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FAB INDUSTRIES INC  
Form 10-Q  
July 13, 2004

FORM 10-Q QUARTERLY REPORT

UNITED STATES SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

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

For the quarterly period ended May 29, 2004

OR

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

For the transition period from \_\_\_\_\_ TO \_\_\_\_\_

Commission file number 1-5901

FAB INDUSTRIES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE

13-2581181

(State or other jurisdiction of  
incorporation or organization)

(I.R.S. Employer  
Identification No.)

200 MADISON AVENUE, NEW YORK, N.Y.

10016

(Address of principal executive office)

(Zip Code)

(212) 592-2700

(Registrant's telephone number, including area code)

N/A

(Former name, former address and former fiscal year;  
if changed since last report)

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

Indicate by a check mark whether the registrant is an accelerated filer (as

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defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [X]

As of July 13, 2004, 5,215,031 shares of the registrant's common stock, \$0.20 par value, were outstanding.

FAB INDUSTRIES INC. AND SUBSIDIARIES

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(1)

FAB INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE 13 WKS ENDED

-----  
May 29, 2004                      May 31, 2003

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|  | (unaudited)   | (unaudited)   |
|--|---------------|---------------|
| Net sales                                    | \$ 14,596,000 | \$ 13,646,000 |
| Cost of goods sold                           | 12,285,000    | 12,293,000    |
| Gross profit                                 | 2,311,000     | 1,353,000     |
| Operating Expenses:                          |               |               |
| Selling, general and administrative expenses | 1,993,000     | 1,579,000     |
| Gain on sale of fixed assets                 | (322,000)     | (142,000)     |
| Total operating expenses                     | 1,671,000     | 1,437,000     |
| Operating income (loss)                      | 640,000       | (84,000)      |
| Other income:                                |               |               |
| Interest and dividend income                 | 108,000       | 347,000       |
| Net gain on investment securities            | 434,000       | 232,000       |
| Total other income                           | 542,000       | 579,000       |
| Income before taxes                          | 1,182,000     | 495,000       |
| Income tax expense                           | 415,000       | 175,000       |
| Net income                                   | \$ 767,000    | \$ 320,000    |
| Income per share: (Note 5)                   |               |               |
| Basic  | \$ 0.15       | \$ 0.06       |
| Diluted                                      | \$ 0.15       | \$ 0.06       |
| Cash dividends declared per share            | \$ 3.00       | \$ --         |

See notes to condensed consolidated financial statements.

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FAB INDUSTRIES, INC. AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

|                     | FOR THE 26 WKS ENDED |               |
|---------------------|----------------------|---------------|
|                     | May 29, 2004         | May 31, 2003  |
|                     | (unaudited)          | (unaudited)   |
| Net sales           | \$ 24,737,000        | \$ 25,233,000 |
| Cost of goods sold  | 21,997,000           | 23,139,000    |
| Gross profit        | 2,740,000            | 2,094,000     |
| Operating Expenses: |                      |               |

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|  |             |           |
|--|-------------|-----------|
| Selling, general and administrative expenses | 3,669,000   | 3,207,000 |
| Gain on sale of fixed assets                 | (1,007,000) | (316,000) |
| Other expense (Note 12)                      | 250,000     | --        |
|  | -----       | -----     |
| Total operating expenses                     | 2,912,000   | 2,891,000 |
|  | -----       | -----     |
| Operating loss                               | (172,000)   | (797,000) |
|  | -----       | -----     |
| Other income:                                |             |           |
| Interest and dividend income                 | 330,000     | 694,000   |
| Net gain on investment securities            | 602,000     | 203,000   |
|  | -----       | -----     |
| Total other income                           | 932,000     | 897,000   |
|  | -----       | -----     |
| Income before taxes                          | 760,000     | 100,000   |
|  | -----       | -----     |
| Income tax expense                           | 285,000     | 50,000    |
|  | -----       | -----     |
| Net income                                   | \$ 475,000  | \$ 50,000 |
|  | =====       | =====     |

Income per share: (Note 5)

|                                   |         |         |
|-----------------------------------|---------|---------|
| Basic                             | \$ 0.09 | \$ 0.01 |
| Diluted                           | \$ 0.09 | \$ 0.01 |
| Cash dividends declared per share | \$ 3.00 | \$ --   |

See notes to condensed consolidated financial statements.

(3)

FAB INDUSTRIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

A S S E T S

-----

AS OF

|  |              |                   |
|--|--------------|-------------------|
|  | -----        | -----             |
|  | May 29, 2004 | November 29, 2003 |
|  | -----        | -----             |
|  | (unaudited)  |                   |

Current Assets:

|   |              |              |
|---|--------------|--------------|
| Cash and cash equivalents (Note 2)  | \$ 1,847,000 | \$ 3,397,000 |
| Investment securities available-for-sale (Note 3)   | 17,936,000   | 29,004,000   |
| Accounts receivable-net of allowance of<br>\$900,000 for doubtful accounts for both periods | 8,276,000    | 7,171,000    |
| Inventories (Note 4)  | 5,319,000    | 5,531,000    |
| Deferred tax asset  | 673,000      | 506,000      |
| Other current assets  | 414,000      | 701,000      |
|   | -----        | -----        |

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|   |              |              |
|---|--------------|--------------|
| Total current assets                    | 34,465,000   | 46,310,000   |
|   | -----        | -----        |
| Property, plant and equipment - at cost | 31,678,000   | 33,787,000   |
| Less: Accumulated depreciation          | 23,700,000   | 24,303,000   |
|   | -----        | -----        |
|   | 7,978,000    | 9,484,000    |
| Other assets                            | 2,257,000    | 2,281,000    |
|   | -----        | -----        |
|   | \$44,700,000 | \$58,075,000 |
|   | =====        | =====        |

See notes to condensed consolidated financial statements.

