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SPORTS ARENAS INC
Form 10-Q
January 12, 2005

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

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 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 0-2380

SPORTS ARENAS, INC.

(Exact name of registrant as specified in its charter)

Delaware 13-1944249

(State of Incorporation) (I.R.S. Employer I.D. No.)

7415 Carroll Road, Suite C, San Diego, California 92121

(Address of principal executive offices) (Zip Code)

Registrant's telephone number, including area code (858) 408-0364

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 Act). Yes No X
--- ---

The number of shares outstanding of the issuer's only class of common stock (\$.01 par value) as of November 30, 2004 was 5,441,734 shares.

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SPORTS ARENAS, INC.

FORM 10-Q

QUARTER ENDED SEPTEMBER 30, 2004

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SPORTS ARENAS, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS

ASSETS

	September 30, 2004	June 30, 2004
	----- (Unaudited)	----- Audited
Current assets:		
Cash and cash equivalents	\$ 67,230	\$ 186,716
Receivables	153,577	275,004
Inventories	455,872	605,843
Prepaid expenses	18,867	27,005

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Total current assets	695,546	1,094,568
<hr/>		
Property and equipment, at cost:		
Equipment.....	1,997,600	1,997,600
Less accumulated depreciation and amortization	(1,220,367)	(1,167,688)
<hr/>		
Net property and equipment	777,233	829,912
<hr/>		
Other assets:		
Investment	3,616,653	3,797,288
Deferred tax assets	1,783,000	1,330,000
Other	77,371	77,371
<hr/>		
	5,477,024	5,204,659
<hr/>		
	\$ 6,949,803	\$ 7,129,139
	=====	=====

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SPORTS ARENAS, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEETS (CONTINUED)

LIABILITIES AND SHAREHOLDERS' EQUITY

	September 30, 2004	June 30, 2004
	----- (Unaudited)	----- Audited
Current liabilities:		
Current portion of long-term debt	\$ 17,865	\$ 18,071
Accounts payable	192,787	241,540
Accrued payroll and related expenses	254,573	278,286
Accrued income taxes	979,000	979,000
Other liabilities	2,533	--
<hr/>		
Total current liabilities	1,446,758	1,516,897
<hr/>		
Long-term debt, excluding current portion	63,004	67,232
<hr/>		
Deferred taxes liabilities	5,158,000	5,158,000
<hr/>		
Minority interest in consolidated subsidiary	15,000	15,000
<hr/>		

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Commitments and contingencies (Note 4)

Shareholders' equity:

Common stock, \$.01 par value, 50,000,000 shares		
authorized, 10,883,467 issued and outstanding ..	340,521	340,521
Additional paid-in capital	2,038,776	2,038,776
Treasury stock	(915,176)	(915,176)
Retained earnings	(1,197,080)	(1,092,111)
Total shareholders' equity.....	267,041	372,010
	\$ 6,949,803	\$ 7,129,139

See accompanying notes to consolidated condensed financial statements.

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SPORTS ARENAS, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF OPERATIONS
THREE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
(Unaudited)

	2004	2003
Revenues:		
Other	7,719	8,631
Other-related party	14,755	3,404
	22,474	12,035
Costs and expenses:		
Selling, general, and administrative	151,486	183,573
Depreciation and amortization	10,209	5,901
	161,695	189,474
Loss from operations	(139,221)	(177,439)
Other income (charges):		
Investment income:		
Related party	8,599	3,471
Other	--	297
Interest expense and amortization of finance costs	(1,058)	(334)
Equity in income (loss) of investees	(26,635)	26,788
	(19,094)	30,222

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Loss from continuing operations before income taxes..	(158,315)	(147,217)
Income tax benefit	294,000	48,000
	-----	-----
Income (loss) from continuing operations	135,685	(99,217)
	-----	-----
Discontinued operations (Note 7):		
Loss from operations of discontinued segments.....	(399,654)	(529,996)
Income tax benefit	159,000	211,000
	-----	-----
Loss on discontinued operations	(240,654)	(318,996)
	-----	-----
Net loss	\$ (104,969)	\$ (418,213)
	=====	=====
Per common share (based on weighted average shares outstanding) basic and diluted:		
Income (loss) from continuing operations	\$0.01	(\$0.00)
Discontinued operations	(0.02)	(0.01)
	-----	-----
Net loss	(\$0.01)	(\$0.02)
	=====	=====
Weighted average number of shares outstanding	10,883,467	27,250,000
	=====	=====
See accompanying notes to consolidated condensed financial statements.		

