholders' equity	379,977	460,932
Total liabilities and shareholders' equity	\$ 27,560,195	\$ 28,554,902

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

Table of Contents**TREECON RESOURCES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

	For the Three Months Ended March 31,	
	2004	2003
Net revenues	\$ 10,323,467	\$ 9,192,796
Cost of sales	8,314,037	7,779,118
Gross profit	2,009,430	1,413,678
Selling, general and administrative expenses	1,486,508	1,561,488
Operating income (loss)	522,922	(147,810)
Other income (expenses):		
Interest expense	(300,089)	(564,665)
Interest income and other	45,619	39,690
Total other expenses	(254,470)	(524,975)
Income (loss) from continuing operations before income taxes	268,452	(672,785)
Income tax expense		
Income (loss) from continuing operations	268,452	(672,785)
Discontinued operations, net of income taxes		
Net income (loss)	\$ 268,452	\$ (672,785)
Net income (loss) per share, basic and diluted	\$.01	\$ (.04)

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

Table of Contents**TREECON RESOURCES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited)**

	For the Six Months Ended March 31,	
	2004	2003
Net revenues	\$ 21,724,554	\$ 18,894,099
Cost of sales	17,845,199	15,822,999
Gross profit	3,879,355	3,071,100
Selling, general and administrative expenses	3,005,761	3,545,529
Operating income (loss)	873,594	(474,429)
Other income (expenses):		
Interest expense	(689,588)	(1,148,575)
Interest income and other	73,039	(9,086)
Total other expenses	(616,549)	(1,157,661)
Income (loss) from continuing operations before income taxes	257,045	(1,632,090)
Income tax benefit		
Income (loss) from continuing operations	257,045	(1,632,090)
Discontinued operations, net of income taxes		(66,700)
Net income (loss)	\$ 257,045	\$ (1,698,790)
Net income (loss) per share, basic and diluted	\$.01	\$ (.09)

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

Table of Contents**TREECON RESOURCES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited)**

	For the Six Months Ended March 31,	
	2004	2003
Operating Activities:		
Income (loss) from continuing operations	\$ 257,045	\$ (1,632,090)
Adjustments to reconcile loss from continuing operations to net cash provided by (used in) operating activities:		
Depreciation and amortization	337,926	369,782
Provision for doubtful accounts	87,492	275,242
Interest accrual on notes to related party	662,617	994,687
Loss on investment in limited liability company	58,813	51,481
Cash expenses related to discontinued operations		(9,548)
Changes in:		
Accounts and sales contracts receivable	464,959	2,206,664
Inventories	(73,958)	867,978
Prepaid expenses and other	81,296	663,154
Accounts payable	508,680	(236,127)
Accrued expenses and other	116,785	(410,013)
Net cash provided by operating activities	2,501,655	3,141,210
Investing Activities:		
Capital expenditures, net	(164,397)	(646,791)
Notes and other receivables	(287,277)	(209,916)
Receivables from related parties	18,025	(96,635)
Net cash used in investing activities	(433,649)	(953,342)

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

Table of Contents**TREECON RESOURCES, INC.****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)****(Unaudited)**

	For the Six Months Ended March 31,	
	2004	2003
Financing Activities:		
Net borrowings (principal payments) on line of credit arrangements	\$	\$ (1,981,836)
Proceeds from borrowings on long-term debt		174,146
Principal payments on related party note payable	(1,500,000)	
Principal payments on long-term debt	(702,779)	(1,828,803)
Net cash used in financing activities	(2,202,779)	(3,636,493)
Net decrease in cash	(134,773)	(1,448,625)
Cash at beginning of period	2,562,705	2,327,766
Cash at end of period	\$ 2,427,932	\$ 879,141
Supplemental Schedule of Cash Flow Information:		
Cash paid during the period for:		
Interest	\$ 17,993	\$ 111,655
Income taxes	\$	\$

Supplemental Schedule of Noncash Investing and Financing Activities:

On October 31, 2003, the Company determined that two customers were no longer related parties, and therefore reclassified amounts due from them to accounts and sales contracts receivable (\$9,000) and current notes receivable (\$581,000) from related party receivables. The customers had previously been considered related parties because they had owned minority interests in Southern Forest Products and Wood Forest Products. Wood Forest Products ceased operations during fiscal year ended September 30, 2003. The Company purchased the minority interest in Southern Forest Products effective September 30, 2002.

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

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TREECON RESOURCES, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (continued)

(Unaudited)

Supplemental Schedule of Noncash Investing and Financing Activities (continued):

In February 2003, SFP sold all its interest in Quantum Fuel & Refining, Inc. to a related party and received as consideration the related party's 24.95% interest in SFP, which then became a wholly owned subsidiary of TTI.

