

CORRPRO COMPANIES INC /OH/

Form 10-Q/A

February 13, 2004





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**CORRPRO COMPANIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**  
(In Thousands)

	September 30, 2003 (Unaudited)	March 31, 2003 (Audited)
<b>Assets</b>		
Current Assets:		
Cash and cash equivalents	\$ 5,126	\$ 7,037
Accounts receivable, net	25,612	18,156
Other receivables, net	1,410	7,192
Inventories	9,217	8,233
Prepaid expenses and other	4,210	3,436
Assets held for sale	7,551	9,846
	<u>53,126</u>	<u>53,900</u>
Total current assets	53,126	53,900
Property, plant and equipment, net	6,853	6,982
Other Assets:		
Goodwill	14,205	13,343
Other assets	2,768	3,023
Deferred income taxes	451	482
	<u>17,424</u>	<u>16,848</u>
Total other assets	17,424	16,848
	<u>\$ 77,403</u>	<u>\$ 77,730</u>
<b>Liabilities and Shareholders Equity</b>		
Current Liabilities:		
Short-term borrowings and current portion of long-term debt	\$ 48,405	\$ 50,476
Accounts payable	8,976	9,081
Accrued liabilities and other	13,358	12,755
Liabilities held for sale	4,945	3,454
	<u>75,684</u>	<u>75,766</u>
Total current liabilities	75,684	75,766
Long-term debt, net of current portion	649	765
Commitments and contingencies		
Shareholders Equity:		
Serial preferred shares		
Common shares	2,276	2,276
Additional paid-in capital	46,560	46,560
Accumulated deficit	(46,123)	(45,076)
Accumulated other comprehensive loss	(679)	(1,597)
Common shares in treasury, at cost	(964)	(964)
	<u>1,070</u>	<u>1,199</u>
Total shareholders equity	1,070	1,199

\$ 77,403

\$ 77,730

The accompanying Notes to Consolidated Financial Statements are an integral part of these balance sheets.

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**CORRPRO COMPANIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**  
**(UNAUDITED)**  
**(In Thousands, Except Per Share Data)**

	For the Three Months Ended September 30,		For the Six Months Ended September 30,	
	2003	2002	2003	2002
Revenues	\$ 34,433	\$ 31,473	\$ 67,485	\$ 61,162
Operating cost and expenses:				
Cost of sales	22,938	20,939	44,922	41,092
Selling, general & administrative expenses	7,888	9,115	15,864	18,152
Operating income	3,607	1,419	6,699	1,918
Interest expense	1,609	1,535	3,088	2,819
Income from continuing operations before income taxes, discontinued operations and cumulative effect of change in accounting principle	1,998	(116)	3,611	(901)
Provision for income taxes	655	414	1,008	784
Income (loss) from continuing operations before discontinued operations and cumulative effect of change in accounting principle	1,343	(530)	2,603	(1,685)
Discontinued operations:				
Loss from operations, net	(3,223)	(2,828)	(3,604)	(4,120)
Loss on disposal, net of income taxes			(46)	
Cumulative effect of change in accounting principle				(18,238)
Net loss	\$ (1,880)	\$ (3,358)	\$ (1,047)	\$ (24,043)
Earnings (loss) per share Basic:				
Income (loss) from continuing operations	\$ 0.16	\$ (0.06)	\$ 0.31	\$ (0.20)
Discontinued operations:				
Loss from operations, net	(0.38)	(0.34)	(0.42)	(0.49)
Loss on disposal, net of income taxes			(0.01)	
Cumulative effect of change in accounting principle				(2.18)
Net loss	\$ (0.22)	\$ (0.40)	\$ (0.12)	\$ (2.87)
Earnings (loss) per share Diluted:				
Income (loss) from continuing operations	\$ 0.14	\$ (0.06)	\$ 0.28	\$ (0.20)
Discontinued operations:				
Loss from operations, net	(0.34)	(0.34)	(0.38)	(0.49)
Loss on disposal, net of income taxes			(0.01)	
Cumulative effect of change in accounting principle				(2.18)
Net loss	\$ (0.20)	\$ (0.40)	\$ (0.11)	\$ (2.87)
Weighted average shares				
Basic	8,408	8,403	8,408	8,376
Diluted	9,356	8,403	9,382	8,376



The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

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**CORRPRO COMPANIES, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**  
**(UNAUDITED)**  
**(In Thousands)**

	Six Months Ended September 30,	
	2003	2002
<b>Cash flows from operating activities:</b>		
Net loss	\$ (1,047)	\$ (24,043)
Adjustments to reconcile net loss to net cash provided by (used for) operating activities:		
Loss from discontinued operations	3,650	4,120
Depreciation and amortization	1,403	1,487
401(k) matching contribution in Treasury shares		136
Pension Accrual adjustment		498
European Operation impairment charge		450
European Operation currency translation adjustment		(247)
Deferred income taxes	(63)	(69)
Cumulative effect of change in accounting principle		18,238
Gain (loss) on sale of assets	23	(11)
Changes in operating assets and liabilities:		
Accounts and other receivables	(1,331)	2,192
Inventories	(729)	1,203
Prepaid expenses and other	(673)	(1,420)
Other assets	(429)	175
Accounts payable and accrued expenses	51	1,037
	<u>1,902</u>	<u>27,789</u>
Net cash provided by continuing operating activities	<u>855</u>	<u>3,746</u>
<b>Cash flows from investing activities:</b>		
Additions to property, plant and equipment	(306)	(235)
Proceeds from disposal of property, plant and equipment	74	54
	<u>(232)</u>	<u>(181)</u>
Net cash used for investing activities	<u>(232)</u>	<u>(181)</u>
<b>Cash flows from financing activities:</b>		
Net payments under Revolving Credit Facility and lines of credit	(2,886)	(1,807)
	<u>(2,886)</u>	<u>(1,807)</u>
Net cash used for financing activities	<u>(2,886)</u>	<u>(1,807)</u>
Effects on cash of foreign currency exchange rates	216	148
Cash provided by discontinued operations	136	454
Net increase (decrease) in cash and cash equivalents	(1,911)	2,360
Cash and cash equivalents at beginning of period	7,037	4,815
Cash and cash equivalents at end of period	\$ 5,126	\$ 7,175

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**Supplemental disclosures of cash flow information**

Cash paid during the period for:

Income taxes	\$ 252	\$ 544
Interest	\$ 2,545	\$ 2,929

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

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**CORRPRO COMPANIES, INC. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**  
**(In Thousands, Except Per Share Data)**

**NOTE 1 INTERIM FINANCIAL STATEMENTS**

The accompanying interim consolidated financial statements include the accounts of Corrpro Companies, Inc. and subsidiaries (the Company ). All significant intercompany accounts and transactions have been eliminated in consolidation.

The information furnished in the accompanying interim consolidated financial statements has not been audited by independent accountants. In the opinion of management, the interim consolidated financial statements include all adjustments, consisting only of normal and recurring adjustments, necessary for a fair presentation of the consolidated financial position, results of operations and cash flows for the interim periods presented. The results of operations for the three months or for the six months ended September 30, 2003 are not necessarily indicative of the results that may be expected for the fiscal year ending March 31, 2004 or any other period. The interim consolidated financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the fiscal year ended March 31, 2003.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that 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 reporting period. Actual results could differ from those estimates.

**NOTE 2 INVENTORIES**

	<u>September 30, 2003</u>	<u>March 31, 2003</u>
Inventories consist of the following:		
Component parts and raw material	\$ 4,959	\$ 5,250
Finished goods	4,258	2,983
	<u>\$ 9,217</u>	<u>\$ 8,233</u>

**NOTE 3 PROPERTY, PLANT AND EQUIPMENT**

	<u>September 30, 2003</u>	<u>March 31, 2003</u>
Property, plant and equipment consist of the following:		
Land	\$ 532	\$ 443
Buildings and improvements	5,987	4,897
Equipment, furniture and fixtures	16,187	15,610
	<u>22,706</u>	<u>20,950</u>
Less: Accumulated depreciation	(15,853)	(13,968)
	<u>\$ 6,853</u>	<u>\$ 6,982</u>

**NOTE 4 EARNINGS PER SHARE**

Basic earnings per share ( EPS ) is computed by dividing net income for the period by the

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weighted average number of common shares outstanding for the period, which was 8,408 and 8,403 for the three months ended September 30, 2003 and 2002, respectively, and 8,408 and 8,376 for the six months ended September 30, 2003 and 2002, respectively. Diluted EPS for the period has been determined by dividing net income by the weighted average number of common shares and potential common shares outstanding for the period, which was 9,356 and 8,403 for the three months ended September 30, 2003 and 2002, respectively and 9,382 and 8,376 for the six months ended September 30, 2003 and 2002, respectively. Stock options and the warrants are the only potential common shares.

**NOTE 5 STOCK PLANS**

The Company granted options to purchase 10 and 36 common shares under the 1997 Option Plan and the Non-Employee Director Option Plan during the six months ended September 30, 2003 and 2002, respectively. In addition, options previously granted to purchase 120 and 49 common shares at exercise prices ranging from \$1.30 to \$12.10 expired or were forfeited during the six months ended September 30, 2003 and 2002, respectively.

*Stock-based compensation*

As permitted by Statement of Financial Accounting Standard (SFAS), No. 123, Accounting for Stock-Based Compensation, (SFAS 123), the Company accounts for employee stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) and the Financial Accounting Standards Board (FASB) Interpretation No. 44, Accounting for Certain Transactions Involving Stock-Based Compensation, an interpretation of APB Opinion No. 25 (FIN 44) and related interpretations. Stock-based compensation related to non-employees is based on the fair value of the related stock or options in accordance with SFAS 123 and its interpretations. Expense associated with stock-based compensation is amortized over the vesting period of each individual award. The following table illustrates the effect on net income (loss) and income (loss) per common share as if the Black-Scholes fair value method described in SFAS 123 had been applied to the Company's stock option plans:

	For the Three Months Ended September 30,		For the Six Months Ended September 30,	
	2003	2002	2003	2002
Net loss:				
As reported	\$ (1,880)	\$ (3,358)	\$ (1,047)	\$ (24,043)
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	96	80	246	203
Pro forma loss	\$ (1,976)	\$ (3,438)	\$ (1,293)	\$ (24,246)
Basic loss per share:				
As reported	\$ (0.22)	\$ (0.40)	\$ (0.12)	\$ (2.87)
Pro Forma	\$ (0.24)	\$ (0.41)	\$ (0.15)	\$ (2.89)
Diluted loss per share:				
As reported	\$ (0.20)	\$ (0.40)	\$ (0.11)	\$ (2.87)
Pro Forma	\$ (0.21)	\$ (0.41)	\$ (0.14)	\$ (2.89)

For purposes of this pro forma, the fair value of each option grant was estimated using the Black-Scholes option-pricing model. The significant assumptions used were a risk-free interest rate of 3.3%, an expected volatility of 164.0%, an expected life of 10 years and no expected dividends.