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SPORTS ARENAS, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
THREE MONTHS ENDED SEPTEMBER 30, 2004 AND 2003
(Unaudited)

	2004	2003
	-----	-----
Cash flows from operating activities:		
Income (loss) from continuing operations	\$ 135,685	\$ (99,217)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Depreciation and amortization	10,209	5,901
Equity in (income) loss of investees	26,635	(26,788)
Provision for deferred income taxes	(294,000)	(48,000)
Changes in assets and liabilities:		
Decrease in receivables	1,956	372,718
Decrease in prepaid expenses	630	10,302
Increase (decrease) in accounts payable	30,895	(2,825)
Increase (decrease) in accrued expenses	4,442	(38,044)
	-----	-----
Net cash provided (used) by operating activities....	(83,548)	174,047
	-----	-----
Cash flows from investing activities:		
Capital expenditures	--	(97,110)
Distributions from investees	154,000	--
	-----	-----
Net cash provided (used) by investing activities ...	154,000	(97,110)
Net cash used by discontinued operations	(185,504)	(424,209)

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Net cash used by investing activities	(31,504)	(521,319)
<hr/>		
Cash flows from financing activities:		
Scheduled principal payments on long-term debt ...	(4,434)	(2,835)
Proceeds from long-term debt	--	31,871
<hr/>		
Net cash provided (used) by financing activities ...	(4,434)	29,036
<hr/>		
Net decrease in cash and cash equivalents	(119,486)	(318,236)
Cash and cash equivalents, beginning of period	186,716	365,674
<hr/>		
Cash and cash equivalents, end of period	\$ 67,230	\$ 47,438
	=====	=====

See accompanying notes to consolidated condensed financial statements.

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SPORTS ARENAS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
SEPTEMBER 30, 2004 AND 2003 (Unaudited)

1. Basis of Presentation:

The information furnished reflects all adjustments of a recurring nature which management believes are necessary to a fair statement of the Company's financial position, results of operations and cash flows for the interim periods. Certain information and note disclosures normally included in consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company's Annual Report filed on form 10-K on January 3, 2005 for the year ended June 30, 2004.

Due to the seasonal fluctuations of the golf club shaft manufacturing operations, the financial results for the interim periods ended September 30, 2004 and 2003, are not necessarily indicative of operations for the entire year.

2. Revenue Recognition:

The Company recognizes revenue when persuasive evidence of an arrangement exists, delivery has occurred, the amount is fixed or determinable and collectibility is probable. All of these conditions are typically met at the time the Company ships products to its customers.

3. Investment:

The Company's investment consists of a 35 percent beneficial interest in UCV, L.P. (UCV) The following is summarized results of operations of UCV for the periods ended September 30, 2004 and 2003:

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	2004	2003
	-----	-----
Revenues	\$ 971,754	\$ 128,848
Operating and general and administrative costs.....	(296,334)	(32,769)
Depreciation	(282,922)	(17,853)
Interest and amortization of loan costs	(468,597)	(40,790)
	-----	-----
Net income (loss)	\$ (76,099)	\$ 37,436
	=====	=====

4. Contingencies:

A lawsuit was filed on January 10, 2003 in the United States District Court for the Southern District of California by Masterson Marketing, Inc. (Masterson) against Penley Sports, LLC. Masterson's lawsuit originally asserted claims for copyright infringement, breach of contract and breach of fiduciary duty, and sought compensatory damages, punitive damages, statutory damages, and attorney fees. The Company filed a motion to dismiss all claims. In response to that motion, Masterson dropped all claims except those for claims of copyright infringement and breach of contract. Masterson also dropped all prayers for punitive damages, statutory damages, and attorney fees. It is not possible at this time to predict the outcome of this litigation. We intend to vigorously defend against these claims

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5. Business segment information:

As a result of the Company adopting a plan of disposition for the sale of Penley Sports, LLC and reclassifying this activity to discontinued operations, the Company now principally only operates in one business segment, commercial real estate rental, through its investee, UCV. Other revenues, which are not part of an identified segment, consist primarily of property management fees.