(4)

FAB INDUSTRIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

L I A B I L I T I E S and  
-----  
S T O C K H O L D E R S ' E Q U I T Y  
-----

|                                      | AS OF        |                   |
|--------------------------------------|--------------|-------------------|
|                                      | May 29, 2004 | November 29, 2003 |
|                                      | -----        |                   |
|                                      | (unaudited)  |                   |
|                                      | -----        |                   |
| Current liabilities:                 |              |                   |
| Accounts payable                     | 3,111,000    | \$ 1,913,000      |
| Corporate income and other taxes     | 1,118,000    | 861,000           |
| Accrued payroll and related expenses | 782,000      | 763,000           |
| Other current liabilities            | 1,441,000    | 1,106,000         |
|                                      | -----        | -----             |
| Total current liabilities            | 6,452,000    | 4,643,000         |
|                                      | -----        | -----             |
| Deferred income taxes                | --           | 52,000            |
| Other noncurrent liabilities         | 4,739,000    | 4,451,000         |
|                                      | -----        | -----             |
| Total liabilities                    | 11,191,000   | 9,146,000         |
|                                      | -----        | -----             |
| Stockholders' equity                 | 33,509,000   | 48,929,000        |
|                                      | -----        | -----             |
|                                      | \$44,700,000 | \$58,075,000      |
|                                      | =====        | =====             |

See notes to condensed consolidated financial statements.

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FAB INDUSTRIES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY  
 FOR THE 26 WEEKS ENDED May 29, 2004 (unaudited)

|   | Total        | Common Stock *   |             | Retained Earnings | Accumulated Other Comprehensive Income (Loss) |
|---|--------------|------------------|-------------|-------------------|---|
|   |              | Number of Shares | Amount      |                   |   |
| Balance at November 29, 2003  | \$48,929,000 | 6,724,944        | \$1,345,000 | \$85,225,000      | \$ (186,000)                                  |
| Net income  | 475,000      |                  |             | 475,000           |   |
| Change in net unrealized holding loss on investment securities available-for-sale, net of taxes | (250,000)    |                  |             |                   | (250,000)                                     |
| Total comprehensive income  | 225,000      |                  |             |                   |   |
| Cash dividends  | (15,645,000) |                  |             | (15,645,000)      |   |
| Balance at May 29, 2004 (Unaudited)   | \$33,509,000 | 6,724,944        | \$1,345,000 | \$70,055,000      | \$ (436,000)                                  |

\* Common stock \$0.20 par value - 15,000,000 shares authorized.  
 Preferred stock \$1.00 par value - 2,000,000 shares authorized, none issued.

See notes to condensed consolidated financial statements.

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FAB INDUSTRIES, INC. AND SUBSIDIARIES  
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

|                       | FOR THE 26 WEEKS ENDED |     |
|-----------------------|------------------------|-----|
|                       | May 29, 2004           | May |
|                       | (unaudited)            | (u  |
| OPERATING ACTIVITIES: |                        |     |
| Net income            | \$ 475,000             | \$  |

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|   |              |
|---|--------------|
| Adjustments to reconcile net income to net cash provided by (used in) operating activities: |              |
| Provision for doubtful accounts   | 350,000      |
| Depreciation and amortization   | 815,000      |
| Deferred income taxes   | (52,000)     |
| Net gain on investment securities   | (602,000)    |
| Gain on disposition of fixed assets   | (1,007,000)  |
| Decrease (increase) in:   |              |
| Accounts receivable   | (1,455,000)  |
| Inventories   | 212,000      |
| Other current assets  | 287,000      |
| Other assets  | 24,000       |
| (Decrease) increase in:   |              |
| Accounts payable  | 1,198,000    |
| Accruals and other liabilities  | 899,000      |
|   | -----        |
| Net cash provided by (used in) operating activities   | 1,144,000    |
|   | -----        |
| CASH FLOWS FROM INVESTING ACTIVITIES:   |              |
| Purchases of property, plant and equipment  | (40,000)     |
| Proceeds from dispositions of property and equipment  | 1,738,000    |
| Acquisition of investment securities  | --           |
| Proceeds from sales of investment securities  | 11,253,000   |
|   | -----        |
| Net cash provided by (used in) investing activities   | 12,951,000   |
|   | -----        |
| CASH FLOWS FROM FINANCING ACTIVITIES:   |              |
| Dividends   | (15,645,000) |
|   | -----        |
| Decrease in cash and cash equivalents   | (1,550,000)  |
| Cash and cash equivalents, beginning of period  | 3,397,000    |
|   | -----        |
| Cash and cash equivalents, end of period  | \$ 1,847,000 |
|   | =====        |

See notes to condensed consolidated financial statements.

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

1. Basis of presentation:

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X of the Securities and Exchange Commission. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the 26 weeks ended May 29, 2004 are not necessarily indicative of the results that may be expected for the entire fiscal year ending November 27, 2004. The balance

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sheet at November 29, 2003 has been derived from the audited balance sheet at that date. The financial information included in the quarterly report should be read in conjunction with the consolidated financial statements and footnotes thereto included in the Company's Form 10-K for the fiscal year ended November 29, 2003.