During the six months ended March 31, 2003, the Company completed the spin-off of its subsidiary, Overhill Farms, Inc., and recorded a charge against retained earnings (accumulated deficit) of approximately \$134,000, representing the Company's net investment in Overhill Farms at the time of distribution.

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

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TREECON RESOURCES, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

March 31, 2003

(Unaudited)

1. NATURE OF BUSINESS AND ORGANIZATIONAL MATTERS

TreeCon Resources, Inc., formerly Overhill Corporation and Polyphase Corporation (the Company), is a holding company that, through its subsidiaries, currently operates in forestry and timber related businesses. These operations are conducted through the Company's wholly owned subsidiary Texas Timberjack, Inc. (Timberjack or TTI) and TTI's subsidiaries Southern Forest Products, LLC (SFP) and Wood Forest Products, LLC (WFP). The operations of WFP ceased during fiscal 2003. Through these entities, the Company distributes, leases and provides financing for industrial and logging equipment and is also engaged in the harvesting and processing of timber products.

The Company's Board of Directors, in August 2001, approved a plan to spin off all of its shares of Overhill Farms, Inc. (Overhill Farms) to the holders of the Company's common stock. This spin-off was completed in October 2002. Overhill Farms has been accounted for as a discontinued operation in the accompanying financial statements.

2. BASIS OF PRESENTATION

The condensed consolidated financial statements include the continuing operations of the Company, its wholly owned subsidiaries and its majority owned subsidiaries. All material intercompany accounts and transactions were eliminated. Certain prior year amounts have been reclassified to conform to the current period presentation.

The accompanying unaudited condensed 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. Additionally, a nonrecurring adjustment was made for the quarter ended December 31, 2002 to recognize a valuation allowance on parent company notes receivable from two former directors of the Company and from an attorney who performed services for the Company and Overhill Farms, Inc. in the past. This adjustment reduced the carrying amount of the notes to the fair market value of the underlying collateral. The net effect of the adjustment was to reduce assets and increase SG&A expenses by \$176,000. Operating results for the three and six months ended March 31, 2004 are not necessarily indicative of the results that may be expected for the year ended September 30, 2004, or for any other period.

The condensed consolidated balance sheet at September 30, 2003 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements.

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For further information, refer to the financial statements and footnotes thereto included in the Company's annual report on Form 10-K for the year ended September 30, 2003.

3. INVENTORIES

Inventories are summarized as follows:

	March 31, 2004	September 30, 2003
Forestry equipment	\$ 7,603,403	\$ 6,839,180
Finished wood products	1,107,558	1,417,931
Unharvested and harvested but unprocessed timber	497,120	877,012
	<u>\$ 9,208,081</u>	<u>\$ 9,134,123</u>

4. PER SHARE DATA

The following table sets forth the calculation of net earnings (loss) per share for the periods presented:

	For the Three Months Ended March 31,	
	2004	2003
Numerator:		
Income (loss) from continuing operations	\$ 268,452	\$ (672,785)
Discontinued operations		
Net income (loss) attributable to common shareholders	<u>\$ 268,452</u>	<u>\$ (672,785)</u>
Denominator:		
Denominator for basic earnings per share - Weighted average shares	<u>18,615,464</u>	<u>18,615,464</u>
Effect of dilutive securities:		
Warrants		
Dilutive potential common shares		
Denominator for diluted earnings (loss) per share	<u>18,615,464</u>	<u>18,615,464</u>
Net earnings (loss) per share - basic and diluted:		

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Continuing operations	\$.01	\$	(.04)
Discontinued operations				
Net earnings (loss) per share	\$.01	\$	(.04)

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Table of Contents**4. PER SHARE DATA (CONTINUED)**

	For the Six Months Ended March 31,	
	2004	2003
Numerator:		
Income (loss) from continuing operations	\$ 257,045	\$ (1,632,090)
Discontinued operations		(66,700)
Net income (loss) attributable to common shareholders	\$ 257,045	\$ (1,698,790)
Denominator:		
Denominator for basic earnings per share - Weighted average shares	18,615,464	18,615,464
Effect of dilutive securities:		
Warrants		
Dilutive potential common shares		
Denominator for diluted earnings (loss) per share	18,615,464	18,615,464
Net earnings (loss) per share - basic and diluted:		
Continuing operations	\$.01	\$ (.09)
Discontinued operations		
Net earnings (loss) per share	\$.01	\$ (.09)

No dilutive securities were outstanding during the three and six months ended March 31, 2004 and 2003.