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During the quarter ended September 30, 2002, the Company issued warrants to the lenders (see Note 12 Revolving Credit Facility and Senior Notes) under its Revolving Credit Facility and Senior Notes. The warrant issued to the Revolving Credit Facility lender permits the lender to purchase 467 shares at a purchase price of \$0.01 per share, and the warrant issued to the Senior Notes lender permits the lender to purchase up to 467 shares at a purchase price of \$0.01 per share. For purposes of financial reporting, the warrants were valued at \$313 each and the aggregate amount of \$626 increased paid-in-capital and reduced short-term and long-term debt. The \$313 discount per facility was fully amortized by the Revolving Credit Facility termination date of July 2003, and will be fully amortized by the Senior Notes termination date of January 15, 2008.

**NOTE 7 COMPREHENSIVE INCOME**

Accumulated other comprehensive income (loss) is reported separately from retained earnings and additional paid-in-capital in the Consolidated Balance Sheets. Items considered to be other comprehensive income (loss) includes adjustments made for foreign currency translation (under SFAS No. 52) and pensions (under SFAS No. 87).

Components of other accumulated comprehensive loss consist of foreign currency translation adjustments of \$(679) and \$(1,597) as of September 30, 2003 and March 31, 2003, respectively.

Components of comprehensive income (loss) consist of the following:

	<b>Six Months Ended September 30,</b>	
	<b>2003</b>	<b>2002</b>
Net income (loss)	\$ (1,047)	\$ (24,043)
Other Comprehensive income (loss):		
Write-off of translation adjustment related to discontinued operations		3,546
Write-off of translation adjustment related to European operations		(247)
Write-off of Pension		498
Translation adjustment	918	(576)
Total comprehensive income (loss)	\$ (129)	\$ (20,822)

**NOTE 8 ASSETS AND LIABILITIES HELD FOR SALE**

In July 2002, the Company's Board of Directors approved a formal business restructuring plan. The multi-year plan includes a series of initiatives to improve operating income and reduce debt. The Company intends to sell non-core business units and use the proceeds to reduce debt. The Company has engaged outside professionals to assist in the disposition of the domestic and international non-core business units. Prior to the quarter ended September 30, 2002, the Company's non-core domestic and international units were reported as the Other Operations and International Operations reporting segments. Effective as of the quarter ended September 30, 2002, the Other Operations and the International Operations reporting segments have been eliminated and the non-core domestic and

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international units are reported as discontinued operations. Prior-year financial statements have been reclassified to reflect these non-core units as discontinued operations, which are also referred to as assets and liabilities held for sale.

In the second quarter of fiscal 2004, the Company's Board of Directors had approved a resolution to keep the European Operations and remove them from discontinued operations. After careful deliberation, the Board concluded that due to the strength of the local management team, the similar characteristics of the served markets, and the favorable prospects for this business, the Company's value would be enhanced by maintaining our European presence rather than by selling the operations at this time. Effective in the second quarter of fiscal 2004, the Company reported quarterly and annual results of the European Operations in its continuing operations. Prior-year financial statements have been reclassified to reflect the European Operations as continuing operations. See Note 11 Business Segments for the effect of the change in income from operations as a result of the resolution to keep the European Operations.

Assets and liabilities held for sale as of September 30, 2003 and March 31, 2003 consisted of:

	<b>September 30, 2003</b>	<b>March 31, 2003</b>
	<u>          </u>	<u>          </u>
Cash	\$ 1,009	\$ 1,296
Accounts receivable	3,625	4,656
Inventory	1,189	1,394
Prepaid expenses	1,843	2,173
Property, plant and equipment, net	(263)	(101)
Goodwill and other assets	148	428
	<u>          </u>	<u>          </u>
Assets held for sale	<b>\$ 7,551</b>	<b>\$ 9,846</b>
	<u>          </u>	<u>          </u>
Current liabilities	\$ 4,945	\$ 3,525
Deferred taxes		(71)
	<u>          </u>	<u>          </u>
Liabilities held for sale	<b>\$ 4,945</b>	<b>\$ 3,454</b>
	<u>          </u>	<u>          </u>

The Company allocated interest to discontinued operations of \$66 and \$411 for the three months ended September 30, 2003 and 2002, respectively, and \$255 and \$813 for the six months ended September 30, 2003 and 2002, respectively, based on estimated proceeds from the discontinued operations disposition that will be used to pay down the Revolving Credit Facility and Senior Notes (see Note 12 Revolving Credit Facility and Senior Notes). The interest rate used to calculate the interest expense allocated was the weighted average interest rate of the Revolving Credit Facility and Senior Notes.

Potential operating gains or losses may be experienced with the disposition of the non-core assets at the time of disposal during implementation of the restructuring plan. Listed below are the statements of operations for discontinued operations for the three months ended September 30, 2003 and 2002 and six months ended September 30, 2003 and 2002.



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	<b>For the Three Months Ended September 30,</b>		<b>For the Six Months Ended September 30,</b>	
	<b>2003</b>	<b>2002</b>	<b>2003</b>	<b>2002</b>
Revenues	\$ 2,610	\$ 7,592	\$ 6,076	\$ 13,833
Operating cost and expenses:				
Cost of sales	2,003	5,028	4,687	9,111
Selling, general & administrative expenses	3,764	4,903	4,738	7,951
Operating income (loss)	(3,157)	(2,339)	(3,349)	(3,229)
Loss on disposal			46	
Interest expense	66	411	255	813
Income (loss) from discontinued operations before income taxes	(3,223)	(2,750)	(3,650)	(4,042)
Provision for income taxes		78		78
Income (loss) from discontinued operations	\$ (3,223)	\$ (2,828)	\$ (3,650)	\$ (4,120)

During the second quarter of fiscal 2004, the Company recorded an impairment charge relating to its Middle East Operations of \$3,278. During the first quarter of fiscal 2004, the Company sold its Asia Pacific Operations for a net loss of \$46 after taking into account an impairment charge on net assets which was recorded during the fourth quarter of fiscal 2003 totaling \$1,575. During fiscal 2003, the Company disposed of four non-strategic business units. First, in March 2003, the Company sold its Bass Trigon Software business unit for \$3,150 and recognized a gain of \$194. Also, in March 2003, the Company recorded a note receivable for \$6,232, for which the Company collected \$5,932 on April 2, 2003, for its Rohrbach Cosasco Systems subsidiary and recognized a gain of \$1,809. The Company also disposed of two smaller international offices with a net gain of \$92 during fiscal 2003. The net proceeds from dispositions were used to pay down debt.

**NOTE 9 RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In January 2003, the Financial Accounting Standards Board ( FASB ) issued Interpretation No. 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. This Interpretation addresses the consolidation by business enterprises of various interest entities as defined in the Interpretation. The Company does not expect the adoption of this Interpretation to have a material impact on its results of operations or financial position.

In April 2003, the FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. This statement amends SFAS No. 133 for decisions made (1) as part of the Derivatives Implementation Group process that effectively required amendments to SFAS No. 133, (2) in connection with other FASB projects dealing with financial instruments and (3) in connection with implementation issues raised in relation to the application of the definition of a derivative. This statement is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003, with certain exceptions. The Company has adopted SFAS No. 149 and the adoption has not had a material impact on its results of operations or financial position.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments and Characteristics of both Liabilities and Equity which requires freestanding financial instruments such as mandatorily redeemable shares, forward purchase contracts and written put options to be reported as liabilities by their issuers as well as related new disclosure requirements. The provisions of SFAS No. 150 are effective for instruments entered into or modified after May 31, 2003 and pre-existing instruments as of the beginning of the first interim period that commences after June 15, 2003.

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The application of this statement has not had an effect on the Company's consolidated financial statements.

**NOTE 10 PRODUCT WARRANTIES**

In the normal course of business, we provide warranties and indemnifications for our products and services. We provide warranties that the products we distribute are in compliance with prescribed specifications. In addition, we have indemnity obligations to our customers for these products, which have also been provided to us from our suppliers, either through express agreement or by operation of law.

At September 30, 2003, accrued warranty costs were not material to the consolidated balance sheet.

**NOTE 11 BUSINESS SEGMENTS**

In July 2002, the Company's Board of Directors approved a formal business restructuring plan. The multi-year plan includes a series of initiatives to improve operating income and reduce debt. The Company intends to sell non-core business units and use the proceeds to reduce debt. The Company has engaged outside professionals to assist in the disposition of the domestic and international non-core business units. Prior to the quarter ended September 30, 2002, the Company's non-core domestic and international units were reported as the Other Operations and International Operations reporting segments. Effective as of the quarter ended September 30, 2002, the Other Operations and the International Operations reporting segments have been eliminated and the non-core domestic and international units are reported as discontinued operations. Prior-year financial statements have been reclassified to reflect these non-core units as discontinued operations, which are also referred to as assets and liabilities held for sale.

In the second quarter of fiscal 2004, the Company's Board of Directors had approved a resolution to keep the European Operations and remove them from discontinued operations. After careful deliberation, the Board concluded that due to the strength of the local management team, the similar characteristics of the served markets, and the favorable prospects for this business, the Company's value would be enhanced by maintaining our European presence rather than by selling the operations at this time. Effective in the second quarter of fiscal 2004, the Company reported quarterly and annual results of the European Operations in its continuing operations. Prior-year financial statements have been reclassified to reflect the European Operations as continuing operations.

We have organized our operations into three business segments: Domestic Core Operations, Canadian Operations and European Operations. Our business segments and a description of the products and services they provide are described below:

*Domestic Core Operations.* The Domestic Core Operations segment consists of the Company's operations in the United States, which provide products and services including corrosion control, coatings, pipeline integrity, risk assessment and inspection services. This segment provides corrosion control products and services to a wide-range of customers in a number of industries including: energy, utilities, water and wastewater treatment, chemical and petrochemical, pipelines, defense and municipalities. In addition, this segment provides coatings services to customers in the entertainment, aerospace, transportation, petrochemical and electric power industries, as well as inspection services to customers in the pharmaceutical, chemical and energy industries. Finally, this segment includes a

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production facility in the United States that assembles and distributes cathodic protection products, such as anodes, primarily to the United States market.

*Canadian Operations.* The Canadian Operations segment provides corrosion control, pipeline integrity and inspection services to customers in Canada who are primarily in the oil and gas industry. These customers include pipeline operators, petrochemical plants and refineries. The Canadian Operations segment also includes production facilities that assemble products such as anodes and rectifiers.