The Company's Board of Directors has determined that it is in the best interests of its stockholders to sell the Company's textile business as a going concern. In order to maximize stockholder value, the Board of Directors adopted resolutions dated March 1, 2002, which authorized, subject to stockholder approval, the sale of the Company's business pursuant to a Plan of Liquidation and Dissolution (the "Plan"). The Company's stockholders approved the Plan at the Company's annual meeting on May 30, 2002. The Plan provides the Company's officers and directors will continue to operate the Company's textile business in its current fashion and pursue a sale of the business as a going concern. The Company's Board of Directors has approved the engagement of McFarland Dewey & Co., LLC financial advisors in November 2002 to assist with the sale of the business. The accompanying financial statements have been prepared on a going concern basis. There can be no assurance, however, that the Company will be successful in selling its business or if it does sell the business, that it will be able to recover full value of its assets, particularly its property, plant and equipment. On February 18, 2004, August 1, 2003 and May 30, 2002, the Company's Board of Directors declared a liquidating distribution of \$3.00 per share, \$4.00 per share and \$10.00 per share, respectively, which resulted in a payment to stockholders of \$15,645,000, \$20,860,000 and \$52,380,000 in March 2004, August 2003 and June 2002, respectively. Of the total June 2002 liquidating dividend, \$6,641,000 was deducted from additional paid in capital until the paid in capital account was eliminated and represents a return of capital. The remaining liquidating dividend of \$45,739,000 was deducted from retained earnings.

The Company's plan of liquidation provides the Company's officers and directors will continue to operate the Company's textile business in its current fashion and pursue the sale of the business as a going concern. If the Company is not sold by May 2005, all assets will be transferred to a liquidating trust. The liquidating trust would then succeed to all our remaining assets, liabilities and obligations.

The Company is currently in compliance with the 40% limitation on holding investment securities set forth in the Investment Company Act of 1940 and intends to remain in compliance with such requirement in the future.

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### DERIVATIVE INSTRUMENTS AND HEDGING ACTIVITIES

The Company is party to equity option contract as part of its investing activities. Option contracts are contractual agreements that give the purchaser the right, but not the obligation, to purchase or sell a financial instrument at a predetermined exercise price. In return for this right, the purchaser pays a premium to the seller of the option. By selling or writing options, the Company receives a premium and becomes obligated during the term of the option to purchase or sell a financial instrument at a predetermined exercise price if the option is exercised, and assumes the risk of not being able to enter into a closing transaction if a liquid secondary market does not exist.



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In accordance with SFAS No. 133, the Company's policy is to recognize all derivatives instruments as either assets or liabilities on the balance sheet at fair value. Changes in fair value are recognized in the income statement in the period in which they occur. Derivatives are not used for trading purposes. Derivatives are used to hedge against fluctuations in the market value of equity securities.

### ACCOUNTING FOR STOCK-BASED COMPENSATION

The Company's stock option plans were terminated subsequent to the fiscal year ended November 30, 2002 and there has been no stock compensation expense under the disclosure-only provision of SFAS No.123 subsequent thereto.

### COST OF GOODS SOLD

Cost of goods sold includes labor, purchases, inbound freight charges, receiving costs, warehousing costs and the change in inventory during the period. Excess fixed production costs are not inventoried and are expensed in the period incurred.

### SELLING, GENERAL AND ADMINISTRATIVE EXPENSE

Selling, general and administrative expenses primarily include costs relating to administrative and salespersons salaries and benefits, bad debt expense, professional and consulting fees, insurance expense and rent for the New York office.

### REVENUE RECOGNITION

The Company recognizes its revenues upon shipment of the related goods. Shipping terms are FOB shipping point pursuant to the Company's sales agreements. Risk of loss transfers to the Company's customers at the time the goods are transferred to a common carrier, per the Company's sales agreements. The acceptance of goods by customers is not subject to inspection. Allowances for estimated returns are provided when sales are recorded.

### SHIPPING AND HANDLING COSTS

Shipping and handling costs billed to customers are recorded as revenue. The costs associated with shipping goods to customers are recorded as cost of goods sold. The majority of the shipping costs are paid directly by the Company's customers to independent trucking companies.

### RECLASSIFICATIONS

Certain accounts in 2003 financial statements have been reclassified with the 2004 presentations for comparative purposes.

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

2. Cash and cash equivalents consist of the following (in thousands):

|  | May 29, 2004 | November 29, 2003 |
|--|--------------|-------------------|
|  | - - - - -    | - - - - -         |

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|  |          |          |
|--|----------|----------|
| Cash   | \$ 293   | \$ 549   |
| Taxable and tax-free short-term debt instruments | 1,554    | 2,848    |
|  | -----    | -----    |
|  | \$ 1,847 | \$ 3,397 |