5. INVESTMENT IN LIMITED LIABILITY COMPANY

TTI has a 49.9% ownership in a construction related limited liability company (the LLC), which is accounted for under the equity method. TTI's initial capital investment in the LLC was nominal, and its investment in the LLC is comprised primarily of related party receivables arising from operating advances and financed equipment sales to the LLC, with such sales being transacted primarily at Texas Timberjack's cost of acquiring the related equipment. During fiscal 2002, the partnership's activities were substantially reduced and only minimal activity currently exists. The net related party receivable from the LLC, included in long term other assets, decreased \$212,000 to \$317,000 during the six months ended March 31, 2004. Additionally, we recorded a loss of approximately \$59,000 related to TTI's investment in the LLC during the six months ended March 31, 2004.

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6. ASSETS HELD FOR SALE

During the fiscal year ended September 30, 2000, in exchange for approximately \$400,000 of raw timber inventory and the assumption of certain liabilities, SFP acquired all of the outstanding stock of Quantum Fuel & Refining, Inc. (Quantum) from TTI s minority partner in SFP. Quantum s assets consist primarily of a non-operating refinery in Egan, Louisiana. Liabilities assumed included a \$1.0 million note payable, along with accrued interest, to Mr. Harold Estes, President of TTI. SFP acquired the assets of Quantum for resale and had classified the assets as held for sale since the date of acquisition. In February 2003, SFP sold 100% of the stock of Quantum back to TTI s minority partner in SFP, and received in exchange the aforementioned minority partner s 24.95% interest in SFP, which then became a wholly-owned subsidiary of TTI.

Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS

Forward-Looking Statements

The following discussion and analysis should be read in conjunction with our condensed consolidated financial statements and notes to financial statements included elsewhere in this document. This report, together with our unaudited condensed financial statements and notes thereto, contain forward-looking statements. These forward-looking statements, which generally include the plans and objectives of management for future operations, including plans and objectives relating to our future economic performance and management s current beliefs regarding revenues we might earn if we are successful in implementing our business strategies.

This report contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements are based on current expectations or beliefs, including, but not limited to, statements concerning our operations and financial performance and condition. For this purpose, statements of historical fact may be deemed to be forward-looking statements. Forward-looking statements include statements which are predictive in nature, which depend upon or refer to future events or conditions, which include words such as expects, anticipates, intends, plans, believes, estimates, or similar expressions. In addition, any statements concerning future financial performance (including future revenues, earnings or growth rates), ongoing business strategies or prospects, and possible future company actions, which may be provided by management, are also forward-looking statements. We caution that these statements by their nature involve risks and uncertainties, and actual results may differ materially depending on a variety of important factors, including, among others:

the impact of competitive products and pricing;

market conditions, and weather patterns that may affect the cost of timber as well as the market for our equipment;

changes in our business environment, including actions of competitors and changes in customer preferences, as well as disruptions to our customers businesses;

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the occurrence of acts of terrorism, such as the events of September 11, 2001, or acts of war;

changes in governmental laws and regulations, including income taxes;

market demand for new and existing products;

other factors as may be discussed in this report and other reports we file with the Securities and Exchange Commission, including those described in Item 7 of our annual report on Form 10-K for the fiscal year ended September 30, 2002.

the Risk Factors Related to our Business and Industry described below.

Risk Factors Related to Our Business and Industry

The Company is subject to various risks which could have a negative effect on the Company and its financial condition. These risks could cause actual operating results to differ from those expressed in certain forward looking statements contained in this Form 10-Q as well as in other Company communications. Before you invest in our securities you should carefully consider these risk factors together with all other information included in our publicly filed documents.

Logging Equipment Industry. The demand for our logging equipment products is directly related to the strength of the logging industry in East Texas. If the demand for timber declines, we will experience a decrease in product demand. A decline in demand for timber can occur due to national economic factors such as decreased construction starts or increased mortgage interest rates. A decline can also occur due to regional or local factors, such as extended bad weather or the closing of paper or saw mills that drive the East Texas logging economy.

We are the authorized distributor of Timberjack and Blount logging equipment. For continued success, we must offer equipment that is technologically advanced and competitively priced when compared to our competition. If our competitors begin to offer equipment with better, more efficient operation, we may be unable to maintain our sales volumes. Also, we must be able to meet or improve upon our competitors price and financing offerings.