*European Operations.* The European Operations segment provides corrosion control products and services to customers in the petroleum, utility, industrial, marine and offshore markets, as well as to governmental entities in connection with their infrastructure assets.

Financial information relating to the Company's operations by segment are presented below:

	For the Three Months Ended September 30,		For the Six Months Ended September 30,	
	2003	2002	2003	2002
<b>Revenue:</b>				
Domestic Core Operations	\$ 24,820	\$ 23,105	\$ 48,798	\$ 45,560
Canadian Operations	6,522	5,180	12,219	9,561
European Operations	3,091	3,188	6,468	6,041
	<u>\$ 34,433</u>	<u>\$ 31,473</u>	<u>\$ 67,485</u>	<u>\$ 61,162</u>
<b>Operating Income:</b>				
Domestic Core Operations	\$ 4,108	\$ 3,553	\$ 8,529	\$ 6,876
Canadian Operations	1,840	1,500	2,814	2,243
European Operations	382	(563)	735	(303)
Corporate Related Costs and Other	(2,723)	(3,071)	(5,379)	(6,898)
	<u>\$ 3,607</u>	<u>\$ 1,419</u>	<u>\$ 6,699</u>	<u>\$ 1,918</u>

**NOTE 12 REVOLVING CREDIT FACILITY AND SENIOR NOTES**

*Revolving Credit Facility.* In March 1999, the Company entered into an \$80 million revolving credit facility that originally expired on April 30, 2002 (the "Revolving Credit Facility"). Initial borrowings were used to repay existing domestic bank indebtedness. Through a series of subsequent amendments, including an amendment executed by the Company on November 14, 2003 and effective as of October 31, 2003, (the "November 2003 Revolver Amendment"), the size of the Revolving Credit Facility was reduced to \$27.5 million and the expiration date was extended to January 31, 2004. Borrowings under the Revolving Credit Facility are further limited to borrowing base amounts as defined. The Revolving Credit Facility provides for interest on borrowings at prime plus 5.00% and requires the Company to pay a facility fee of 1.00% on the commitment amount. The rate at September 30, 2003 was 9.0%.

Borrowings under the Revolving Credit Facility, as amended, are secured by the Company's domestic accounts receivable, inventories, certain intangibles, machinery and equipment and owned real estate as well as certain assets in Canada. The Company also has pledged slightly less than two-thirds of the capital stock of two of its foreign subsidiaries. The Revolving Credit Facility, as amended,

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requires the Company to maintain certain financial ratios and places limitations on the Company's ability to pay cash dividends, incur additional indebtedness and make investments, including acquisitions. At September 30, 2003, the Company had \$21,887 outstanding under the Revolving Credit Facility. Total availability under the Revolving Credit Facility at September 30, 2003 was approximately \$1,298, after giving consideration to the borrowing base limitations, under the Revolving Credit Facility. At September 30, 2003, the Company was in compliance with the financial covenants under the Revolving Credit Facility, as amended by the November 2003 Revolver Amendment.

Under the terms of the amendments to the Revolving Credit Facility, any cash proceeds from the disposition of targeted Company assets will be used to reduce the Revolving Credit Facility and the Senior Notes in a ratio of 56% and 44%, respectively. Any net asset disposition payments to reduce the Revolving Credit Facility will result in a proportionate reduction in the lender's commitments in the Revolving Credit Facility.

In connection with the Sixth Amendment to the Revolving Credit Facility, the lender group received a warrant ( Revolving Credit Facility Warrant ) to purchase 467 of the Company's common shares at a purchase price of \$0.01 per share exercisable at any time after July 31, 2003 until September 23, 2012. The Revolving Credit Facility Warrant contains a provision which permitted the Company to reduce the amount of the Revolving Credit Facility Warrant by up to 50% based upon prepayments of principal made by the Company under the Revolving Credit Facility prior to July 31, 2003 with cash proceeds received from the disposition of targeted Company assets. These prepayments resulted in the Revolving Credit Facility Warrant being reduced by approximately 82 common shares at July 31, 2003.

*Senior Notes.* In January 1998, the Company issued, through a private placement, \$30 million of Senior Notes due 2008 (the Senior Notes ). Through a series of subsequent amendments, including an amendment executed by the Company on November 14, 2003 and effective as of October 31, 2003 (the November 2003 Senior Notes Amendment ), the terms and conditions of the Senior Notes have been modified to, among other things, change the interest rate payable on the Senior Notes and to defer certain principal payments thereunder. The Senior Notes, as amended, bear interest at 11.35% until January 31, 2004. In addition, the agreement relating to the Senior Notes (the Senior Notes Agreement ), as amended, provides for any overdue amount to bear an interest rate of the greater of 13.35% or 2.00% over the rate of interest publicly announced by The Bank of New York from time to time in New York City as its Prime Rate on the outstanding principal payments and overdue amounts.

The Senior Notes require a principal payment of \$8,712, which has been deferred pursuant to the November 2003 Senior Notes Amendment to January 31, 2004, and monthly principal payments of \$384, the commencement of which has been similarly deferred until February 15, 2004 ( Notes Principal Repayments ) and are secured equally and ratably with debt under the Revolving Credit Facility. In addition, the Senior Notes Agreement, as amended, provides that any cash proceeds from the disposition of targeted Company assets will be used to reduce the Revolving Credit Facility and the Senior Notes in a ratio of 56% and 44%, respectively. The Company is required to maintain certain financial ratios under the Senior Notes Agreement. As of September 30, 2003, the Company is currently in compliance with the financial covenants under the amended Senior Notes Agreement.

Within the Senior Notes Agreement is a yield maintenance amount provision, which ensures that the lender is paid the entire interest amount of the Senior Notes. The yield maintenance amount provisions apply to certain optional prepayments of principal under the Senior Notes and provides that the Senior Notes shall be subject to prepayment, in whole at any time or from time to time in part, at the option of the Company, at 100% of the principal amount so prepaid plus interest thereon to the

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prepayment date and the yield maintenance amount, if any, with respect to each Senior Note. Any partial prepayment of the Senior Notes, which meet certain criteria, shall be applied against the principal amount of the Senior Notes scheduled to become due in the inverse order of maturity thereof. Fiscal year 2003 results include an interest charge of approximately \$1,045 relating to the yield maintenance amount provisions of the Senior Notes Agreement.

In connection with prior amendments in September 2002, the Senior Notes lender received a warrant ( Senior Notes Warrant ) to purchase 467 of the Company's Common Shares at a purchase price of \$0.01 per share exercisable at any time after July 31, 2003 until September 23, 2012. The Senior Notes Warrant contains a provision which permitted the Company to reduce the amount of the Senior Notes Warrant by up to 50% based upon prepayments of principal made by the Company under the Senior Notes prior to July 31, 2003 with cash proceeds received from the disposition of targeted Company assets. These prepayments resulted in the Senior Notes Warrant being reduced by approximately 82 common shares at July 31, 2003.

*The Proposed Transaction.* As previously publicly reported, the Company has entered into a non-binding letter of intent with an undisclosed investment firm with respect to the recapitalization and refinancing of the Company (the Proposed Transaction ). The Proposed Transaction is subject to a number of conditions, including that the parties secure commitments for senior and subordinated debt financing and that the parties enter into definitive agreements. In addition, the proposed transaction would require approval from the Company's shareholders as well as from the lenders under both the Revolving Credit Facility and the Senior Notes. Each of the November 2003 Revolver Amendment and the November 2003 Senior Notes Amendment requires the Company to meet certain milestones related to its efforts to consummate the Proposed Transaction, which the Company has satisfied to date. There can be no assurance that the Proposed Transaction will be consummated, and if consummated, what the terms for such transaction will be.

If the Company cannot successfully consummate the Proposed Transaction on or before January 31, 2004, it will need to negotiate arrangements with its lenders to, among other things, extend the maturity of the Revolving Credit Facility and defer the Notes Principal Repayments beyond January 31, 2004. There can be no assurance, however, that the Company will be able to reach acceptable arrangements with its existing lenders or on what terms such arrangements would be. If the Company is not able to negotiate mutually acceptable arrangements with its existing lenders, events could occur that would have a material adverse effect on the Company's liquidity and financial condition and could result in its inability to operate as a going concern. If the Company is unable to operate as a going concern, it may file, or have no alternative but to file, bankruptcy or insolvency proceedings or pursue a sale or sales of assets to satisfy creditors.

### **NOTE 13 CUMULATIVE EFFECT OF CHANGE IN ACCOUNTING PRINCIPLE**

In June 2001, Statement of Financial Accounting Standards No. 141, Business Combinations ( SFAS 141 ), and Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets ( SFAS 142 ), were issued by the Financial Accounting Standards Board. SFAS 141 eliminates the pooling-of-interests method for business combinations and requires the use of the purchase method and establishes criteria to be used in determining whether acquired intangible assets are to be separated from goodwill.

In July 2001, Statement of Financial Accounting Standards No. 142, Goodwill and Other

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Intangible Assets ( SFAS 142 ), were issued by the Financial Accounting Standards Board. SFAS 142 changes the accounting for goodwill and indefinite life intangibles from an amortization approach to a non-amortization approach, and require periodic tests for impairment of these assets. Upon the Company's adoption of SFAS 142 on April 1, 2002, the provisions of SFAS 142 required the discontinuance of amortization of goodwill and indefinite life intangibles that had been recorded in connection with previous business combinations. The Company has completed its initial impairment testing as of April 1, 2002 under SFAS 142 and recorded an impairment loss totaling \$18,238 of which \$11,832 related to discontinued operations and \$6,406 related to continuing operations. The loss was recognized as the cumulative effect of a change in accounting principle. This impairment testing is also done annually in the fourth quarter and such testing indicated no additional impairment as of March 31, 2003.

Amortizable intangibles at September 30, 2003 amounted to a net book value of \$994. These intangibles are primarily related to patents and trademarks with useful lives ranging from 3 to 15 years. Amortization expense for each of the next five years is expected to be \$242.

**NOTE 14 SUBSEQUENT EVENT**

During the second quarter of fiscal 2004, the Company recorded an impairment charge relating to its Middle East Operations. Subsequent to the second quarter of fiscal 2004, the Company has signed a purchase agreement with an undisclosed buyer of its Middle East Operations. The transaction is anticipated to close prior to the fiscal 2004 year-end but is subject to local government approval and other closing conditions. There can be no assurance that this transaction will be completed.