6. Liquidity

The accompanying consolidated condensed financial statements have been prepared assuming the Company will continue as a going concern. The Company has suffered recurring losses and is forecasting negative cash flows for the next twelve months. These items raise substantial doubt about the Company's ability to continue as a going concern. The Company's ability to continue as a going concern is dependent on selling the operations of its subsidiary, Penley Sports, and obtaining funds from additional financing of the properties owned by UCV and its subsidiaries. The consolidated financial statements do not contain adjustments, if any, including diminished recovery of asset carrying amounts, that could arise from forced dispositions and other insolvency costs.

7. Discontinued Operations:

On September 16, 2004 the Company committed to a plan of disposal of the graphite golf club shaft operation owned by Penley Sports, LLC (Penley). The Company is currently in negotiations to sell Penley to the former owner, Carter Penley. Carter Penley has verbally agreed to fund any cash flow deficits from November 1, 2004 until a sale is consummated or until the negotiations end. In either event, the Company will not be required to repay the advances unless the Company ceases negotiations without cause.

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As a result of adopting a plan of disposal, the operations related to Penley for both the current period and the prior period, have been restated and recorded as discontinued operations. The operations of Penley included a small sublease of a portion of its leased premises which were included in the real estate operation segment. The following is a summary of the income (loss) from the discontinued business segments:

	2004	2003
	-----	-----
GOLF:		
Revenues.....	\$ 436,586	\$ 609,525
Golf costs	(574,628)	(633,261)
SG&A- direct	(84,164)	(318,004)
SG&A- corporate allocation ...	(135,000)	(147,000)
Depreciation	(42,470)	(41,391)
	-----	-----
Loss	(399,676)	(530,131)
	-----	-----
REAL ESTATE OPERATION:		
Revenues	20,022	19,335
Rental costs	(20,000)	(19,200)
	-----	-----
Loss.....	22	135
	-----	-----
Total loss from discontinued operations	\$ (399,654)	\$ (529,996)
	=====	=====

The following is a summary of the assets and liabilities related to Penley that were included in the balance sheets as of September 30, 2004 and June 30, 2004:

	September 30	June 30
	-----	-----
Assets:		
Trade receivables.....	\$ 145,526	\$ 264,997
Inventories	455,872	605,843
Prepaid expenses	15,933	23,441
Equipment & leasehold improvements.	1,611,946	1,611,946
Accumulated depreciation	(941,105)	(898,635)
Other assets	18,252	18,252
Liabilities:		
Accounts payable	105,081	184,729
Accrued payroll and related.....	21,913	47,535

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL

----- CONDITION AND RESULTS OF OPERATIONS: -----

LIQUIDITY AND CAPITAL RESOURCES -----

The independent auditors' report dated November 15, 2004 included in our June 30, 2004 Annual Report on Form 10-K contained the following explanatory paragraph:

The accompanying consolidated financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in

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Note 11 to the consolidated financial statements, the Company has suffered recurring losses, and is forecasting negative cash flows from operating activities for the next twelve months. These items raise substantial doubt about the Company's ability to continue as a going concern. Management's plans in regard to these matters are also described in Note 11. The consolidated financial statements do not include any adjustments that might result from the outcome of this uncertainty

As noted below, the recurring losses and negative cash flows relate to the Company's golf club shaft manufacturing operations. The Company has not been successful in its efforts to increase sales, reduce manufacturing costs or obtain additional investors for this operation. As a result, on September 16, 2004, the Company committed to a plan of disposal of the graphite golf club shaft operation owned. The Company is currently in negotiations to sell Penley to the former owner, Carter Penley. Carter Penley has verbally agreed to fund any cash flow deficits from November 1, 2004 until a sale is consummated or until the negotiations end. In either event, the Company will not be required to repay the advances unless the Company ceases negotiations without cause.