3. Investment Securities:

At May 29, 2004 and November 29, 2003, investment securities available-for-sale consisted of the following (in thousands):

| May 29, 2004 (unaudited)  | Cost      | Gross Unrealized Holding Gain | Gross Unrealized Holding Loss | Fair Value |
|---------------------------|-----------|-------------------------------|-------------------------------|------------|
| Equities                  | \$ 750    | \$ 15                         | \$ 0                          | \$         |
| U.S. Treasury obligations | 5,549     | 1                             | 0                             | 5,         |
| Corporate bonds           | 250       | 0                             | (248)                         |            |
| Money market              | 11,619    | 0                             | 0                             | 11,        |
|                           | -----     | -----                         | -----                         | -----      |
|                           | \$ 18,168 | \$ 16                         | (\$248)                       | \$ 17,     |
|                           | =====     | =====                         | =====                         | =====      |

| November 29, 2003         | Cost      | Gross Unrealized Holding Gain | Gross Unrealized Holding Loss | Fair Value |
|---------------------------|-----------|-------------------------------|-------------------------------|------------|
| Equities                  | \$ 750    | \$ 17                         | \$ 0                          | \$         |
| U.S. Treasury obligations | 27,519    | 418                           | 0                             | 27,        |
| Corporate bonds           | 253       | 0                             | (250)                         |            |
| Money Market              | 297       | 0                             | 0                             |            |
|                           | -----     | -----                         | -----                         | -----      |
|                           | \$ 28,819 | \$ 435                        | (\$250)                       | \$ 29,     |

During the six months ended May 29, 2004, the Company invested a portion of its investment securities in equity consisting of a portfolio of Standard and Poor's 100 ("S&P 100") common stocks, the fair value of which varies consistently with changes in the S&P 100 index. To hedge against fluctuations in the market value of the portfolio, the Company has purchased short-term S & P 100 index put options and sold short-term S & P 100 index call options. Although the Company uses these instruments to hedge against fluctuations in the market value of the securities, the Company has not elected to use hedge accounting. All gains and losses from the use of these instruments are included in the income statement in the period that they occur. At May 29, 2004 and November 29, 2003, the Company had no such investments, but will continue to invest in such equities in the future.

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### 3. Investment Securities (continued):

The Company has agreements with various brokerage firms to carry its account as a customer. The brokers have custody of the Company's securities and, from time to time, cash balances, which may be due from these brokers. These securities and/or cash positions serve as collateral for any amounts due to brokers or as collateral for securities sold short or securities purchased on margin. The securities and/or cash positions also serve as collateral for potential defaults of the Company.

The Company is subject to credit risk if the brokers are unable to repay balances due or deliver securities in their custody. It is the policy of the Company to limit the amount of credit exposure to any one financial institution. The Company has received confirmation indicating that, with respect to investment securities, each custodian with the exception of one custodian maintains appropriate insurance coverage. During fiscal 2003 and the six months ended May 29, 2004, that custodian had an average balance of approximately \$9.6 million, and \$6.7 million, respectively, of the Company's cash under investment which from time to time during such periods was invested entirely in equity securities. At May 29, 2004, that custodian had approximately \$5.6 million of the Company's cash under investments, which were all invested in U.S. Treasury obligations. The Company's investment policy currently permits up to 50% of the Company's portfolio to be held by the custodian.

#### 4. Inventories:

The Company's inventories are valued at the lower of cost or market. Cost is determined principally by the last-in, first-out (LIFO) method with the remainder being determined by the first-in, first-out (FIFO) method. Because the inventory valuation under the LIFO method is based upon an annual determination of inventory levels and costs as of the fiscal year-end, the interim LIFO calculations are based on management's estimates of expected year-end inventory levels and costs.

|   | May 29, 2004 | November 29, 2003 |
|---|--------------|-------------------|
|   | -----        | -----             |
| Raw materials   | \$ 1,799,000 | \$ 1,446,000      |
| Work in process   | 1,653,000    | 1,867,000         |
| Finished goods  | 1,867,000    | 2,218,000         |
|   | -----        | -----             |
| Total   | \$ 5,319,000 | \$ 5,531,000      |
|   | =====        | =====             |
| Approximate percentage of<br>inventories valued<br>under LIFO valuation | 63%          | 61%               |
|   | =====        | =====             |
| Excess of FIFO valuation<br>over LIFO valuation                         | \$ 1,307,000 | \$ 1,007,000      |
|   | =====        | =====             |

Inventories accounted for under the LIFO method are goods manufactured for the Apparel segment. Inventories accounted for under the FIFO method are goods manufactured for the Home Furnishing and Accessories and the Other segments. Both methods are not used for similar types of goods. The Company reviews inventory values on a quarterly basis for items requiring markdowns to lower of cost or market value or due to obsolescence.

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## NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

5. Income Per Share:

Basic and diluted earnings per share for the 13 weeks ended May 29, 2004 and May 31, 2003 are calculated as follows:

|                                      | Net<br>Income | Average<br>Shares |
|--------------------------------------|---------------|-------------------|
|                                      | -----         | -----             |
| For the 13 weeks ended May 29, 2004: | \$767,000     | 5,215,031         |
|                                      | -----         | -----             |
| For the 13 weeks ended May 31, 2003: | \$320,000     | 5,238,015         |
|                                      | -----         | -----             |

Basic and diluted earnings per share for the 26 weeks ended May 29, 2004 and May 31, 2003 are calculated as follows:

|                                      | Net<br>Income | Average<br>Shares |
|--------------------------------------|---------------|-------------------|
|                                      | -----         | -----             |
| For the 26 weeks ended May 29, 2004: | \$475,000     | 5,215,031         |
|                                      | -----         | -----             |
| For the 26 weeks ended May 31, 2003: | \$ 50,000     | 5,238,015         |
|                                      | -----         | -----             |

There were no options outstanding during the 26 weeks ended May 29, 2004 and May 31, 2003, respectively. During fiscal 2002, all outstanding options were either exercised or cancelled.