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### **ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**

#### **General**

Corrpro Companies, Inc. was founded in 1984 and is organized under the laws of the State of Ohio. As used in this report, the terms "Corrpro" and the "Company" mean Corrpro Companies, Inc. and its consolidated subsidiaries unless the context indicates otherwise.

#### **Products and Services**

Corrpro provides corrosion control related services, systems, equipment and materials to the infrastructure, environmental and energy markets. Our products and services include (i) corrosion control engineering services, systems and equipment ("corrosion control"), (ii) coatings services ("coatings") and (iii) pipeline integrity and risk assessment services.

**Corrosion Control.** Corrpro's specialty in the corrosion control market is cathodic protection. We offer a comprehensive range of services in this area, which include the design, manufacture, installation, maintenance and monitoring of cathodic protection systems. Cathodic protection is an electrochemical process that prevents corrosion for new structures and stops the corrosion process for existing structures. It can provide a cost-effective alternative to the replacement of corroding structures. In order to understand how cathodic protection works, it is helpful to first understand the corrosion process. Steel, the most common metal protected by cathodic protection, is produced from iron ore. To produce steel, the iron ore is subjected to a refining process that adds energy. Once the steel is put back into the environment, it begins to revert back to its original state (i.e., iron ore) by releasing the added energy back into the surrounding environment. This process of dispersing energy is called corrosion. Cathodic protection electrodes, called anodes, are placed near, and connected to, the structure to be protected (i.e., the cathode). Anodes are typically made from cast iron, graphite, aluminum, zinc or magnesium. A cathodic protection system works by passing an electrical current from the anode to the cathode. This process maintains the energy level on the cathode, thus stopping it from corroding. Instead, the anode corrodes, sacrificing itself to maintain the integrity of the structure. In order for the electrical current to pass from the anode to the cathode, they both must be in a common environment. Therefore, cathodic protection can only be used to protect structures that are buried in soil, submerged in water or encased in concrete. Structures commonly protected against corrosion by the cathodic protection process include oil and gas pipelines, offshore platforms, above and underground storage tanks, ships, electric power plants, bridges, parking garages, transit systems and water and wastewater treatment equipment.

In addition to cathodic protection, our corrosion control services include corrosion engineering, material selection, inspection services, advanced corrosion research and testing. We also sell a variety of materials and equipment including anodes, rectifiers and corrosion monitoring probes used in cathodic protection and corrosion monitoring systems.

**Coatings.** Corrpro offers a wide variety of coatings-related services designed to provide our customers with longer coatings life, reduced corrosion, improved aesthetics and lower life-cycle costs for their coated structures. Coatings services include research, testing, evaluation and application of coatings. In addition, we provide project management services for coatings maintenance programs, including condition surveys, failure analysis, selection of site surface preparation methods and selection and application of coatings. We also provide specialized coatings application services for structures

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with aggressive corrosion conditions such as the inside and outside of storage tanks and pipelines.

***Pipeline Integrity and Risk Assessment Services.*** Corrpro offers a comprehensive line of pipeline integrity, risk assessment and inspection services, including assessment, surveys, inspection, analysis, repairs and ongoing maintenance. By offering a wide range of services, we are able to provide pipeline owners with one-stop shopping for the preservation of their pipeline systems.

## **Dispositions**

In July 2002, the Company's Board of Directors approved a formal business restructuring plan. The multi-year plan includes a series of initiatives to improve operating income and reduce debt. The Company intends to sell non-core business units and use the proceeds to reduce debt. The Company has engaged outside professionals to assist in the disposition of the domestic and international non-core business units. Prior to the quarter ended September 30, 2002, the Company's non-core domestic and international units were reported as the Other Operations and International Operations reporting segments. Effective as of the quarter ended September 30, 2002, the Other Operations and the International Operations reporting segments have been eliminated and the non-core domestic and international units are reported as discontinued operations. Prior-year financial statements have been reclassified to reflect these non-core units as discontinued operations, which are also referred to as assets and liabilities held for sale.

In the second quarter of fiscal 2004, the Company's Board of Directors had approved a resolution to keep the European Operations and remove them from discontinued operations. Effective in the second quarter of fiscal 2004, the Company reported quarterly and annual results of the European Operations in its continuing operations. Prior-year financial statements have been reclassified to reflect the European Operations as continuing operations.

During fiscal 2004, the Company sold its Asia Pacific Operations for a minimal loss after taking into account an impairment charge on net assets which was recorded during the fourth quarter of fiscal 2003 totaling \$1.6 million. During fiscal 2003, four non-strategic business units were sold. These dispositions included Rohrback Cosasco Systems subsidiary, Bass Trigon Software business unit and two smaller international offices. The proceeds from these dispositions were used to pay down debt. For further information about our discontinued operations see Note 8, Assets and Liabilities Held for Sale, Notes to Consolidated Financial Statements.

## **Segments**

We have organized our operations into three business segments: Domestic Core Operations, Canadian Operations and European Operations. Our non-core domestic, which were sold in fiscal 2003, our Asia Pacific, which was sold in the first quarter of fiscal 2004, and our Middle East Operations are reported as discontinued operations. Our business segments and a description of the products and services they provide are described below:

***Domestic Core Operations.*** The Domestic Core Operations segment consists of the Company's operations in the United States, which provide products and services including corrosion control, coatings, pipeline integrity, risk assessment and inspection services. This segment provides corrosion control products and services to a wide-range of customers in a number of industries including: energy, utilities, water and wastewater treatment, chemical and petrochemical, pipelines, defense and municipalities. In addition, this segment provides coatings services to customers in the entertainment,



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aerospace, transportation, petrochemical and electric power industries, as well as inspection services to customers in the pharmaceutical, chemical and energy industries. Finally, this segment includes a production facility in the United States that assembles and distributes cathodic protection products, such as anodes, primarily to the United States market.

**Canadian Operations.** Our Canadian Operations segment provides corrosion control, pipeline integrity and inspection services to customers in Canada, which are primarily in the oil and gas industry. These customers include pipeline operators and petrochemical plants and refineries. The Canadian Operations segment also includes production facilities that assemble products such as anodes and rectifiers.

**European Operations.** The European Operations segment provides corrosion control products and services to customers in the petroleum, utility, industrial, marine and offshore markets, as well as to governmental entities in connection with their infrastructure assets.

**A. RESULTS OF OPERATIONS Three Months Ended September 30, 2003 Compared to Three Months Ended September 30, 2002 Revenues**

Revenues from continuing operations for the fiscal 2004 second quarter totaled \$34.4 million compared to \$31.5 million in the fiscal 2003 second quarter, an increase of \$2.9 million, or 9.4%. Revenues from the discontinued operations were \$2.6 million in the fiscal 2004 second quarter compared to \$7.6 million in the prior-year period. The decrease in discontinued operations is primarily attributable to the sale of several discontinued businesses.

Fiscal 2004 second quarter revenues relating to our Domestic Core Operations segment totaled \$24.8 million compared to \$23.1 million in the fiscal 2003 second quarter, an increase of \$1.7 million or 7.4%. This revenue increase relates primarily to a large engineering project that started in late calendar 2002 and is scheduled to continue into fiscal year 2005. Also, contributing to this increase were improved revenue levels in our coatings services and material sales businesses compared to the prior-year period.

Our Canadian Operations segment revenues for the second quarter of fiscal 2004 totaled \$6.5 million compared to \$5.2 million in the prior-year second quarter, an increase of \$1.3 million or 25.9%. This increase is due primarily to increased volume of material and rectifier sales as well as increases in the energy segment of our business.

Our European Operations segment revenues for the second quarter of fiscal 2004 totaled \$3.1 million compared to \$3.2 million in the prior-year second quarter, a decrease of \$0.1 million or 3.1%. Revenues remained relatively flat quarter-over-quarter.

**Gross Profit**

Gross profit margins were 33.4% for the fiscal 2004 second quarter compared to 33.5% for the fiscal 2003 second quarter. Gross margins continue to benefit from a number of high margin jobs offset by lower margin material sales in our Domestic Core Operations and Canadian Operations, as well as our overall continued effort to improve operating efficiencies and productivity.

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### **Selling, General and Administrative Expenses**

Selling, general and administrative expenses totaled \$7.9 million (22.9% of revenues) for the fiscal 2004 second quarter compared to \$9.1 million (29.0% of revenues) in the fiscal 2003 second quarter, a decrease of \$1.2 million. The fiscal 2004 second quarter had \$0.6 million related to professional fees associated with our lender requirements while the fiscal 2003 second quarter had \$0.7 million in professional fees related to lender requirements, \$0.7 million of pension expense related to our European Operations and a \$0.5 million impairment charge recorded for our European Operations. Selling, general and administrative expenses, as a percentage of revenue, continue to show positive results from our efforts to streamline our operations.

### **Operating Income from Continuing Operations**

Operating income totaled \$3.6 million in the second quarter of fiscal 2004 compared to \$1.4 million for the fiscal 2003 second quarter, an increase of \$2.2 million. The increase in operating income in the fiscal 2004 second quarter resulted from improved revenue levels and lower operating expenses.

### **Interest Expense**

Interest expense totaled \$1.6 million in the second quarter of fiscal 2004 compared to \$1.5 million in the fiscal 2003 second quarter, an increase of \$0.1 million. Interest rates increased as a result of amending our credit facilities, which were partially offset by lower debt levels.

### **Income Tax Provision**

The Company recorded a provision for income taxes of \$0.7 million for the fiscal 2004 second quarter compared to a provision of \$0.4 million for the fiscal 2003 second quarter. Our income tax provision is based on our effective tax rate. Our effective tax rate is based on the statutory rates in effect in the countries in which we operate. The Company recorded a provision below the statutory tax rate of 34% since the Company has utilized the tax benefits of losses in the Domestic Core Operations for which a previously recorded valuation allowance has been provided for. The Company intends to maintain a full valuation allowance on its domestic net deferred tax assets and net operating loss carry-forwards until sufficient evidence exists to support the reversal of the remaining reserve.

### **Income (Loss) from Continuing Operations**

Income from continuing operations for the fiscal 2004 second quarter was \$1.3 million compared to a loss of \$0.5 million in the second quarter of fiscal 2003, an increase of \$1.8 million. The fiscal 2004 second quarter increase in operating income is the result of improved revenue levels improved operating efficiencies and our overall efforts to streamline operations.

### **Discontinued Operations**

Loss from discontinued operations for the fiscal 2004 second quarter was \$3.2 million compared to a loss from discontinued operations of \$2.8 million in the prior-year period, an increase of \$0.4 million. Also, during the second quarter of fiscal 2004, the Company recorded a \$3.3 million impairment charge on net assets related to its Middle East Operations, which is included in discontinued operations.