Timber and Wood Products Industry. Our ability to maintain profitability in the highly competitive timber and wood products industry is contingent upon continued strong demand for our lumber products. If lumber prices drop, we may not be able to sell our products at a profit. Lumber prices are influenced by factors that influence the strength of the construction industry, such as housing starts, interest rates, and overall economic conditions.

Our sawmill and wood treating plant have been in operation for many years, and more efficient equipment is now available. If our equipment must be replaced or upgraded, additional capital investment will increase our depreciation expense.

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Overall Business. Our overall business and our reported results are affected by general economic and political conditions in the United States. This includes wars and other international conflicts and the threat thereof; actions by the United States Federal Reserve Board and other central banks, actions by the United States Securities and Exchange Commission, actions by environmental regulatory agencies, including those related to engine emissions and the risk of global warming; actions by other regulatory bodies; actions by rating agencies, capital market disruptions, investor sentiment, inflation and deflation rates, interest rate levels, customer borrowing and repayment practices, and the number of customer loan delinquencies and defaults; actions of competitors, particularly price discounting; manufacturer production and technological difficulties, changes to accounting standards, the effects of terrorism and the response thereto; and legislation affecting the sectors in which we operate.

Note Payable to Related Party. We currently owe a related party (Mr. Harold Estes) \$23,499,458 for a note payable that matures October 31, 2004. As the collateral pledged against the note payable to Mr. Estes represents all of our ownership of our only continuing operation, Mr. Estes foreclosure on this collateral would have an adverse effect on our ability to continue as a going concern.

Overview

Our strategy is to be the leading supplier of forestry equipment and timber products within our market territories. We intend to create value for our stockholders by continuing to execute our growth and operating strategies. We employ the following corporate strategies:

Continue to provide high quality products and superior services to our customers

Seek internal growth by adding customers and new product lines

Critical Accounting Policies

Management's discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. We base our estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Our significant accounting policies are described in the notes to the audited financial statements that are included in our annual report on Form 10-K for the year ended September 30, 2003.

We believe the following critical accounting policies are related to the more significant estimates and assumptions used in the preparation of our consolidated financial statements.

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Revenue Recognition. We generally recognize revenue when products are shipped, which is when title and risk of loss pass to the buyer, or when services are performed, and provide for estimated returns and allowances at the time of sale. However, a portion of our business relates to the sale of equipment through installment sales contracts. Revenue is recognized on these accounts using the installment method due to frequent late payments, periodic repossessions and related uncertainty with respect to ultimate realization at the time of sale. Under the installment method, we record at the point of sale both a sale and a cost of sale for the total cost of the unit. We initially record gross profit in a deferred profit account to be recognized as proceeds are received, based on the relative percentage of transaction profit to sales price. Given the uncertainty with respect to ultimate collection, interest on installment contracts is recognized on a cash basis.

Allowance for Doubtful Receivables. We account for bad debts on accounts receivable using the reserve method. We establish allowance based on a percentage of parts sales, past bad debt experience, the makeup of the current portfolio and current market conditions. We establish allowances for doubtful notes receivable if, at the date of valuation, management believes it is probable that a loss exists in the portfolio based on an evaluation of the individual notes included in the portfolio, payment history, and the expected credit risk based on subject collateral, if any. We account for bad debts on sales contracts receivable using the reserve method. After reviewing economic conditions, as well as historical trends and collateral values, we evaluate our allowance for doubtful sales contracts based on the estimated loss exposure at any given time in the portfolio, which has historically not been significant in comparison to the total portfolio amount.

Our estimates involve a significant amount of judgment, particularly with respect to notes receivable, which are subject to various forms of collateral for which fair value is often not objectively attainable. Actual results could differ adversely from management estimates resulting in additional losses on receivables over and above the reserves provided. However, we believe our allowances for doubtful receivables are fairly stated as of March 31, 2004.

Inventories. Inventories of forestry equipment are valued at the lower of cost or market or, in the case of repossessed and used equipment, net realizable value, based upon the specific identification method. Inventories of raw timber and finished wood products are stated at the lower of average cost or market.

Impairment of Long-Lived Assets. When long-lived asset impairment indicators are present, we evaluate impairment of long-lived assets in accordance with SFAS No. 144 by projecting undiscounted cash flows of the related assets over the remaining estimated useful lives of such assets. If undiscounted cash flow projections are insufficient to recover the carrying value of the long-lived assets under review, impairment is recorded for the amount, if any, by which the carrying value of such assets exceeds their fair values. Projections of undiscounted cash flows inherently involve management's subjective estimates and assumptions regarding future expected operating results. Actual results could differ from management estimates

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Income Taxes. We record deferred income taxes using the liability method to reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Valuation allowances, if any, are established against deferred tax assets based upon whether or not management believes such assets are more likely than not to be recovered, which is a subjective determination based upon considerations of available positive and negative evidence. As of March 31, 2004, we have recorded a valuation allowance against all of our net deferred tax assets that relate to our continuing operations as we currently believe such amount is not likely to be recoverable given our recent history of operating losses.