6. Comprehensive Income:

Accumulated other comprehensive income (loss) is comprised of unrealized holding gains (losses) related to available-for-sale securities. Comprehensive income was \$225,000 and \$399,000 for the 26 weeks ended May 29, 2004 and May 31, 2003, respectively, and \$468,000 and \$427,000 for the 13 weeks ended May 29, 2004 and May 31, 2003 respectively.

7. Litigation:

On November 10, 2003, a class action suit was filed against the Company in Delaware Chancery Court. The complaint asserts claims against the Company

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and certain of its officers and directors based on the management buy-out proposal at a price allegedly lower than the cash value and book value of the Company's shares and which was an allegedly interested transaction, the amendment to Mr. Bitensky's employment contract, the Company's failure to seek stockholder approval for the management buyout and the Company's failure to file a certificate of dissolution with the Delaware Secretary of State. The complaint alleges such actions constitute violations of defendants fiduciary duties as well as the provisions of the Delaware General Corporation.

The complaint does not seek a specific amount of damages, and seeks to enjoin defendants from effectuating the planned management buyout. The company served an answer to the complainant on December 11, 2003. On each of November 21 and November 26, 2003 class action lawsuits were initiated against the Company in Delaware Chancery Court asserting substantially the same allegations as those described above.

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### 7. Litigation (continued):

The Company believes that each of the claims described above is without merit. Further, certain of the claims described above have been rendered moot by the withdrawal of preliminary offer by management-led buyout to acquire the Company.

A number of claims and lawsuits seeking unspecified damages and other relief are pending against the Company. It is impossible at this time for the Company to predict with any certainty the outcome of such litigation. However, management is of the opinion based upon information presently available, that it is unlikely that any liability would be material in relation to the Company's consolidated financial position and results of operations.

#### Other

The Company has a letter of credit with its insurance provider for \$400,000.

#### 8. Effect of recently Issued Accounting Standards

In January 2003, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 46, "Consolidation of Variable Interest Entities" ("FIN 46"). This interpretation requires certain variable interest entities ("VIEs"), commonly referred to as special purpose entities, to be consolidated by the primary beneficiary of the entity if the equity investors in the entity do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46 was effective for all new VIEs created or acquired after January 31, 2003. During December 2003, the FASB issued a revision to FIN 46 ("FIN 46R"). Under the new provisions, public entities were required to apply the guidance if the entity has interests in VIEs for the periods ending after December 15, 2003. Application of this guidance by public companies was required for all other types of entities for periods

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ending after March 15, 2004. The Company's adoption of FIN 46R did not have an effect on its consolidated financial statements.

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### 9. Derivative Financial Instruments Held or Issued

The Company is party to equity option contracts as part of its investing activities. Option contracts are contractual agreements that give the purchaser the right, but not the obligation, to purchase or sell a financial instrument at a predetermined exercise price. In return for this right, the purchaser pays a premium to the seller of the option. By selling or writing options, the Company receives a premium and becomes obligated during the term of the option to purchase or sell a financial instrument at a predetermined exercise price if the option is exercised, and assumes the risk of not being able to enter into a closing transaction if a liquid secondary market does not exist. As of May 29, 2004, the Company had no equity option contracts. During the six months ended May 29, 2004, the Company was party to equity option contracts from time to time.

#### 10. Segment Information:

The Company adopted SFAS No. 131 "Disclosure About Segments of an Enterprise and Related Information" in fiscal 1999. SFAS No. 131 requires companies to report information on segments using the way management organizes segments within the company for making operating decisions and assessing financial performance.

The Company's chief operating decision-maker is considered to be the Chief Executive Officer (CEO). The Company's CEO evaluates both consolidated and disaggregated financial information in deciding how to allocate resources and assess performance. The Company has identified three reportable segments based upon the primary markets it serves: Apparel Fabrics, Home Fashions, Industrial Fabrics and Accessories and Other.

**Apparel Fabrics:** The Company is a major manufacturer of warp and circular knit fabrics and raschel laces. The Company's textile fabrics are sold to a wide variety of manufacturers of ready-to-wear and intimate apparel for men, women, and children, including dresses and sportswear, children's sleepwear, activewear, swimwear, and recreational apparel.

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### NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

#### 10. Segment Information (continued):

**Home Fashions and Accessories:** While sales primarily to manufacturers of home furnishings, we also use our own textile fabrics internally to produce flannel

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and satin sheets, blanket products, comforters, and other bedding products which we sell to specialty stores, catalogue and mail order companies, and airlines.

Other: The Company produces a line of ultrasonically, hot melt adhesive, flame and adhesive bonded products for apparel, environmental, health care, industrial and consumer markets. The Company's textile fabrics are sold to manufacturers servicing the residential and contract markets. The Company also sells fabrics in the over the counter markets.

The Company neither allocates to the segments nor bases segment decisions on the following:

- Interest and dividend income
- Interest and other expense
- Net gain on investment securities
- Income tax expense or benefit

Many of the Company's assets are used by multiple segments. While certain assets such as Inventory and Property, Plant and Equipment are identifiable by segment, an allocation of the substantial remaining assets is not meaningful.