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**Net Loss**

Net loss totaled \$1.9 million in the second quarter of fiscal 2004 compared to a net loss of \$3.4 million in the prior-year period, an increase in earnings of \$1.5 million. Loss per share on a diluted basis totaled \$0.20 per share compared to \$0.40 in the year-earlier period.

**RESULTS OF OPERATIONS Six months ended September 30, 2003 Compared to  
Six months ended September 30, 2002**

**Revenues**

Revenues from continuing operations for the six months ended September 30, 2003 totaled \$67.5 million compared to prior-year revenues of \$61.2 million, an increase of \$6.3 million or 10.3%. Revenues from the discontinued operations were \$6.1 million for the first six months of fiscal 2004 compared to \$13.8 million in the prior-year period, a decrease of \$7.8 million. The decrease in discontinued operations is primarily attributable to the sale of several discontinued businesses.

For the six months ended September 30, 2003, revenues relating to the Domestic Core Operations totaled \$48.8 million compared to prior-year results of \$45.6 million, an increase of \$3.2 million or 7.1%. This revenue increase relates primarily to a large engineering project that started in late calendar 2002 and is scheduled to continue into fiscal year 2005. Also contributing to this increase were improved revenue levels in our coatings services and material sales businesses compared to the prior-year period.

The Canadian Operations revenues for the six months ended September 30, 2003 totaled \$12.2 million compared to prior-year results of \$9.6 million, an increase of \$2.7 million or 27.8%. The increase is primarily due to increased material and rectifier sales. The increase is due primarily to increased volume of material and rectifier sales as well as increases in the energy segment of our business.

The European Operations revenues for the six months ended September 30, 2003 totaled \$6.5 million compared to prior-year results of \$6.0 million, an increase of \$0.5 million or 7.1%. The increase is primarily due to improved volume levels of material sale year-over-year.

**Gross Profit**

Consolidated gross profit margins were 33.4% for the six months ended September 30, 2003 compared to 32.8% for the prior-year period. Gross margins continue to benefit from a number of high margin jobs in both the Domestic Core Operations and the Canadian Operations.

**Selling, General and Administrative Expenses**

Selling, general and administrative expenses totaled \$15.9 million (23.5% of revenues) for the six months ended September 30, 2003 compared to \$18.2 million (29.7% of revenues) for the prior-year period. Selling, general and administrative expenses for the six months ended September 30, 2003 had \$1.0 million related to professional fees associated with our lender requirements while the prior-year period had \$1.6 million in professional fees related to lender requirements, \$0.7 million related to pension expense related to our European Operations and a \$0.5 million impairment charge recorded for our European Operations. Selling, general and administrative expenses, as a percentage of revenue,

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continue to show positive results from our efforts to streamline our operations.

### **Operating Income from Continuing Operations**

Operating income from continuing operations totaled \$6.7 million for the six months ended September 30, 2003 compared to \$1.9 million in the prior-year period, an increase in earnings of \$4.8 million. This increase is primarily related to the prior-years restructuring costs incurred and improved revenues generated during the current fiscal year.

### **Interest Expense**

Interest expense totaled \$3.1 million for the six months ended September 30, 2003 compared to \$2.8 million in the prior-year period. Interest rates increased as a result of amending our credit facilities, which were partially offset by the lower debt levels.

### **Income Tax Provision**

The Company recorded a provision for income taxes of \$1.0 million for the six months ended September 30, 2003 compared to a provision of \$0.8 million in the prior-year period. Our income tax provision is based on our effective tax rate. Our effective tax rate is based on the statutory rates in effect in the countries in which we operate. The Company recorded a provision below the statutory tax rate of 34% since the Company has not realized the tax benefits of losses in the domestic operations for which a previously recorded valuation allowance has been provided for. The Company intends to maintain a full valuation allowance on its domestic net deferred tax assets and net operating loss carryforwards until sufficient evidence exists to support the reversal of the remaining reserve.

### **Income (Loss) from Continuing Operations**

The income from continuing operations totaled \$2.6 million for the six months ended September 30, 2003 compared to a loss of \$1.7 million of income from continuing operations in the prior-year period, an increase in earnings of \$4.3 million. The fiscal 2004 six months operating income is the result of improved revenue levels, improved operating efficiencies and our overall efforts to streamline operations.

### **Discontinued Operations**

Loss from discontinued operations for the first six months of fiscal 2004 was \$3.7 million compared to \$4.1 million in the prior-year period, a decrease in loss of \$0.4 million. The decreased loss is primarily related to the fact that several non-core businesses had been disposed of during the fiscal 2003 year. This improvement was partially offset by a \$3.3 million impairment charge on net assets related to its Middle East Operations, which was recorded in first six months of fiscal 2004 and is included in the discontinued operations.

### **Cumulative Effect of Change in Accounting**

During the six months ended September 30, 2002, the Company, with the assistance of independent valuation experts, completed its initial assessment test and concluded that certain of its goodwill was impaired. Effective April 1, 2002, the Company has recognized a transitional impairment charge of \$18.2 million as the cumulative effect of a change in accounting principle to reduce the

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carrying values of certain indefinite lived intangible assets and goodwill to estimated fair values as required by SFAS No. 142. This is a non-cash charge and does not impact compliance with the financial covenants contained in our lender agreements.

### **Net Loss**

Net loss totaled \$1.0 million for the six months ended September 30, 2003 compared to \$24.0 million in the prior-year period, an improvement of \$23.0 million, which was primarily attributable to non-cash goodwill impairment charges as a result of a change in accounting principle in the prior-year, improved revenue levels, improved operating efficiencies and our overall efforts to streamline operations. Loss per share on a diluted basis totaled \$0.11 per share compared to \$2.87 per share in the prior-year period.

### **B. LIQUIDITY AND CAPITAL RESOURCES**

At September 30, 2003, the Company had negative working capital of \$25.2 million excluding net assets held for sale, compared to negative \$28.3 million at March 31, 2003, excluding net assets held for sale, which was an improvement of \$3.1 million. This improvement is primarily attributable to increases in accounts receivable and reductions in current debt levels. Also, our accounts receivable increased \$7.5 million primarily due to this being our seasonally busiest time of the year.

During the first six months of fiscal year 2004, cash provided by operating activities totaled \$0.9 million compared to cash provided by operating activities of \$3.7 million in the year-earlier period. Cash used in investing activities totaled \$0.2 million during the first six months of fiscal 2004, which included \$0.3 million for capital expenditures, offset by, \$0.1 million of proceeds from the disposal of capital assets. This compares to cash used in investing activities totaling \$0.2 million during the first six months of fiscal 2003, which included \$0.2 million used for capital expenditures, which was offset by proceeds of less than \$0.1 million from the disposal of capital assets. Cash used for financing activities totaled \$2.9 million, which was used to pay down debt during the first six months of fiscal 2004 compared to cash used by financing activities of less than \$1.8 million that was used to pay down debt in the first six months of fiscal 2003.

*Revolving Credit Facility.* In March 1999, the Company entered into an \$80 million revolving credit facility that originally expired on April 30, 2002 (the *Revolving Credit Facility* ). Initial borrowings were used to repay existing domestic bank indebtedness. Through a series of subsequent amendments, including an amendment executed by the Company on November 14, 2003 and effective as of October 31, 2003, ( *November 2003 Revolver Amendment* ), the size of the *Revolving Credit Facility* was reduced to \$27.5 million and the expiration date was extended to January 31, 2004. Borrowings under the *Revolving Credit Facility* are further limited to borrowing base amounts as defined. The *Revolving Credit Facility* provides for interest on borrowings at prime plus 5.00% and requires the Company to pay a facility fee of 1.00% on the commitment amount.

Borrowings under the *Revolving Credit Facility*, as amended, are secured by the Company's domestic accounts receivable, inventories, certain intangibles, machinery and equipment and owned real estate as well as certain assets in Canada. The Company also has pledged slightly less than two-thirds of the capital stock of two of its foreign subsidiaries. The *Revolving Credit Facility*, as amended, requires the Company to maintain certain financial ratios and places limitations on the Company's ability to pay cash dividends, incur additional indebtedness and make investments, including acquisitions. At September 30, 2003, the Company had \$21.9 million outstanding under the *Revolving*

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Credit Facility. Total availability under the Revolving Credit Facility at September 30, 2003 was approximately \$1.3 million, after giving consideration to the borrowing base limitations, under the Revolving Credit Facility. At September 30, 2003, the Company was in compliance with the financial covenants under the Revolving Credit Facility, as amended by the November 2003 Revolver Amendment.

Under the terms of the amendments to the Revolving Credit Facility, any cash proceeds from the disposition of targeted Company assets will be used to reduce the Revolving Credit Facility and the Senior Notes in a ratio of 56% and 44%, respectively. Any net asset disposition payments to reduce the Revolving Credit Facility will result in a proportionate reduction in the lender's commitments in the Revolving Credit Facility.

In connection with the Sixth Amendment to the Revolving Credit Facility, the lender group received a warrant ( Revolving Credit Facility Warrant ) to purchase 467,000 of the Company's common shares at a purchase price of \$0.01 per share exercisable at any time after July 31, 2003 until September 23, 2012. The Revolving Credit Facility Warrant contains a provision which permitted the Company to reduce the amount of the Revolving Credit Facility Warrant by up to 50% based upon prepayments of principal made by the Company under the Revolving Credit Facility prior to July 31, 2003 with cash proceeds received from the disposition of targeted Company assets. These prepayments resulted in the Revolving Credit Facility Warrant being reduced by approximately 82,000 common shares at July 31, 2003.

*Senior Notes.* In January 1998, the Company issued, through a private placement, \$30 million of Senior Notes due 2008 (the Senior Notes ). Through a series of subsequent amendments, including an amendment executed by the Company on November 14, 2003 and effective as of October 31, 2003 (the November 2003 Senior Notes Amendment ), the terms and conditions of the Senior Notes have been modified to, among other things, change the interest rate payable on the Senior Notes and to defer certain principal payments thereunder. The Senior Notes, as amended, bear interest at 11.35% until January 31, 2004. In addition, the agreement relating to the Senior Notes (the Senior Notes Agreement ), as amended, provides for any overdue amount to bear an interest rate of the greater of 13.35% or 2.00% over the rate of interest publicly announced by The Bank of New York from time to time in New York City as its Prime Rate on the outstanding principal payments and overdue amounts.

