

SCOTTS LIQUID GOLD INC

Form 10KSB

March 14, 2008

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**UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-KSB**

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

For the fiscal year ended December 31, 2007

OR

**o 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 001-13458

SCOTT S LIQUID GOLD-INC.

(Name of small business as specified in its charter)

Colorado
*(State or other jurisdiction of
incorporation or organization)*

84-0920811
*(I.R.S. Employer
Identification No.)*

4880 Havana Street, Denver, CO 80239
(Address of principal executive offices and Zip Code)
(303) 373-4860

(Issuer's telephone number)

Securities registered pursuant to Section 12(b) of the Act: None

Securities registered pursuant to Section 12(g) of the Act: \$0.10 Par Value Common Stock

Check whether the Issuer is not required to file reports pursuant to Section 13 or 15(d) of the Exchange Act. o

Check whether the Issuer (1) filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act during the past 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 þ No o

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendments to this Form 10-KSB. o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act.) YES o NO þ

The issuer's revenues for the fiscal year ended December 31, 2007 were \$17,918,500.

The aggregate market value of the common stock held by non-affiliates of the issuer, assuming directors are affiliates, was \$3,627,949 on January 31, 2008.

As of January 31, 2008, there were 10,575,000 shares of common stock, \$0.10 par value per share, outstanding.

The following documents are incorporated by reference: The Registrant's definitive Proxy Statement for the Annual Meeting of shareholders scheduled to be held on May 6, 2008, is incorporated by reference in Part III.

Transitional Small Business Disclosure Format (check one): Yes o No þ

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PART I

Item 1. Description of Business

General

Scott's Liquid Gold-Inc., a Colorado corporation, was incorporated on February 15, 1954. Through our wholly-owned subsidiaries, we manufacture and market quality household and skin care products and act as a distributor in the United States of beauty care products contained in individual sachets and manufactured by Montagne Jeunesse and of certain other products. In this Report, collectively, the terms "we", "us" or "our" refers to Scott's Liquid Gold-Inc. and our subsidiaries. Our business is comprised of two segments, household products and skin care products.

Our household products consist of (a) Scott's Liquid Gold® for wood, a wood preservative and cleaner, sold nationally for over 30 years; (b) a wood wash and wood wipes under the name of Scott's Liquid Gold; (c) Scott's Liquid Gold Mold Control 500, a consumer product that helps rid homes of mold, introduced in 2006; (d) Touch of Scent®, an aerosol room air freshener, distributed nationally since 1982; and (e) an aerosol air freshener called Odor Extinguisher introduced during 2007. In early 1992, we entered into the skin care business through our subsidiary, Neoteric Cosmetics, Inc. Our skin care products consist primarily of Alpha Hydrox® products, our Neoteric Diabetic products, our Neoteric massage oil products, and products we distribute including the sachets of Montagne Jeunesse and men's grooming sachets and hair care products we import from Australia. At the end of 2007, more than 25 skin care products were being marketed by us with our brand name, as well as the products we distribute.

For information on our operating segments, please see Note 8, Segment Information, to our Consolidated Financial Statements.

This report may contain forward-looking statements within the meaning of U.S. federal securities laws. These statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements and our performance inherently involve risks and uncertainties that could cause actual results to differ materially from the forward-looking statements. Factors that would cause or contribute to such differences include, but are not limited to, continued acceptance of each of our significant products in the marketplace; the degree of success of any new product or product line introduction by us; uncertainty of consumer acceptance of the new Alpha Hydrox products introduced in 2005 and 2007, and Mold Control 500 and wood wash products; competitive factors; any decrease in distribution of (i.e., retail stores carrying) our significant products; continuation of our distributorship agreement with Montagne Jeunesse; the need for effective advertising of our products; limited resources available for such advertising; new competitive products and/or technological changes; dependence upon third party vendors and upon sales to major customers; changes in the regulation of our products, including applicable environmental regulations; continuing losses which could affect our liquidity; the loss of any executive officer; and other matters discussed in this Report. We undertake no obligation to revise any forward-looking statements in order to reflect events or circumstances that may arise after the date of this Report.