Recent Accounting Pronouncements

In May 2003, the Financial Accounting Standards Board (FASB) issued SFAS No.150, Accounting for Certain Financial Instruments with Characteristics of Liabilities and Equity, which is effective at the beginning of the first interim period beginning after June 15, 2003. However, certain aspects of SFAS 150 have been deferred. SFAS No. 150 establishes standards for our classification of liabilities in the financial statements that have characteristics of both liabilities and equity. We will continue to review SFAS No. 150; however, we do not expect SFAS 150 to have a material impact on our financial position, results of operations, or cash flows.

In January 2003, the FASB issued Interpretation No. 46, Consolidation of Variable Interest Entities. Under previous practices, certain entities were included in consolidated financial statements based upon controlling voting interests or in other special situations. Under Interpretation No. 46, certain previously unconsolidated entities will be required to be included in consolidated financial statements of the primary beneficiary, as defined. For variable interest entities, often referred to as special purpose entities, created after January 31, 2003, Interpretation No. 46 is effective immediately. We are currently evaluating the impact, if any, of Interpretation No. 46 on our consolidated financial statements.

In December 2002, the FASB issued Interpretation No. 45, Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. Interpretation No. 45 clarifies the requirement for recognition of a liability by a guarantor at the inception of the guarantee based on the fair value of a non-contingent obligation to perform. Interpretation No. 45 must be applied prospectively to guarantees entered into or modified after December 31, 2002. We are currently in the process of evaluating the impact, if any, of Interpretation No. 45 on our consolidated financial statements.

On July 30, 2002, the Financial Accounting Standards Board (FASB) issued SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities , which requires companies to recognize costs associated with exit or disposal activities when they are incurred rather than at the date of commitment to an exit or disposal plan. The provisions of SFAS No. 146 are effective for exit or disposal activities that are initiated after December 31, 2002. The adoption of SFAS No. 146 is not expected to have a material effect on our financial position, results of operations or cash flows.

In November 2001, the FASB issued Statement No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets (SFAS 144). These rules supersede FASB Statement No. 121,

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Accounting for the Impairment of Long-Lived Assets and for Long-Lived Assets to Be Disposed Of , providing a single accounting model for long-lived assets to be disposed of. Although retaining many of the fundamental recognition and measurement provisions of Statement 121, the new rules significantly change the criteria that would have to be met to classify an asset as held-for-sale. Statement 144 also supersedes the provisions of APB Opinion 30 with regard to reporting the effects of a disposal of a segment of a business. The Statement is effective for fiscal years beginning after December 15, 2001 and interim periods within those fiscal years, although earlier application is encouraged. We adopted SFAS 144 as of October 1, 2001 and such adoption did not have a material impact on our financial condition, results of operations and cash flows.

Results of Operations

Three Months Ended March 31, 2004 Compared to Three Months Ended March 31, 2003

Net Revenues. Net revenues for the three months ended March 31, 2004 increased \$1,131,000 (12.3%) to \$10,323,467 from \$9,193,000 for the three months ended March 31, 2003. The increase in revenues resulted from revenue increases at both our business segments Equipment and Timber Products.

The Equipment segment's net revenues were \$6,574,000 for the second quarter of fiscal 2004 as compared to \$6,504,000 for the second quarter of fiscal 2003, an increase of \$70,000. The increase in net revenues was impacted by increases in equipment sales (\$170,000) and service revenues (\$20,000). This increase was partially offset by a decrease in parts revenues (\$120,000). Although we experienced a strong lumber market during this quarter, our revenue growth was modest due to wet weather.

Our Timber segment's net revenues were \$3,750,000 for the second quarter of fiscal 2004 as compared to \$2,688,000 for the second quarter of fiscal 2003, an increase of \$1,061,000. During the second quarter of fiscal 2003, the sawmill was closed for approximately three weeks because of a log shortage due to rainy weather. This caused our production to decline substantially, which in turn resulted in a decline in our revenues for the previous quarter. Sales for the quarter ended March 31, 2004 were higher than normal due to increased production levels to take advantage of increased prices for larger, longer length timbers. Wet weather and a resulting lack of raw materials caused a decreased supply and increased market price for these timbers during the quarter ended March 31, 2004.