The Senior Notes require a principal payment of \$8.7 million, which has been deferred pursuant to the November 2003 Senior Notes Amendment to January 31, 2004, and monthly principal payments of \$0.4 million, the commencement of which has been similarly deferred until February 15, 2004 ( Notes Principal Repayments ) and are secured equally and ratably with debt under the Revolving Credit Facility. In addition, the Senior Notes Agreement, as amended, provides that any cash proceeds from the disposition of targeted Company assets will be used to reduce the Revolving Credit Facility and the Senior Notes in a ratio of 56% and 44%, respectively. The Company is required to maintain certain financial ratios under the Senior Notes Agreement. As of September 30, 2003, the Company is currently in compliance with the financial covenants under the amended Senior Notes Agreement.

Within the Senior Notes Agreement is a yield maintenance amount provision, which ensures that the lender is paid the entire interest amount of the Senior Notes. The yield maintenance amount provisions apply to certain optional prepayments of principal under the Senior Notes and provides that the Senior Notes shall be subject to prepayment, in whole at any time or from time to time in part, at the option of the Company, at 100% of the principal amount so prepaid plus interest thereon to the prepayment date and the yield maintenance amount, if any, with respect to each Senior Note. Any partial

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prepayment of the Senior Notes, which meet certain criteria, shall be applied against the principal amount of the Senior Notes scheduled to become due in the inverse order of maturity thereof. Fiscal year 2003 results include an interest charge of approximately \$1.0 million relating to the yield maintenance amount provisions of the Senior Notes Agreement.

In connection with prior amendments in September 2002, the Senior Notes lender received a warrant ( Senior Notes Warrant ) to purchase 467,000 of the Company's Common Shares at a purchase price of \$0.01 per share exercisable at any time after July 31, 2003 until September 23, 2012. The Senior Notes Warrant contains a provision which permitted the Company to reduce the amount of the Senior Notes Warrant by up to 50% based upon prepayments of principal made by the Company under the Senior Notes prior to July 31, 2003 with cash proceeds received from the disposition of targeted Company assets. These prepayments resulted in the Senior Notes Warrant being reduced by approximately 82,000 common shares at July 31, 2003.

*The Proposed Transaction.* As previously publicly reported, the Company has entered into a non-binding letter of intent with an undisclosed investment firm with respect to the recapitalization and refinancing of the Company (the Proposed Transaction ). The Proposed Transaction is subject to a number of conditions, including that the parties secure commitments for senior and subordinated debt financing and that the parties enter into definitive agreements. In addition, the proposed transaction would require approval from the Company's shareholders as well as from the lenders under both the Revolving Credit Facility and the Senior Notes. Each of the November 2003 Revolver Amendment and the November 2003 Senior Notes Amendment requires the Company to meet certain milestones related to its efforts to consummate the Proposed Transaction, which the Company has satisfied to date. There can be no assurance that the Proposed Transaction will be consummated, and if consummated, what the terms for such transaction will be.

If the Company cannot successfully consummate the Proposed Transaction on or before January 31, 2004, it will need to negotiate arrangements with its lenders to, among other things, extend the maturity of the Revolving Credit Facility and defer the Notes Principal Repayments beyond January 31, 2004. There can be no assurance, however, that the Company will be able to reach acceptable arrangements with its existing lenders or on what terms such arrangements would be. If the Company is not able to negotiate mutually acceptable arrangements with its existing lenders, events could occur that would have a material adverse effect on the Company's liquidity and financial condition and could result in its inability to operate as a going concern. If the Company is unable to operate as a going concern, it may file, or have no alternative but to file, bankruptcy or insolvency proceedings or pursue a sale or sales of assets to satisfy creditors.

The following table summarized the Company's contractual obligations at September 30, 2003:

(In Thousands)	Payments Due by Period				
	Total	Less Than One Year	1 - 3 Years	4 - 5 Years	After 5 Years
<b>Indebtedness:</b>					
Senior Notes	\$ 25,352	\$ 25,352	\$	\$	\$
Revolving Line of Credit	21,887	21,887			
Other Debt Obligations	2,068	1,420	648		
Operating Leases	6,712	2,291	3,471	750	200
<b>Total Contractual Cash Obligations</b>	<b>\$ 56,019</b>	<b>\$ 50,950</b>	<b>\$ 4,119</b>	<b>\$ 750</b>	<b>\$ 200</b>

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### **Factors Influencing Future Results and Accuracy of Forward Looking Information**

This document includes certain statements that may be deemed forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. These forward-looking statements are based on management's expectations and beliefs concerning future events and discuss, among other things, anticipated future performance and revenues, expected growth and future business plans. Words such as anticipates, expects, intends, plans, believes, seeks, estimates or variations of such words and similar expressions are intended to identify such forward-looking statements. We believe that the following factors, among others, could affect our future performance or the price and liquidity of our common shares and cause our actual results to differ materially from those that are expressed or implied by forward-looking statements, or diminish the liquidity of our common shares: our ability to further extend, amend or refinance our existing debt, including the availability to us of external sources of financing and capital (the failure to receive such financing would have a material adverse effect on our results of operations and financial condition) and the terms and timing thereof; our ability to successfully divest our non-core and international business units and the timing, terms and conditions of such divestitures; the ultimate outcome of the SEC's and the Australian Securities and Investment Commission's investigation of accounting irregularities; the impact of any litigation or regulatory process related to the financial statement restatement process, including the class action litigation already filed (the dismissal of which has been appealed); our mix of products and services; the timing of jobs; the availability and value of larger jobs; qualification requirements and termination provisions relating to government jobs; the impact of inclement weather on our operations; the impact of energy prices on us and our customers' businesses; adverse developments in pending litigation or regulatory matters; the impact of existing, new or changed regulatory initiatives; our ability to satisfy the listing and trading requirements of the AMEX (which, if not satisfied, could result in the suspension of trading as occurred in August 2002 or delisting of our shares from the exchange, which could diminish the liquidity of our common shares) or any other national exchange on which our shares are or will be listed or otherwise provide a trading venue for our shares; and the impact of changing global political and economic conditions. In addition, any forward-looking statement speaks only as of the date on which such statement is made and we do not undertake any obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise.

All phases of our operations are subject to a number of uncertainties, risks and other influences, many of which are beyond our control. Any one of such influences, or a combination, could materially affect the accuracy of the forward-looking statements and the assumptions on which the statements are based. Some important factors that could cause actual results to differ materially from the anticipated results or other expectations expressed in our forward-looking statements include the following:

***Our ability to obtain extensions, amendments and waivers under our debt agreements and availability of additional sources of financing and capital.*** The Company is currently in compliance with all its financial ratios required to be maintained under the amended debt agreements, which includes its net worth covenant and its operating income before depreciation and amortization financial covenant. During November of fiscal 2004, we amended our Revolving Credit Facility and Senior Notes to extend the maturity date under the Credit Facility and defer certain principal payments under the Senior Notes. As amended, both the Revolving Credit Facility and the Senior Notes require that the Company meet certain milestones related to its efforts to refinance this debt. As amended, the Revolving Credit Facility expires on January 31, 2004, and it will be necessary for us to amend this



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Revolving Credit Facility to extend the expiration date. If we are unable to negotiate a further amendment to the Revolving Credit Facility, which, among other things, extends the maturity of the Revolving Credit Facility beyond January 31, 2004, it will be necessary for us to refinance or repay this debt. We cannot assure that we will be able to accomplish such a transaction on terms acceptable to us or at all. Failure to do so would have a material adverse effect on our liquidity and financial condition and could result in our inability to operate as a going concern. If we are unable to operate as a going concern, we may file, or may have no alternative but to file, bankruptcy or insolvency proceedings or pursue a sale or sales of assets to satisfy creditors. In addition, the Senior Notes, as amended, require a principal payment of \$8.7 million by January 31, 2004 and monthly principal payments of \$0.4 million commencing on February 15, 2004. We cannot assure that we will be able to make these payments when due, which will result in our being in default under the Senior Notes and, in that event, the Senior Notes lender may pursue its remedies against us for such a default, including acceleration of principal, which would have a material adverse effect on our liquidity and financial condition and could result in our inability to operate as a going concern. If we are unable to operate as a going concern and are unable to complete the proposed transaction (see below), we may file, or may have no alternative but to file, bankruptcy or insolvency proceedings or pursue a sale or sales of assets to satisfy creditors. If we are unable to complete the proposed transaction, we intend to seek other financing during fiscal 2004 to pay down the Senior Notes and the Revolving Credit Facility. There can be no assurance, however, that we will be able to obtain other financing or as to the terms and conditions under which such financing may be available.

*The Proposed Transaction.* As previously publicly reported, the Company has entered into a non-binding letter of intent with an undisclosed investment firm with respect to the recapitalization and refinancing of the Company (the Proposed Transaction). The Proposed Transaction is subject to a number of conditions, including that the parties secure commitments for senior and subordinated debt financing and that the parties enter into definitive agreements. In addition, the proposed transaction would require approval from the Company's shareholders as well as from the lenders under both the Revolving Credit Facility and the Senior Notes. Each of the November 2003 Revolver Amendment and the November 2003 Senior Notes Amendment requires the Company to meet certain milestones related to its efforts to consummate the Proposed Transaction, which the Company has satisfied to date. There can be no assurance that the Proposed Transaction will be consummated, and if consummated, what the terms for such transaction will be.

If the Company cannot successfully consummate the Proposed Transaction on or before January 31, 2004, it will need to negotiate arrangements with its lenders to, among other things, extend the maturity of the Revolving Credit Facility and defer the Notes Principal Repayments beyond January 31, 2004. There can be no assurance, however, that the Company will be able to reach acceptable arrangements with its existing lenders or on what terms such arrangements would be. If the Company is not able to negotiate mutually acceptable arrangements with its existing lenders, events could occur that would have a material adverse effect on the Company's liquidity and financial condition and could result in its inability to operate as a going concern. If the Company is unable to operate as a going concern, it may file, or have no alternative but to file, bankruptcy or insolvency proceedings or pursue a sale or sales of assets to satisfy creditors.

*The effectiveness of our business restructuring plan.* In July 2002, our Board of Directors approved a formal business restructuring plan. The multi-year plan includes a series of initiatives to improve operating income and reduce debt. We intend to sell non-core business units and use the proceeds to reduce debt. While we expect that operating income improvements combined with debt reduction will result from the business restructuring plan in the long term, it is uncertain at this time to

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what extent such operating income improvements and debt reduction will be achieved as a result of the business restructuring plan and the terms and/or timing thereof. We cannot assure that the business restructuring plan will be successful in enhancing our ability to pursue financing alternatives acceptable to us. During fiscal 2004 our Asia Pacific Operations was sold and in fiscal 2003, we sold four non-strategic business units. The fiscal 2003 dispositions included Rohrback Cosasco Systems, Bass Trigon Software and two smaller international offices. The proceeds from these dispositions were used to pay down debt. For further information about our discontinued operations see Note 2, Assets and Liabilities Held for Sale, Notes to Consolidated Financial Statements included in Item 8 of our Form 10-K.