The 26 weeks and the 13 weeks ended May 29, 2004 and May 31, 2003, includes gain on the sale of fixed assets of \$1,007,000, and \$322,000, and \$316,000 and \$142,000, respectively. Of this, \$441,000 in the 26 weeks ended May 29, 2004 belongs to the Other Segment and the balance applied to the Apparel Segment. In addition, for the 26 weeks ended May 29, 2004 the Apparel Segment includes a \$250,000 reserve for environmental costs.

| (in thousands)                         |          |                                  |         |          |
|--|----------|----------------------------------|---------|----------|
| 26 Weeks Ended 05/29/04<br>(Unaudited) | Apparel  | Home Fashions<br>and Accessories | Other   | Total    |
| -----                                  | -----    | -----                            | -----   | -----    |
| External sales                         | \$17,724 | \$2,595                          | \$4,418 | \$24,737 |
| Intersegment sales                     | 1,657    | 25                               | 96      | 1,778    |
| Operating income/(loss)                | (1,478)  | 186                              | 1,120   | (172)    |
| Segment assets                         | 11,060   | 941                              | 1,572   | 13,573   |

| (in thousands)                         |          |                                  |         |          |
|--|----------|----------------------------------|---------|----------|
| 26 Weeks Ended 05/29/04<br>(Unaudited) | Apparel  | Home Fashions<br>and Accessories | Other   | Total    |
| -----                                  | -----    | -----                            | -----   | -----    |
| External sales                         | \$19,708 | \$1,774                          | \$3,751 | \$25,233 |
| Intersegment sales                     | 1,752    | 21                               | 168     | 1,941    |
| Operating income/(loss)                | (1,056)  | (92)                             | 351     | (797)    |
| Segment assets                         | 15,462   | 920                              | 2,615   | 18,997   |

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26 WEEKS ENDED

| PROFIT OR LOSS (UNAUDITED)        | MAY 29, 2004 | MAY 31, 2004 |
|-----------------------------------|--------------|--------------|
| Total operating loss for segments | \$ (172)     | \$ (797)     |
| Total other income                | 932          | 897          |
| Income before income tax benefit  | \$ 760       | \$ 100       |

| 13 Weeks Ended 05/29/04 | Apparel  | Home Fashions<br>and Accessories | Other   | Total    |
|-------------------------|----------|----------------------------------|---------|----------|
| External sales          | \$10,734 | \$1,362                          | \$2,500 | \$14,596 |
| Intersegment sales      | 608      | 10                               | 54      | 672      |
| Operating income (loss) | (95)     | 263                              | 472     | 640      |

| 13 Weeks Ended 05/31/03 | Apparel  | Home Fashions<br>and Accessories | Other   | Total    |
|-------------------------|----------|----------------------------------|---------|----------|
| External sales          | \$10,586 | \$969                            | \$2,091 | \$13,646 |
| Intersegment sales      | 906      | 2                                | 96      | 1,004    |
| Operating income (loss) | (292)    | (54)                             | 262     | (84)     |

13 WEEKS ENDED

| PROFIT OR LOSS (UNAUDITED)                 | MAY 29, 2004 | MAY 31, 2004 |
|--|--------------|--------------|
| Total operating income (loss) for segments | \$ 640       | \$ (84)      |
| Total other income                         | 542          | 579          |
| Income before taxes on income              | \$ 1,182     | \$ 495       |

11. Commitments:

On July 25, 2003, the Company and Mr. Bitensky amended the employment agreement between the Company and Mr. Bitensky dated as of March 1, 1993 to provide that at such time as the Company is sold or liquidated pursuant to the Plan, in lieu of the annual consulting fees due under such an agreement over the five year consulting period provided therein, Mr. Bitensky will receive a lump sum payment equal to the aggregate net present value of each payment due under such agreement, such present value to be determined utilizing the prevailing prime rate at the time of the payment, as determined by the Board.

Such amendment to the Employment Agreement also provides that Mr. Bitensky relinquishes his right under the terms of the original agreement to require the Company to purchase upon his death approximately \$10,000,000 of shares of Common Stock from his estate. In consideration of Mr. Bitensky's relinquishing such



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right, the Company agreed to transfer to Mr. Bitensky ownership of the three life insurance policies on Mr. Bitensky's life owned by the Company. The Company transferred these policies during fiscal year ended November 29, 2003.

### 12. Other Expense:

During the 26 weeks ended May 29, 2004, the Company recorded an accrual of \$250,000 for environmental costs.

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

The domestic textile industry has been negatively affected by a flow of low cost foreign imports and market conditions since 1998.

The Company's Board of Directors has determined that it is in the best interests of its stockholders to sell the Company's textile business as a going concern. In order to maximize stockholder value, the Board of Directors adopted resolutions dated March 1, 2002, which authorized, subject to stockholder approval, the sale of the Company's business pursuant to a Plan of Liquidation and Dissolution (the "Plan"). The Company's stockholders approved the Plan at the Company's annual meeting on May 30, 2002. The Plan provides the Company's officers and directors will continue to operate the Company's textile business in its current fashion and pursue a sale of the business as a going concern. The Company's Board of Directors has approved the engagement of McFarland Dewey & Co., LLC financial advisors in November 2002 to assist with the sale of the business. The accompanying financial statements have been prepared on a going concern basis. There can be no assurance, however, that the Company will be successful in selling it's business or if it does sell the business, that it will be able to recover full value of it's assets, particularly it's property, plant and equipment. On February 18, 2004, August 1, 2003 and May 30, 2002, the Company's Board of Directors declared a liquidating distribution of \$3.00 per share, \$4.00 per share and \$10.00 per share, respectively, which resulted in a payment to stockholders of \$15,645,000, \$20,860,000 and \$52,380,000 in March 2004, August 2003 and June 2002, respectively. Of the total June 2002 liquidating dividend, \$6,641,000 was deducted from additional paid in capital until the paid in capital account was eliminated and represents a return of capital. The remaining liquidating dividend of \$45,739,000 was deducted from retained earnings.