Gross Profit. Gross profit for the second quarter of fiscal 2004 increased \$596,000 to \$2,009,000 from \$1,414,000 for the second quarter of fiscal 2003. This increase is due to improvements at both the Equipment unit and the Timber unit. The Equipment unit's gross profit margin increased \$230,000 to \$1,338,000 for the second quarter fiscal 2004 from \$1,108,000 for the second quarter fiscal 2003. During the second quarter of fiscal 2003, we made a decision to wholesale our slower moving inventory, which contributed to the reduced Equipment unit's gross profit in the prior quarter. The Timber unit's gross profit increased \$366,000 to \$671,000 for the three months ended March 31, 2004 from \$305,000 for the three months ended March 31, 2003. This increase was caused by a temporary shutdown of the mill due to poor weather conditions during the second quarter of the previous year, which caused production efficiencies to decline, resulting in an increase in the cost of the lumber manufactured.

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Selling, General and Administrative Expenses. Selling, general and administrative expenses (SG&A) for the second quarter of fiscal 2004 declined \$75,000 (4.8%) to \$1,487,000 (14.4% of net revenues) from \$1,561,000 (17.0% of net revenues) for the second quarter of fiscal 2003. SG&A declined \$97,000 in the parent company, although the operating unit SG&A increased \$22,000 from the same period in 2003. This reduction in cost is due to the closing of the corporate office in Addison, Texas and the assignment of parent company functions to Texas Timberjack personnel.

Operating Income. Operating income increased \$671,000 (454%) to \$523,000 for the second quarter of fiscal 2004 from a loss of \$148,000 for the second quarter fiscal 2003. The improvement in operating income is the result of an increase in the gross profit margin and slightly lower SG&A. We intend to continue to reduce SG&A and manage our cost structure with increased emphasis on increasing gross profit margins as we seek to develop additional revenue opportunities.

Other Income/Expenses. Total other income/expenses for the second quarter of fiscal 2004 improved \$271,000 from the second quarter fiscal 2003. This improvement was mostly due to a decline in interest expense of \$265,000 (46.8%) to \$300,000 for the quarter ended March 31, 2004 from \$565,000 for the same quarter in the prior year. This reduction in cost resulted from the refinancing of Harold Estes note during the first quarter of fiscal year 2004 and the resulting reduction of the interest rate to 5% from 9%. Interest expense on other debt also declined due to a reduction in the average principal outstanding.

Net Loss. The net result for the second quarter of fiscal 2004 was income of \$268,000 (\$.01 per share) as compared to a loss of \$673,000 (\$.04 per share) for the second quarter of fiscal 2003.

Six Months Ended March 31, 2004 Compared to Six Months Ended March 31, 2003

Net Revenues. For the six months ended March 31, 2004, net revenues increased \$2,831,000 (15.0 %) to \$21,725,000 as compared to \$18,894,000 for the six months ended March 31, 2003.

Our Equipment unit reported a \$488,000 increase in revenues to \$14,294,000 for the six months ended March 31, 2004 from \$13,806,000 for the six months ended March 31, 2003. This increase is primarily due to increases in sales of equipment (\$619,000). This increase was partially offset by decreases in parts revenue (\$75,000), service revenue (\$9,000), and interest from sales contracts (\$47,000). A continued strong market for timber products, especially oriented strand board (OSB) and dimensional lumber, contributed to the overall higher revenues in the Equipment segment during the six months ended March 31, 2004.

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Our Timber segment reported an increase in revenues of \$2,343,000 to \$7,431,000 for the six months ended March 31, 2004 from \$5,088,000 for the comparable period in 2003. This increase is due to higher market prices, combined with increased production and sales.

Gross Profit. Gross profit for the six months ended March 31, 2004 increased \$808,000 to \$3,879,000 from \$3,071,000 for the comparable period in 2003. Gross profit as a percentage of net revenues increased to 17.9% in 2004 as compared to 16.3 % for the same period in 2003. The gross profit increase was primarily from the Timber segment. The timber operations were able to operate more efficiently during the current period because there was no shut down due to rainy weather.

Selling, General and Administrative Expenses. Selling, general and administrative expenses (SG&A) for the six months ended March 31, 2004 decreased \$540,000 to \$3,006,000 (13.8% of net revenues) from \$3,546,000 (18.8% of net revenues) for the comparable period in 2003. SG&A declined approximately \$29,000 in the operating units during the six month period, while the parent company SG&A declined \$511,000 from the same period in 2003. Part of the decrease was due to a reduction of legal expenses during the first quarter fiscal 2003 incurred in connection with the defense of our class action lawsuit. Also during the first quarter of 2003, in connection with the completion of the spin-off of Overhill Farms, we provided for reserves of \$176,000 against notes receivable from two of our directors and from an attorney who performed services for us in the past. Also contributing to the reduction in cost was the closing of the corporate office in Addison, Texas and the assignment of parent company functions to Texas Timberjack personnel.