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Strategy

Our strategy is to manufacture and market high quality consumer products which are distinct within each category in which we compete. Scott's Liquid Gold for wood distinguishes itself from competing products as a wood cleaner and preservative, not simply a polish. Mold Control 500 is based on technology developed and patented by a national laboratory. Touch of Scent is different from most competing aerosol air fresheners in that it need not be shaken before each use and because it may be activated by an attractive dispenser which may be mounted on any hard, smooth surface. It is more convenient to use than competing aerosol brands. With respect to our line of skin care products, Alpha Hydrox was one of the first alpha hydroxy acid skin care products sold to retailers for resale to the public at affordable prices. In 1998, we added a retinol product to our skin care line. In the first half of 1999, we introduced *Neoteric Diabetic Skin Care*®. Since 2001, we have sold Montagne Jeunesse sachets which are reasonably priced and designed for single use by the consumer. We will continue to examine other possible new products which we believe may fit well with our expertise and financial capabilities. We have introduced other new products or variants of products in subsequent years.

The growth in sales of Alpha Hydrox from 1992 through 1996 caused us to make substantial investments in property, plant and equipment to handle that growth and the anticipated future growth of our skin care products. The decline in sales of those products in 1998 through 2004 and in 2006 and 2007, as well as declines in sales of household chemical products, has resulted in efforts by us to maintain or increase sales of the existing products, to introduce new products, and to decrease our costs of doing business. We introduced new products and engaged in cost-cutting programs during 2000, 2001, 2002 and 2006. Additionally, we introduced several new Alpha Hydrox products in 2005, two new Alpha Hydrox products in 2006, and four new Alpha Hydrox products in 2007.

Our goal for 2008 is to resume sales growth and attain profitability. To achieve these goals, we will continue to work on expanding the distribution of Montagne Jeunesse products and our distribution of products manufactured by others, as well as of our newer Alpha Hydrox products, increasing sales of Scott's Liquid Gold for wood and our new mold remediation product Mold Control 500 and introducing new products. Within the household product line we plan to introduce three to four new products or items including some additions to our air fragrance product line. We will also consider the development of new niche products, offer to manufacture private label products for others, and explore the possibility of joint ventures and other projects which would utilize our manufacturing or marketing capabilities.

Products

Scott's Liquid Gold for wood, a wood cleaner and preservative, has been our core product since our inception. It has been popular throughout the U.S. for over thirty years. Scott's Liquid Gold for wood, when applied to wood surfaces such as furniture, paneling, kitchen cabinets, outside stained doors and decking, penetrates microscopic pores in the surface and lubricates beneath, restoring moisture and, at the same time, minimizes the appearance of scratches, darkening the wood slightly. Scott's Liquid Gold preserves wood's natural complexion and beauty without wax. In May 2004, we commenced the introduction of an additional wood care product in a wipe form; however, sales have been minimal so far. In the second quarter of 2005 we introduced

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a wood wash product under the Scott's Liquid Gold product line; however, we have obtained limited distribution so far.

During the second quarter of 2006 we began the introduction of our mold remediation product Mold Control 500. It is too early to determine if this introduction will be successful. Scott's Liquid Gold Mold Control 500 is an advanced restoration, remediation and antibacterial disinfectant system designed for consumer use on mildew, fungus, mold and fungal spores.

In 1982, we added the room air freshener Touch of Scent to our line of household products. Touch of Scent, available in many fragrances, is intended to be used in conjunction with a decorative dispenser which can be mounted on any hard surface and into which the consumer inserts an aerosol refill unit. At a touch, the dispenser propels the fragrance from a refill unit into the air, masking unpleasant odors and refreshing the air with a pleasant scent. We manufacture the refill unit. Unlike some competitive aerosol air fresheners, Touch of Scent is extremely dry and, therefore, leaves practically no residue after use. Touch of Scent sales have not been strong in recent years. In 2007, we introduced Odor Extinguisher which is a room air freshener and is sold in containers in the shape of a fire extinguisher.

Household products accounted for 44.9% of our consolidated net sales in 2007 and 53.1% in 2006.

In early 1992, we began to market two skin care products under the trade name of Alpha Hydrox. Since that time we have made additions to our skin care products, some of which were discontinued. In 2005, we introduced four new Alpha Hydrox products with refined formulas, and in 2007 we introduced a value priced Alpha Hydrox White line of products. At the end of 2007, our skin care line consisted of over 15 products. Our Alpha Hydrox skin care products are sold through a wholly-owned subsidiary, Neoteric® Cosmetics, Inc. Except for the Montagne Jeunesse sachets and other products noted below which are distributed by us, our skin care products are manufactured by Neoteric Cosmetics. Several of the Alpha Hydrox products contain alpha hydroxyethanoic acids in low but effective concentrations. Properly blended with a carrier, alpha hydroxyethanoic acids gently slough off dead skin cells to promote a healthier, more youthful appearance and diminish fine lines and wrinkles. Our products with alpha hydroxy acids (AHAs) include facial care products, a body lotion and a foot crème. Our other skin care products do not contain AHAs. These products include Neoteric Diabetic Skin Care, which is a healing crème and a therapeutic moisturizer developed by us to address the skin conditions of diabetics, caused by poor blood circulation, and which contains a patented oxygenated oil technology; an Alpha Hydrox Oxygenated Moisturizer, which is our second skin care product based on the oxygenated oil technology; a Retinol product containing a patented Microsponge technology that softens fine lines and wrinkles; and a body wash. The Montagne Jeunesse sachets, described more below, do not contain AHAs.