The Company's plan of liquidation provides the Company's officers and directors will continue to operate the Company's textile business in its current fashion and pursue the sale of the business as a going concern. If the Company is not sold by May 2005, all assets will be transferred to a liquidating trust. The liquidating trust would then succeed to all our remaining assets, liabilities and obligations.

The Company is currently in compliance with the 40% limitation on holding investment securities set forth in the Investment Company Act of 1940 and intends to remain in compliance with such requirement in the future.

### RESULTS OF OPERATIONS

#### Second Quarter and Six Months

#### FISCAL 2004 COMPARED TO FISCAL 2003

Net sales for the second quarter of fiscal 2004 were \$14,596,000 as compared to

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\$13,646,000 in the similar 2003 period, an increase of \$950,000 or 7.0%. Even though the domestic textile industry has been negatively affected by a flow of low cost foreign imports and market conditions since 1998, the Company in the current quarter has shown a slight increase in all 3 segments; Apparel, Home Fashions and Accessories and Other, as a result of volume increases to several customers. For the six months ended May 29, 2004, net sales were \$24,737,000, a decline of \$496,000, or 2.0% from 2003.

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Gross margins as a percentage of sales for the second quarter of fiscal 2004 increased to 15.8% from 9.9% as compared to the similar 2003 period. For the six months ended May 29, 2004 gross margins increased to 11.1% compared to 8.3% in the similar 2003 period. These increases are due to a more favorable product mix and reduction in costs due to employee termination and related expenses and a decrease in depreciation expenses. For the six months and three months ended May 29, 2004 and the six months and three months ended May 31, 2003, an increase in LIFO reserves of \$300,000 was recorded. This was due to higher average FIFO prices.

Selling, general and administrative expenses for the 13 weeks and 26 weeks increased by \$414,000 and \$462,000, respectively, compared to the similar 2003 period. An increase in professional fees, salesmen's commission, and provision for doubtful accounts was partially offset by a reduction in payroll and other expenses.

Other expenses for the 26 weeks include an accrual for \$250,000 for environmental costs, which was recorded in the quarter ending February 28, 2004.

For the 13 weeks and 26 weeks ended May 29, 2004, the Company has a gain on the sale of fixed assets of \$322,000 and \$1,007,000 respectively, compared to \$142,000 and \$316,000 respectively for the 13 weeks and 26 weeks ended May 31, 2003.

Interest and dividend income for the 13 and 26 weeks ended May 29, 2004 decreased by \$239,000 and \$364,000 respectively from the similar 2003 period. On March 10, 2004, the Company distributed its third liquidating distribution of \$3.00 per share, or \$15,645,000. Accordingly, the Company had lower average invested balances for the three and six months ended May 29, 2004. In the current quarter, the Company realized gains from the sale of investment securities of \$434,000 compared to \$232,000 in the comparable second quarter of 2003. For the six months ended May 29, 2004, the Company realized gains from the sale of investment securities of \$602,000 compared to \$203,000 in last year's comparable six months.

The effective income tax rate for the current quarter was 35.1% as compared to 35.4% last year's second quarter. The effective income tax rate for the 26 weeks ended May 29, 2004 was 37.5%, as compared to 50.0% last year's 26 weeks. The prior year's 50% effective income tax rate for the 26 weeks ended May 31, 2003, was due to minimum state and franchise taxes.

As a result of these factors, the Company has net income of \$767,000 or \$0.15 basic and diluted earnings per share and \$475,000 or \$0.09 basic and diluted earnings per share for the 13 weeks and 26 weeks ended May 29, 2004, respectively, compared to net income of \$320,000 or \$0.06 basic and diluted earnings per share and \$50,000 or \$0.01 basic and diluted earnings per share for the 13 and 26 weeks ended May 31, 2003, respectively.

LIQUIDITY AND CAPITAL RESOURCES

Net cash provided by operating activities for the 26 weeks ended May 29, 2004 amounted to \$1,144,000 due to an increase in operating cash flows from increased gross margins and an increase in accounts payable, accruals and other liabilities, partially offset by an increase in accounts receivable. The variability of operating cash flows is principally caused by sales fluctuations and the amount of cash provided by changes in working capital accounts. Net proceeds from sales of investment securities were \$11,253,000 for the 26 weeks ended May 29, 2004 compared to acquisition of investment securities of \$634,000 in the comparative 2003 period. The Company mainly used the proceeds from sales of investment securities during the 26 weeks ended May 29, 2004 for the third liquidating distribution of \$3.00 per share or \$15,645,000 on March 10, 2004.

Stockholders equity was \$33,509,000 (\$6.43 book value per share) at May 29, 2004 as compared to \$48,929,000 (\$9.38 book value per share) at the previous year-end November 29, 2003 and \$64,977,000 (\$12.40 book value per share) at May 31, 2003. The reduction in stockholders' equity from May 31, 2003 was primarily due to the second liquidating distribution of \$4.00 per share, or \$20,860,000 on August 22, 2003 and the third liquidating distribution of \$3.00 per share or \$15,645,000 paid on March 10, 2004.

Management believes that the Company's current financial position is adequate to satisfying working capital requirements and to internally fund any future expenditures to maintain its manufacturing facilities for the next twelve months.