Other Income/Expenses. Total other income/expenses during the six months ended March 31, 2004, consisting primarily of interest expense, decreased to \$617,000, as compared to \$1,158,000 for the six months ended March 31, 2003, a decrease of \$541,000 (46.7%). This improvement was mostly due to a decline in interest expense of \$459,000 (40.0%) to \$690,000 for the six months ended March 31, 2004 from \$1,149,000 for the same period in the prior year. This reduction in cost resulted from the refinancing of Harold Estes note during the first quarter of fiscal year 2004 and the resulting reduction of the interest rate to 5% from 9%. Interest expense on other debt also declined due to a reduction in the average principal outstanding.

Net Income/Loss. The net result for the six months ended March 31, 2004 was a net income of \$257,000 (\$.01 per share) as compared to a net loss of \$1,699,000 (\$.09 per share) for the comparable period in the prior year.

We currently expect to improve on our operating results, primarily through (a) improving gross margins achieved by raising our pricing structure on equipment sales (b) growing revenues on profitable equipment lines (c) increasing production and cost efficiencies at the sawmill operations (d) reducing raw timber inventory costs at the sawmill operations (e) reducing SG&A expenses in both segments and (f) pursuing profitable investments relating to the timber industry.

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Improvement in our operating results may not continue should the East Texas timber market soften, or if the supply of large timbers and decking increases and causes prices to fall. Market conditions and weather patterns may affect the cost of timber, as well as the market for our equipment. Our business may also suffer other adverse changes, such as the impact of competitive products and pricing.

Liquidity and Capital Resources

Historically, principal sources of liquidity are cash flows from operations and additional financing capacity. Our cash and cash equivalents decreased by \$135,000 during the first six months of fiscal 2004, as compared to a decrease of \$1,449,000 during the first quarter of fiscal 2003.

During the first six months of fiscal 2004, our operating activities resulted in cash provided of \$2,502,000, as compared to cash provided of \$3,141,000 during the first six months of fiscal 2003. During the current period, cash provided resulted primarily from operating income (\$257,000), noncash expenses (\$1,147,000), reduction in accounts receivable (\$465,000), increase in accounts payable (\$509,000), and increase in accrued expense and other liabilities (\$117,000). Changes in inventories and prepaid expenses and other assets generally offset. As of March 31, 2004, we had a working capital deficit of approximately \$6,876,000, resulting from the reclassification to current liabilities during the first six months of fiscal 2003 of our note and accrued interest to Mr. Estes, which has now been renewed through October 2004.

During the first six months of fiscal 2004, our investing activities resulted in a use of cash of approximately \$434,000, as compared to a use of cash of \$953,000 during the first half of fiscal 2003. Our use of cash in the current period resulted from capital expenditures of \$165,000, together with an increase of \$287,000 in notes receivable. This was offset by an \$18,000 source of funds from a reduction of related party receivables during the six months ended March 31, 2004.

During the first six months of fiscal 2004, our financing activities resulted in a use of cash of approximately \$2,203,000, as compared to a use of cash of \$3,636,000 during the first six months of fiscal 2003. The use of cash in the current period resulted from repayments on long-term debt of \$703,000 and principal payments on the note to Mr. Estes of \$1,500,000.

We believe that funds available to us from operations and existing capital resources will be adequate for our operating and capital requirements for at least the next twelve months. Our note payable to Mr. Harold Estes has a balance as of March 31, 2004 of \$23.0 million, plus accrued interest, and matures on October 31, 2004. This is a renewal of a note that matured on October 31, 2003. Subsequent to October 31, 2003, we agreed with Mr. Estes to a further extension of the maturity date to October 31, 2004, under substantially the same terms and conditions except for a reduction of the interest rate to 5% from 9%. Interest payable to Mr. Estes as of October 31, 2003, totaling approximately \$2.1 million, was added to the principal of the refinanced note. Principal payments of \$1.5 million were made during the six months ended March 31, 2004. As the collateral pledged against the note payable to Mr. Estes represents all of our ownership of our only continuing operation, Mr. Estes' foreclosure on such collateral upon maturity or thereafter would have a material adverse effect on our ability to continue as a going concern.