The Company is expecting a \$200,000 to \$250,000 cash flow deficit in the remaining three quarters of the year ending June 30, 2005 from operating activities after estimated distributions from UCV (\$300,000, primarily distributions from real estate operations), estimated capital expenditures (\$3,000) and scheduled principal payments on long-term debt, excluding any estimated payments to be received from the sale of Penley. This analysis does not include the obligation to pay federal and state income taxes totaling \$979,000 related to the taxable income reported from the sale of apartment project owned by UCV. Management is currently uncertain about how it will obtain the funds to pay these tax liabilities.

Management is currently evaluating other sources of working capital including the proceeds that would become available for distribution to the Company from refinancing the debt related to one of the properties owned by UCV or selling one of the properties owned by UCV. Management has not assessed the likelihood of any other sources of long-term or short-term liquidity. If the Company is not successful in obtaining other sources of working capital this could have a material adverse effect on the Company's ability to continue as a going concern. However, other than the tax liabilities noted above, management believes it will be able to meet its financial obligations for the next twelve months.

The Company has working capital deficit of \$751,212 at September 30, 2004, which is a \$328,883 increase in the working capital of deficit if \$422,329 at June 30, 2004. The increase in working capital deficit is primarily attributable to the cash used by operating activities for the three months ended September 30, 2004.

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One of the properties owned by UCV is subject to a loan agreement that requires Sports Arenas, Inc. to maintain a minimum net worth of \$1,000,000 and a minimum cash balance of \$100,000. As of June 30, 2004 and September 30, 2004, the Company did not meet the net worth requirement and as of September 30, 2004 the Company did not meet the minimum cash requirement. UCV is in the process of requesting a waiver from the lender regarding this covenant. However, it is uncertain whether the lender will grant a waiver. If UCV is unable to obtain a waiver from the lender, the lender could call the loan due.

CRITICAL ACCOUNTING POLICIES

We prepared the consolidated condensed financial statements of the Company in

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conformity with accounting principles generally accepted in the United States of America. As such, we are required to make certain estimates, judgments and assumptions that we believe are reasonable based upon the information available. These estimates and assumptions affect the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the periods presented.

We have several significant accounting estimates, such as; income taxes, long lived assets and accounts receivable and inventories, which were discussed in the Form 10-K for the year ended June 30, 2004, that are both important to the portrayal of our financial condition and results of operations, and require management's most difficult, subjective and complex judgments. Typically, the circumstances that make these judgments complex and difficult have to do with making estimates about the effect of matters that are inherently uncertain. During the three months ended September 30, 2004, we did not make any new accounting estimates that are considered significant accounting estimates other than related to income taxes nor were there any significant changes related to our significant accounting estimates that would have a material impact on our consolidated financial position, results of operations, cash flows or our ability to conduct business.

"SAFE HARBOR" STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

With the exception of historical information (information relating to the Company's financial condition and results of operations at historical dates or for historical periods), the matters discussed in this Management's Discussion and Analysis of Financial Condition and Results of Operations are forward-looking statements that necessarily are based on certain assumptions and are subject to certain risks and uncertainties. These forward-looking statements are based on management's expectations as of the date hereof, and the Company does not undertake any responsibility to update any of these statements in the future. Actual future performance and results could differ from that contained in or suggested by these forward-looking statements as a result of the factors set forth in this Management's Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in the Company's filings with the Securities and Exchange Commission.

RESULTS OF OPERATIONS

As a result of the Company adopting a plan of disposition for the sale of Penley Sports, LLC and reclassifying this activity to discontinued operations, the Company now principally only operates in one business segment, commercial real estate rental, through its investee, UCV. Other revenues, which are not part of an identified segment, consist primarily of property management fees.

Selling, general and administrative costs decreased in 2004 primarily due to a decrease in professional fees. This was partially offset by a decrease in the amount of corporate expenses allocated to the discontinued operations of the golf segment.

Equity in income of investees decreased in 2004 due to the losses incurred from the operation of the one of the three properties owned by UCV which was not included in the quarter ended September 2003 because it was acquired on September 26, 2003. leases.

Discontinued Operations:

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As discussed in Footnote 7 of Notes to Consolidated Condensed Financial Statements, the Company has classified its operations in the golf and real estate rental segments as discontinued operations.