In April of 2001, we made our first sale of skin care sachets under a distributorship agreement with Montagne Jeunesse. Our agreement covers sales in the United States. Montagne Jeunesse is a trading division of Medical Express (UK) Ltd., a company located in England. Montagne Jeunesse sachet products are currently sold by others in the United Kingdom, Holland, Italy, Ireland, Canada, Australia, Germany and Austria. Examples of the Montagne Jeunesse products are a facial scrub, a mud pack, face masks, a cream for foot rubs, and one night hair color. A significant portion of our sales are now generated through the distribution of the Montagne Jeunesse products

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and, therefore, are dependent on the agreement under which they are purchased by us. See Manufacturing and Suppliers below.

Other products distributed in the United States by us as of December 31, 2007 and the date of this Report are DaVinci and Moosehead men's grooming products (introduced in 2006 and 2007), Neoteric massage oils for bath, body and massage (introduced in 2007) and bath, body and hair care products of Baylis & Harding (introduced in 2007).

Our business is seasonal to some extent. Sales of Montagne Jeunesse products have been higher in the fourth quarter than other quarters because of holiday promotions.

Through our research and development group, we continually consider and evaluate possible new products to be manufactured or sold by us. Generally these products involve household products or skin care products. However, the Company will also consider consumer products in other areas.

Marketing and Distribution

All of our products are sold nationally, directly and through independent brokers, to mass marketers, drugstores, supermarkets, and other retail outlets and to wholesale distributors. In both 2007 and 2006, Wal-Mart Stores, Inc. (Wal-Mart) accounted for approximately 28% of our sales of household products. With regard to our skin care products, Wal-Mart accounted for approximately 35% of 2007 sales (23% in 2006), and Rite-Aid accounted for approximately 13% of 2007 sales (7% in 2006). Wal-Mart and Rite-Aid accounted for approximately 34% and 8%, respectively, of the combined sales of household products and skin care products in 2007. No long-term contracts exist between us and Wal-Mart, Rite Aid or any other customer. We permit returns of our products by our customers, a common industry practice. A recent practice of retailers has been to return products that have either been discontinued or not sold after a period of time. We subtract any returns from gross sales in determining our net sales and provide a reserve for such returns which is netted against accounts receivable and gross sales on our financial statements.

During the years 2001 through 2004, and again in 2006 and 2007, we experienced a decrease in the distribution of the Alpha Hydrox products as a result of slowing sales. In 2005, we introduced four new items in our Alpha Hydrox line of cosmetics, which resulted in some increased distribution by selling those products to retail store chains not carrying any of our other Alpha Hydrox products. If sales of one of our products continue to decline, other retail stores, including potentially Wal-Mart and Rite-Aid, may discontinue the product. One of our strategies is to maintain or increase sales of products through limited television advertising. The level of advertising for our products is constrained by our size and financial resources. Any significant decrease in the distribution of Alpha Hydrox or Scott's Liquid Gold products at retail stores could have a material adverse effect on our sales and operating results.

Our Scott's Liquid Gold wood care products, Mold Control 500 product, and Alpha Hydrox products have been advertised nationally on network television, on cable television, and, at times, in print media. Expenditures for these purposes in 2007 were a small amount relative to net sales and these expenditures in prior years. In the past, we have also used radio advertising in selected areas and may do so in the future. To date, we have not used television advertising for the Montagne Jeunesse products. We

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periodically review our advertising plans and may revise planned advertising expenditures based upon actual sales results and competitive conditions.

To enable consumers to make informed decisions, our containers and promotional materials note the concentration of alpha hydroxy acid contained in each of our Alpha Hydrox products which contain such acids. We recommend the use of sunscreen in our written directions contained in every box of Alpha Hydrox products with such acids. We do not exaggerate benefits to be expected from the use of our products. We also maintain a 24-hour, toll free telephone number and website for use by consumers of our products.