***Our reputation and financial condition could be affected by the securities litigation and related investigations and/or a restatement of financial statements.*** On March 20, 2002, we first announced that we had become aware of accounting irregularities caused by apparent internal misconduct in our Australian subsidiary and that, to the extent that the accounting irregularities materially affect previously filed financial statements, we restated our audited financial statements for our fiscal year which ended March 31, 2001 as well as unaudited financial information for the first nine months through December 31, 2001 of our fiscal year ended March 31, 2002, as previously released. In addition, we recorded a charge to earnings for our loss on investment related to the subsidiary. This charge was taken in the Company's fiscal fourth quarter ended March 31, 2002. Subsequent to this announcement, a purported class action lawsuit was filed against us and certain of our current and former directors and officers, asserting claims under the federal securities laws, which was dismissed with prejudice in May 2003. In June 2003, the plaintiffs filed a notice of appeal from the order of dismissal. In addition to significant expenditures we may have to make to defend ourselves in these matters and the related significant financial penalties that might be imposed on us if the plaintiffs prevail, the publicity surrounding the litigation and the SEC inquiry of these matters could affect our reputation with our customers and suppliers and have an impact on our financial condition and results of operations.

***Our compliance with the listing standards and reporting requirements of the stock exchange on which our common shares trade.*** We are required by the stock exchange on which we list our common shares for trading to maintain certain listing standards and meet certain reporting requirements in order to continue trading and to remain listed on that exchange. In September 2003, we received a notice from the American Stock Exchange confirming that as of June 30, 2003 we did not have a sufficient amount of shareholders' equity to meet its guidelines. We have since submitted a plan to the American Stock Exchange that we believe demonstrates our ability to meet or exceed the required listing standards, however, if we cannot demonstrate that we will be in compliance within 18 months of June 30, 2003, our common shares may not be allowed to trade on the stock exchange. In such case, we would pursue an alternative trading venue although it may make it more difficult for us to raise funds through the sale of our securities. In addition, it may make it more difficult for an investor to dispose of, or to obtain accurate quotations of, our common shares and negatively impact the market price. Our shares had been suspended from trading on the American Stock Exchange in August 2002, because of, among other reasons, the late filing of our Form 10-K/A for the fiscal year ended March 31, 2002. There can be no assurances that our shares will not be delisted or that trading will not be suspended again and if so, that trading would be permitted to resume.

***Adverse developments in pending litigation or regulatory matters.*** From time to time, we are involved in litigation and regulatory proceedings, including those disclosed in "Legal Proceedings" of our annual report on Form 10-K and in our other periodic reports filed with the Securities and Exchange Commission. There are always significant uncertainties involved in litigation and regulatory proceedings and we cannot guarantee the result of any action. Regulatory compliance is often complex

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and subject to variation and unexpected changes, including changing interpretations and enforcement agendas affecting the regulatory community. We may need to expend significant financial resources in connection with legal and regulatory procedures and our management may be required to divert attention from other portions of our business. If, as a result of any proceeding, a judgment is rendered, decree is entered or administrative action is taken against us or our customers, it may materially and adversely affect our business, financial condition and results of operations.

***Our profitability can be impacted by our mix of products and services.*** Given that our selling, general and administrative costs are largely fixed in terms of dollars, our profitability is dependent upon the amount of gross profit that we are able to realize. We typically generate higher gross profit margins on pure engineering service jobs than on those jobs that include a material or installation component. In addition, our gross profit margins also can be negatively impacted when we utilize subcontractors. Therefore, a shift in mix from engineering services to more construction and installation type work or an increase in the amount of subcontracting costs could have a negative impact on our operating results. In addition, certain of the products that we sell have gross profit margins that are considerably lower than our overall average gross profit margin. A shift in mix which results in a greater percentage of revenues relating to these lower margin products would also have a negative impact on our operating results.

***The timing of jobs can impact our profitability.*** There are a number of factors, some of which are beyond our control, that can cause projects to be delayed and thus negatively impact our profitability for the related period. These factors include the availability of labor, equipment or materials, customer scheduling issues, delays in obtaining required permits and weather. In addition, when we are working as a subcontractor on a project, our portion of the project can be delayed as a result of factors relating to other contractors.

***The availability and value of larger jobs can impact our profitability.*** While the majority of our jobs are relatively small, we can have a number of individual contracts in excess of \$1 million in progress at any particular time. These larger contracts typically generate more gross profit dollars than our average size jobs. Therefore, the absence of larger jobs, which can result from a number of factors, including market conditions, can have a negative impact on our operating results.

***Qualification requirements and termination provisions relating to government jobs.*** We derive revenues from contracts with the United States, its agencies and other governmental entities. Government contracting is subject to competitive bidding processes and there can be no assurance that we will be the successful bidder for future contracts. Fluctuations in government spending and the amount of government contracts received also could adversely affect our revenues and profitability. In addition, it is the policy of the United States that certain small businesses and other concerns have the maximum practicable opportunity to participate in performing contracts let by any federal agency. To the extent that we do not meet applicable criteria for government jobs, we could be limited in our ability to participate directly in contracts being let by the United States and other governmental entities with similar requirements. Certain contracts with governmental entities contain provisions permitting the governmental entities to terminate the contract for convenience prior to completion of the contract. To the extent that any of our contracts with a government entity are so terminated, our revenues and profitability could be adversely impacted.

***Our operations can be impacted by inclement weather.*** A large portion of our service work is performed in the field. Therefore, excessive amounts of rain, snow or cold, as well as other unusual weather conditions, including hurricanes and typhoons, can result in work stoppages. Also, working under inclement weather conditions can reduce our efficiencies, which can have a negative impact on

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our profitability.

***Our business is impacted by changes in energy prices.*** The products and services we provide to our customers in the energy markets are, to some extent, deferrable in the event that these customers reduce their capital and discretionary maintenance expenditures. The level of spending on these types of expenditures can be influenced by oil and gas prices and industry perceptions of future prices. Our experience indicates that our energy customers react to declining oil and gas prices by reducing their capital and discretionary maintenance expenditures. This reaction has in the past, and may in the future, have a negative impact on our business. We are unable to predict future oil and gas prices. However, we believe that a prolonged period of low energy prices could have a negative impact on our business. Typically, there is a delay between the time prices decline and when we start to experience a negative impact on our results of operations. Conversely, there is also a delay between the time energy prices increase and when we start to experience a positive impact on our results of operations.

***The impact of changing global, political and economic conditions.*** Changing political and economic conditions regionally or worldwide can adversely impact our business. Deteriorating political and general economic conditions may result in customers delaying or canceling contracts and orders for our products and services, difficulties and inefficiencies in the performance of our services including work stoppages, and difficulties in collecting payment from our customers. As a result, such conditions can negatively impact our results of operations and our cash flows. Moreover, we have operations in the Middle East region with revenues totaling \$6.1 million for the six months of fiscal 2004 and net assets of approximately \$2.6 million at September 30, 2003. These operations can be negatively impacted by changing economic and political conditions. All of our international operations except Canada and our European Operations are a part of the Company's net assets held for sale.

***Existing, new or changed regulatory initiatives can impact our business.*** Corrpro and its customers are subject to federal, state and local environmental and other laws and regulations. These laws and regulations affect our operations by imposing standards for the protection of health, welfare and the environment. Such laws and regulations, and applicable interpretations thereof, could expose us to liability for acts which are or were in compliance at the time such acts were performed. We cannot predict whether future legislative or regulatory developments may occur which would have an adverse effect on Corrpro.

These risks must be considered by any investor or potential investor in the Company.

## **C. CRITICAL ACCOUNTING POLICIES**

The Company's consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States. As such, some accounting policies have a significant impact on amounts reported in these financial statements. A summary of those significant accounting policies can be found in the Company's fiscal 2003 Annual Report on Form 10-K, filed on June 30, 2003, in the Note 1 Summary of Significant Accounting Policies, Notes to Consolidated Financial Statements, and under the caption Significant Accounting Policies within Management's Discussion and Analysis of Financial Condition and Results of Operations. In particular, judgment is used in areas such as revenue recognition for construction and engineering contracts, determining the allowance for uncollectible accounts and inventory valuation reserves, asset impairment and deferred tax assets.

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**D. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS**

In January 2003, the Financial Accounting Standards Board ( FASB ) issued FASB Interpretation No. ( FIN ) 46, Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51. This Interpretation addresses the consolidation by business enterprises of various interest entities as defined in the Interpretation. The provisions of FIN 46 are effective on February 1, 2003 for all variable interest entities created after January 31, 2003. For all variable interest entities created prior to February 1, 2003 the provisions of this statement are effective for periods ending after December 31, 2003. The Company does not expect the adoption of this Interpretation to have a material impact on its results of operations or financial position.

In April 2003, the FASB issued Statement of Financial Accounting Standards ( SFAS ) No. 149, Amendment of Statement 133 on Derivative Instruments and Hedging Activities. This statement amends SFAS No. 133 for decisions made (1) as part of the Derivatives Implementation Group process that effectively required amendments to SFAS No. 133, (2) in connection with other FASB projects dealing with financial instruments and (3) in connection with implementation issues raised in relation to the application of the definition of a derivative. This statement is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003, with certain exceptions. The adoption of SFAS No. 149 did not have a material impact on the results of operations or financial position of the Company.

In May 2003, the FASB issued SFAS No. 150, Accounting for Certain Financial Instruments and Characteristics of both Liabilities and Equity which requires freestanding financial instruments such as mandatorily redeemable shares, forward purchase contracts written put options to be reported as liabilities by their issuers as well as related new disclosure requirements. The provisions of SFAS No. 150 are effective for instruments entered into or modified after May 31, 2003 and pre-existing instruments as of the beginning of the first interim period that commences after June 15, 2003. The application of this Statement did not have an effect on the Company's consolidated financial statements.

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**ITEM 3. Quantitative and Qualitative Disclosures About Market Risk**

**Market Risk Disclosures**

In the normal course of business, our operations are exposed to continuing fluctuations in foreign currency values and interest rates that can affect the cost of operating and financing our business.

**Interest Rate Risk**

Our primary interest rate risk exposure results from our variable interest rate Revolving Credit Facility, Senior Notes and various smaller lines of credit that we maintain with foreign banks. If interest rates were to increase 200 basis points (2%) from the rates at September 30, 2003 rates, and assuming no changes in debt from the September 30, 2003 levels, the additional annual expense would be approximately \$1.0 million on a pre-tax basis.