ITEM 3 - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to market risk primarily due to fluctuations in interest rates. The Company and its unconsolidated subsidiary, UCV, utilizes both fixed rate and variable rate debt.

The following table presents scheduled principal payments and related weighted average interest rates of the Company's long-term fixed rate debt for the fiscal years ended June 30:

	2005	2006	2007	2008	2009	Total	Fair Value
	-----	-----	-----	-----	-----	-----	-----
Fixed rate debt	\$13,000	\$19,000	\$20,000	\$21,000	\$8,000	\$81,000	(1) \$81,000
Weighted average interest rate	4.6%	4.6%	4.6%	4.9%	4.9%	4.6%	4.6%

The following table presents scheduled principal payments and related weighted average interest rates of the UCV's long-term fixed rate and variable rate debt for the fiscal years ended June 30:

	2005	2006	2007	2008	2009	Thereafter	Total	F
	-----	-----	-----	-----	-----	-----	-----	-----
Fixed rate debt	\$216,000	\$300,000	\$596,000	\$336,000	\$2,723,000	\$18,493,000	\$22,664,000	\$2
Weighted average interest rate	4.6%	4.6%	4.6%	6.1%	6.0%	6.0%	6.1%	
Variable Rate Debt	\$158,000	\$199,000	\$211,000	\$223,000	\$238,000	\$5,487,000	\$6,516,000	\$
Weighted average interest rate	5.8%	5.8%	5.8%	5.8%	5.8%	5.8%	5.8%	

(1) The fair value of fixed-rate and variable rate debt was estimated based on the current rates offered for fixed-rate debt with similar risks and maturities.

The Company does not enter into derivative or interest rate transactions for speculative or trading purposes.

ITEM 4. CONTROLS AND PROCEDURES

An evaluation was carried out under the supervision and with the participation of the Company's management, including its Chief Executive Officer and its Chief Financial Officer, of the effectiveness of the disclosure controls and procedures (as defined in Rule 13a-14(c) under the Securities and Exchange Act of 1934 (the "Exchange Act") as of September 30, 2004. Based on this evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules

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and forms. There have been no changes in the Company's internal control over financial reporting (as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934) during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. Legal Proceedings

As of September 30, 2004, there were no changes in legal proceedings from those set forth in Item 3 of the Form 10-K filed for the year ended June 30, 2004.

ITEM 2. Changes in Securities

NONE

ITEM 3. Defaults upon Senior Securities

N/A

ITEM 4. Submission of Matters to a Vote of Security Holder

NONE

ITEM 5. Other Information

NONE

ITEM 6. Exhibits & Reports on Form 8-K

(a) Exhibits:

- 31.1 Certification of Chief Executive Officer
- 31.2 Certification of Chief Financial Officer
- 32.1 Certification of Chief Executive Officer pursuant to Sec. 906
- 32.2 Certification of Chief Financial Officer pursuant to Sec. 906

(b) Reports on Form 8-K: NONE

- On July 6, 2004, the Company filed a Current Report on Form 8-K reporting under Item 4 - Changes in Registrant's Certifying Accountant that on June 29, 2004, the Company dismissed KPMG LLP as its Independent Registered Public Accounting Firm and on June 30, 2004, the Company engaged Peterson & Co., LLP as its successor Independent Registered Public Accounting Firm.
- On July 9, 2004, the Company filed a Current Report on Form 8-K reporting under Item 9. Regulation FD Disclosure that on June 30, 2004 the Company, Harold S. Elkan and Andrew Bradley, Inc. entered into a Debt Payment & Extra Compensation Agreement.
- On September 7, 2004, the Company filed a Current Report on Form 8-K reporting under Item 1.01.- Entry into a Material Definitive Agreement that on September 2, 2004, the Company and Harold S. Elkan entered into the Stock Restriction Agreement, with an effective date of June 30, 2004 pursuant to, and as contemplated by, the Debt Payment and Compensation Agreement.

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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.

SPORTS ARENAS, INC.

By: /s/ Harold S. Elkan

Harold S. Elkan, President and Director

Date: January 12, 2005

By:/s/ Steven R. Whitman

Steven R. Whitman, Treasurer,
Principal Accounting Officer and Director

Date: January 12, 2005