Commitments:

On July 25, 2003, the Company and Mr. Bitensky amended the Employment Agreement between the Company and Mr. Bitensky dated as of March 1, 1993 to provide that at such time as the Company is sold or liquidated pursuant to the Plan, in lieu of the annual consulting fees due under such an agreement over the five year consulting period provided therein, Mr. Bitensky will receive a lump sum payment equal to the aggregate net present value of each payment due under such agreement, such present value to be determined utilizing the prevailing prime rate at the time of the payment, as determined by the Board.

Such amendment to the Employment Agreement also provides that Mr. Bitensky relinquishes his right under the terms of the original agreement to require the Company to purchase upon his death approximately \$10,000,000 of shares of Common Stock from his estate. In consideration of Mr. Bitensky's relinquishing such right, the Company agreed to transfer to Mr. Bitensky ownership of the three life insurance policies on Mr. Bitensky's life owned by the Company. The Company transferred these policies during fiscal year ended November 29, 2003.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the period. The critical accounting policies that affect the Company's more complex judgments and estimates are described in the Company's Annual Report on Form 10-K for the fiscal year ended November 29, 2003.

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FORWARD-LOOKING INFORMATION

Certain statements in this report are "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995. All forward-looking statements involve risks and uncertainties. In particular, any statement contained herein, in press releases, written statements or other documents filed with the Securities and Exchange Commission, or in our communications and discussions with investors and analysts in the normal course of business including, but not limited to, meetings, phone calls and conference calls, regarding the sale of our assets pursuant to a plan of liquidation and dissolution, as well as expectations with respect to future sales and operating efficiencies prior to a sale of the company, are subject to known and unknown risks, uncertainties and contingencies, many of which are beyond our control and which may cause actual results, performance or achievements to differ materially from anticipated results, performances or achievements. Forward-looking statements, which are based on certain assumptions and describe our future plans, strategies, and expectations, are generally identifiable by the use of words "may", "will", "should", "expect", "anticipate", "estimate" "believe" "intend" or "project" or the negative of them or other variations of them or comparable terminology.

Factors that could have a material adverse effect on our operations and future prospects include, but are not limited to: our ability to find qualified buyers for our assets; overall economic and business conditions; our continuing ability to support the demand for our goods and services; competitive factors in the industries in which we compete; changes in government regulation; changes in tax requirements (including tax rate changes, new tax laws and revised tax law interpretations); interest rate fluctuations and other capital market conditions, including foreign currency rate fluctuations; material contingencies provided for in a sale of our assets; de-listing of our common stock from the American Stock Exchange; our ability to retain key employees through any wind down period; and any litigation arising as a result of our plan to wind down our operations. These risks and uncertainties should be considered in evaluating any forward-looking statements contained in this quarterly report on Form 10-Q.

We undertake no obligation to update or revise a forward-looking statement, whether as a result of new information, future events, or otherwise, other than required by law.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company is exposed to risk of fluctuations in the market value of equity securities. To manage this exposure, the Company uses derivatives to hedge against fluctuations in the market value of equity securities. The Company's policy is to recognize all derivative instruments as either assets or liabilities on the balance sheet at fair value. Changes in the fair value are recognized in the income statement in the period in which they occur. Derivatives are not used for trading purposes. At May 29, 2004 and November 29, 2003, the Company has no such investments, but will continue to invest in such equities in the future.

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ITEM 4. CONTROLS AND PROCEDURES

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- (a) **EVALUATION OF DISCLOSURE CONTROLS AND PROCEDURES:** Our Chief Executive Officer and Chief Financial Officer, having concluded, based on their evaluation, as of the end of the period covered by this report, that our disclosure controls and procedures (as defined in the Securities and Exchange Act of 1934 Rules 13a-15(e) and 15-15(e)) are (1) effective to ensure that material information required to be disclosed by us in reports filed or submitted by us under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms, and (2) designed to ensure the material information required to be disclosed by us in such reports is accumulated, organized and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriated, to allow timely decisions regarding required disclosure.
- (b) **INTERNAL CONTROL OVER FINANCIAL REPORTING:** There were no significant changes in the Company's internal controls over financial reporting (as defined in Rules 13a-15(f) and 15(d)-15(f) under the Securities and Exchange Act of 1934, as amended) that occurred during the Company's most recent quarter that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

It should be noted that any system of controls, however well designed and operated, can provide only reasonable, and not absolute assurance that the objectives of the system will be met. In addition, the design of any control system is based in part upon certain assumptions about the likelihood of future events. Because of these and other inherent limitations of control systems, there is only reasonable assurance that our controls will succeed in achieving their stated goals under all potential future conditions.

### PART II. OTHER INFORMATION

#### Item 6. Exhibits and Reports on Form 8-K

a) Exhibits:

- 31.1 Certification by Samson Bitensky pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 31.2 Certification by David A. Miller pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
- 32.1 Certification by Samson Bitensky pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification by David A. Miller pursuant to 18 U.S.C. Section 1350, as adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

b) Reports on Form 8-K:

The Company furnished on April 13, 2004, a report on Form 8-K announcing, under Item 9 of such form, its earnings for the 13 weeks ended February 28, 2004.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Dated: July 13, 2004

FAB INDUSTRIES, INC.

By: /s/ Samson Bitensky

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Chairman of the Board  
And Chief Executive Officer

By: /s/ David A. Miller

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David A. Miller  
Vice President-Finance, Treasurer  
and Chief Financial Officer  
(Principal Financial and Accounting  
Officer)

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