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Following is a summarization of our contractual obligations at March 31, 2004:

Future debt maturities at March 31, 2004:

<u>Fiscal Year</u>	
Remainder of 2004	\$ 68,001
2005	23,553,725
2006	
2007	
2008	
Total	\$ 23,621,726

Other contractual obligations at March 31, 2004:

In addition to the contractual obligations mentioned above, at March 31, 2004, we had open purchase orders for equipment to be delivered in the subsequent quarter totaling approximately \$880,000.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk Obligations. We are not currently subject to interest rate risk on variable interest rate obligations as of March 31, 2004. However, we are subject to interest rate risk on our fixed interest rate obligations. Based upon outstanding amounts of fixed rate obligations as of March 31, 2004, a hypothetical 10% decrease in average market interest rates would increase the fair value of outstanding fixed rate debt by approximately \$64,000.

We do not own, nor do we have an interest in, any other market risk sensitive instruments.

Item 4. Controls and Procedures

The Company was late in filing its Form 10-Q reports for the quarters ended December 31, 2002, March 31, 2003, and June 30, 2003, its Form 10-K report for the fiscal year ended September 30, 2003, and its Form 10-Q report for the quarter ended December 31, 2003. During the time that these reports were due, the Company had a different Board of Directors and Chief Executive Officer. The current Board of Directors and Chief Executive Officer were appointed and elected in March, 2004. The Company was also late in filing this Form 10-Q report for the quarter ended March 31, 2004.

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The spin-off of Overhill Farms in October 2002 and the concurrent resignation of William Shatley, the Company's Chief Financial Officer at the time, left the Company with only its Chief Executive Officer, who remained with the Company without pay to aid in transition, two

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additional Board Members and no paid employees. The CEO subsequently resigned in December 2003. This shortage of personnel and the resignation of the Company's auditors in November 2003 prevented the Company from filing the reports in a timely manner. The Company was without outside auditors until March, 2004 when Langley, Williams and Co., L.L.C. was engaged, and at which time the Company was able to gather the information necessary to complete and file the late reports.

The information gathered included a note dated November 1, 2002 from an attorney who had performed work for Overhill Farms, Inc. and the Company. The \$262,350 note is secured by an unperfected lien on 86,000 shares of Overhill Farms Inc. stock, a former subsidiary of the Company that was spun off in October 2002. The Company has written down the note to the value of the stock. In evaluating the Company's controls and procedures, management concluded that the controls and procedures that allowed the loan evidenced by the note to be made were not adequate. The letter to the Audit Committee included in the Report to the Board of Directors issued by Langley, Williams & Co., L.L.C. in connection with the audit of the Company's financial statements for the fiscal year ended September 30, 2003 also mentions this loan and states that the auditors concluded that the controls and procedures that allowed the loan to be made without proper authorization were not adequate. Since that time the Company has implemented enhanced control measures. These measures have included instituting Board approval procedures for loans and other significant actions and increasing controls on bank accounts.

The Company will continue to evaluate the effectiveness of its controls and procedures on an ongoing basis and will implement further actions as necessary in its continuing efforts to strengthen its control process.

Evaluation of Disclosure Controls and Procedures

The Company's senior management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, evaluated the effectiveness of the design and operation of the Company's disclosure controls and procedures, as of the date of this report. Based upon that evaluation, combined with a consideration of the additional procedures described above, the Company's Chief Executive Officer and Chief Financial Officer concluded that as of the filing date of this report the information required to be disclosed in the reports that the Company files or submits under the Exchange Act has been recorded, processed, summarized and reported as required.

Changes to Internal Control over Financial Reporting

Other than as described above, there have been no significant changes in the Company's internal control over financial reporting during the period covered by this report that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

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PART II OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in various lawsuits, claims and proceedings related to the conduct of our business. Our management does not believe that the disposition of any pending claims is likely to adversely affect our financial condition, results of operations or cash flows.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits

<u>Number</u>	<u>Description</u>
31*	Certifications Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32*	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

* Filed herewith

(b) Reports on Form 8-K

No reports on Form 8-K were filed during the quarter ended March 31, 2004.

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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.

**TREECON RESOURCES, INC.
(Registrant)**

Date: July 22, 2004

By: /s/ Mike Boatman

Mike Boatman
President and Chief Executive Officer

(principal executive officer)

Date: July 22, 2004

By: /s/ Mike Boatman

Mike Boatman
principal financial officer

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EXHIBITS FILED WITH THIS REPORT ON FORM 10-Q

<u>Number</u>	<u>Description</u>
31	Certifications Required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as Adopted Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32	Certification of Chief Executive Officer and Chief Financial Officer Pursuant to 18 U.S.C. Section 1350, As Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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