**Foreign Operations and Foreign Currency Exchange Risk**

Our foreign subsidiaries generally conduct business in local currencies, creating foreign exchange risk. During the first six months of fiscal 2004, the Company recorded a favorable foreign currency translation adjustment of \$0.9 million related to net assets located outside the United States. This foreign currency translation adjustment resulted primarily from the weakening of the United States Dollar in relation to the Canadian Dollar and the British Pound. We do not enter into derivatives to hedge foreign currency exchange risk. Our foreign operations are also subject to other customary risks of operating in a global environment, such as unstable political situations, the effect of local laws and taxes, tariff increases and regulations and requirements for export licenses, the potential imposition of trade or foreign exchange restrictions and transportation delays.

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**ITEM 4. Controls and Procedures**

(b) Evaluation of Disclosure Controls and Procedures.

The Company's Chief Executive Officer and Chief Financial Officer (the Senior Officers), with the participation of other members of the Company's management, have evaluated the effectiveness of the Company's disclosure controls and procedures as of September 30, 2003. Based on that evaluation, the Senior Officers have concluded that, as of September 30, 2003, the Company's disclosure controls and procedures are effective in ensuring that information required to be disclosed by the Company is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. There were no changes in internal controls that occurred during the Company's most recent fiscal quarter that have materially affected, or are reasonably likely to affect, the Company's internal controls.

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**PART II. OTHER INFORMATION**

**ITEM 1. Legal Proceedings**

As previously reported, in January 2000, the Michigan Department of Environmental Quality ( MDEQ ) issued an administrative decision which effectively limited the scope of MDEQ 's 1995 approval of certain assessment methodologies utilized by Corrpro in determining whether certain underground storage tanks meet Michigan 's regulatory requirements for upgrade by means of cathodic protection. The MDEQ decision also would have required us to conduct further assessments and provide certain information. The assessment methodologies at issue have been and remain recognized by the Environmental Protection Agency ( EPA ) and the other states in which we utilized such methodologies for virtually identical purposes. We believed that MDEQ 's decision was in error and on January 24, 2000, filed a complaint and claim of appeal in the Circuit Court for the County of Ingham, Michigan seeking declaratory relief and appealing the decision on several grounds. In its November 14, 2000 ruling, the Ingham Circuit Court reversed MDEQ 's decision that directed we take certain actions and provide certain information, however, the court also found that MDEQ had not approved the full use of the assessment methodologies we utilized in Michigan.

We believed that the circuit court 's finding that MDEQ had not approved full use of the methodologies was not supported by the evidence, and was contradicted by evidence contained in the administrative record. On December 5, 2000, we filed, in the Michigan Court of Appeals, an application for leave to appeal the circuit court 's finding that MDEQ did not approve the full use of the assessment methodologies we utilized in Michigan. By order dated February 14, 2001, the Michigan Court of Appeals denied our application for leave to appeal the circuit court 's finding. On March 7, 2001, we filed an application for leave to appeal with the Supreme Court of the State of Michigan. On August 28, 2001, the Michigan Supreme Court denied our application for leave to appeal.

As a result of these proceedings, the MDEQ 's administrative decision finding that certain of our assessment methodologies were not approved in full was upheld, but the MDEQ was found not to have jurisdiction to enforce its decision against us. In July 2002, the MDEQ sent certain underground storage tank owners and operators who may have relied on our method of assessment a notice informing them that certain of such owners and operators ' tanks were improperly upgraded, that such owners and operators are to provide to MDEQ upon request evidence that they have conducted state required tank tightness testing, and certain of such tanks must be internally inspected. MDEQ also advised that internally inspected tanks that do not satisfy applicable criteria should be taken out-of-service and removed from the ground.

On July 25, 2002, a summons and complaint was issued from the Circuit Court for the County of Ingham, Michigan. The action was commenced by Blogett Oil Company, Inc. and other owners and operators of underground storage tanks systems on behalf of themselves and others similarly situated. The complaint relates to the MDEQ regulatory proceeding described immediately above and names both the Company and MDEQ. The plaintiffs seek an unspecified amount of damages in excess of \$25,000 from Corrpro. The plaintiffs also seek injunctive relief prohibiting the MDEQ from declaring that underground storage tanks upgraded by the Company do not meet the current requirement for corrosion protection set forth by law. On November 18, 2002, the court issued an order certifying the underlying class. The Michigan Court of Appeals denied the Company 's application for leave to appeal the Circuit Court 's order certifying the underlying class. By letters dated July 7, 2003 and thereafter, the MDEQ issued a notice to certain owners and operators of tanks upgraded based on the Company 's assessment method that they had until October 7, 2003 to comply with certain actions specified in the MDEQ 's



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notice. In October 2003, the Company and a steering committee representing the class of plaintiffs reached an agreement, subject to court approval, pursuant to which the class of plaintiffs would agree to settle all outstanding matters between the class and the Company and to dismiss the case as to the Company with prejudice. On October 29, 2003 the Circuit Court for the County of Ingham, Michigan approved the settlement and dismissed with prejudice the litigation as to the Company. The settlement amount itself was funded pursuant to applicable policies of insurance maintained by the Company.

During fiscal 2001, the Company discovered that a former employee used an incorrect assessment standard in connection with the evaluation of whether certain underground storage tanks located at as many as 67 sites were eligible for upgrade using cathodic protection. Such evaluations were done using one of the approved assessment methodologies. The tanks at these sites, which are located in five states, were subsequently upgraded using cathodic protection, which arrests corrosion. These tanks are also subject to ongoing leak detection requirements. Based on the Company's review of available information and governmental records, the Company believes that there have not been any releases from the affected tanks as a result of the actions of the former employee. The Company has contacted, and in October and November 2000 met with, officials from the EPA and officials from the corresponding environmental protection agencies of the five states involved to discuss this matter. It is the Company's understanding that none of the states nor the EPA intend to take any enforcement action as a result of the use of the inaccurate standard by the former employee. The Company is currently working with the states and the EPA to develop and implement field investigation procedures to assess the current status of the affected sites. Based on currently available information, the Company does not believe that the cost of field investigation procedures for this matter will have a material effect on the future operations, financial position or cash flows of the Company.

The Company is a defendant in a purported class action suit filed on June 24, 2002, in the United States District Court, Northern District of Ohio, Eastern Division. The complaint also names certain former and current officers and directors of the Company as defendants. The complaint was purportedly filed on behalf of all persons who purchased Corrpro Common Shares during the period April 1, 2000 through March 20, 2002 and alleges violations of the federal securities laws resulting in artificially inflated prices of the Company's Common Shares during the class period. The complaint relates to the Company's announcement that it had discovered accounting irregularities caused by apparent internal misconduct in its Australian subsidiary. The complaint seeks unspecified compensatory damages, fees and expenses on behalf of the putative class. On or about May 27, 2003, the District Court granted, with prejudice, the defendants motions to dismiss the amended and consolidated class action complaint. On June 24, 2003, the plaintiffs filed a notice of appeal to the United States Circuit Court of Appeals for the 6th Circuit from the order of dismissal. The Company is unable at this time to make a determination as to whether an adverse outcome is likely and whether an adverse outcome would have a materially adverse affect on its operations or financial condition.

Company management discovered accounting irregularities at the Australian subsidiary in early calendar 2002 and upon discovery immediately began an internal investigation, which has been conducted under the direction of the Audit Committee of its Board of Directors. The Australian Securities and Investments Commission has commenced an independent investigation of the accounting irregularities. Corrpro voluntarily disclosed this matter to the SEC, which has commenced a formal inquiry. Corrpro is cooperating with both commissions.

In January 2003, the Company received a Consolidated Compliance Order and Notice of Potential Penalty from the Louisiana Department of Environmental Quality pursuant to which the department alleges that the Company's foundry operations failed to submit required storm water

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monitoring information as required by law. The alleged failure relates to periods subsequent to the cessation of the Company's foundry operations. The Company has appealed the matter and the department has agreed to engage an informal resolution of the matter. Based on current available information, the Company does not believe that this matter will have a material effect on the future operations, financial position or cash flows of the Company.

The Company is subject to other legal proceedings and claims which arise in the ordinary course of business.

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**ITEM 6. Exhibits and Reports on Form 8-K**

A. See the Exhibit Index at the last page of this Form 10-Q.

B. Reports on Form 8-K

1. On July 9, 2003, the Registrant furnished a Report on Form 8-K, reporting under Items 7 and 9 thereof the announcement of the operating and financial results for its fiscal year ended March 31, 2003.
2. On July 18, 2003, the Registrant filed a Report on Form 8-K, reporting under Items 7 and 9 thereof of the announcement of the sale of its Asian operations.
3. On August 4, 2003, the Registrant filed a Report on Form 8-K, reporting under Items 7 and 9 thereof the status of the negotiations with its senior lenders, and the mailing of its 2003 annual report to shareholders.
4. On August 14, 2003, the Registrant filed a Report on Form 8-K, reporting under Items 5 and 7 thereof that its bank debt maturity was extended and senior note amortization was rescheduled.
5. On August 20, 2003, the Registrant furnished a Report on Form 8-K, reporting under Item 12 thereof the announcement of the operating and financial results for the fiscal quarter ended June 30, 2003.

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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.

**CORRPRO COMPANIES, INC**  
(Registrant)

Date: February 13, 2004

/s/ Joseph W. Rog

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Joseph W. Rog  
Chairman of the Board, President  
and Chief Executive Officer

/s/ Robert M. Mayer

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Robert M. Mayer  
Senior Vice President, Chief  
Financial Officer

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**EXHIBIT INDEX**

<b>Exhibit No.</b>	<b>Exhibit</b>
10.1	Form Of Amendment To Executive Officer Employment Agreement By And Between The Company And Certain Executive Officers And Schedule Thereto.
10.2	Amendment To November 2000 Agreement By And Between Corrpro Companies, Inc., Commonwealth Seager Holdings Ltd, Corrtch Consulting Group, and Barry W. Schadeck.
10.3	Consulting Agreement dated April 1, 2003 by and between Commonwealth Seager Holdings Ltd. and Corrtch Consulting Group.
10.4	Tenth Amendment to Credit Agreement dated as of October 31, 2003 relating to the Amended and Restated Credit Agreement dated as of June 9, 2000 among the Company, CSI Coating Systems, Inc. and the Lenders party thereto.
10.5	Amendment dated as of October 31, 2003 between the Company and The Prudential Insurance Company of America relating to the Note Purchase Agreement dated as of January 21, 1998.
31.1	Rule 13a-14(a) Certification Chief Executive Officer
31.2	Rule 13a-14(a) Certification Chief Financial Officer
32.1	Section 1350 Certification Chief Executive Officer
32.2	Section 1350 Certification Chief Financial Officer