Our household (except for the Mold Control 500 product) and skin care products are sold in Canada and other foreign countries. Please see Note 8, Segment Information, to the Consolidated Financial Statements for information regarding sales in foreign countries. Currently, foreign sales are made to distributors who are responsible for the marketing of the products, and we are paid for these products in United States currency.

Manufacturing and Suppliers

We own and operate our manufacturing facilities and equipment. With the exception of the other products mentioned below, our wood wipes, and our Mold Control 500 product, we manufacture all of our products, maintaining a high quality standard. Products manufactured by others include Montagne Jeunesse sachets, our wood wipes, our Mold Control 500 product, Odor Extinguisher, the DaVinci and Moosehead men's products, and the Baylis & Harding products. We fill and package our Mold Control 500 product at our facilities. For all of our products, we must maintain sufficient inventories to ship most orders as they are received.

Quality control is enforced at all stages of production, as well as upon the receipt of raw materials from suppliers. Raw materials are purchased from a number of suppliers and, at the present time, are readily available. In 2007, E.I. DuPont became our sole supplier of glycolic acid, which is the most common type of alpha hydroxy acid used by us in our Alpha Hydrox products. Our sole supply for the oxygenated oil used in Neoteric Diabetic Skin Care products is a French company with which we have a non-exclusive supply agreement. Relations with this and other suppliers are satisfactory.

Most of our manufacturing operations, including most packaging, are highly automated, and, as a result, our manufacturing operations are not labor intensive, nor, for the most part, do they involve extensive training. An addition to our plant facilities, completed in early 1996, greatly increased our capacity to produce skin care products. We currently operate on a one-shift basis. Our manufacturing facilities are capable of producing substantially more quantities of our products without any expansion, and, for that reason, we believe that our physical plant facilities are adequate for the foreseeable future.

In 2001, we commenced purchases of the skin care sachets from Montagne Jeunesse under a distributorship agreement covering the United States. On May 4, 2005, our wholly-owned subsidiary, Neoteric Cosmetics, Inc. (Neoteric), entered into a new distribution agreement with Montagne Jeunesse International Ltd (Montagne Jeunesse) covering our distribution of Montagne Jeunesse products. It replaces a distribution agreement in effect since 2000. In the new agreement, Montagne Jeunesse appoints Neoteric as its exclusive distributor to market and distribute Montagne Jeunesse products in the United States of America. The appointment had an initial term of 18

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months, commencing May 3, 2005, and continues in force until terminated by either party by giving to the other party no less than three or six months notice in writing of a termination.

In the agreement, Neoteric agrees, among other things: Not to distribute during the duration of the agreement and for 36 months thereafter any goods of the same description as and which compete with the Montagne Jeunesse products; to use its best endeavors to develop, promote and sell the products in the United States and to expand the sale of the products to all potential purchasers by all reasonable and proper means; to purchase certain core products; to maintain an inventory of the products for Neoteric's own account at a level which is based on three months agreed forecasted sales for the products throughout the United States; and to submit projections of product requirements on a rolling six month basis. Montagne Jeunesse undertakes to use all reasonable endeavors to meet all orders for the products to the extent that such orders do not exceed the forecast for each type of the products. Both parties agree to suggested targeted sales for the first five years of the agreement as stated in the agreement. The prices for our purchases of these products are the published list prices as established by Montagne Jeunesse from time to time, with three months written notice of any change in the published list prices. No party may assign or transfer any rights or obligations under the agreement or subcontract the performance of any obligation.

The agreement may also be terminated for a material breach if the breaching party has failed to remedy the breach within 30 days after receipt of notice in writing and for certain other events. Montagne Jeunesse may terminate the agreement (1) if Neoteric changes its organization or methods of business in a way viewed by Montagne Jeunesse as less effective or (2) if there is a change in control of Neoteric.

The principal and controlling owner of Montagne Jeunesse, Gregory Butcher, owned beneficially, to the best of our knowledge, during 2005 more than 5% of our outstanding common stock; to the best of our knowledge, at February 15, 2008, he owned beneficially less than 5.0% of our outstanding common stock.

On April 4, 2006, we entered into a Product Development, Production and Marketing Agreement with Modec, Inc., a Colorado corporation. Pursuant to this Agreement, we purchase from Modec a product for the treatment of mold; we sell this product as Mold Control 500. We fill and package the product at our facilities and market the product to retail stores in North America. The Agreement provides us with a license for this purpose. We are required to use our commercially reasonable efforts to develop a consumer market for the product in the territory. The initial term of the Agreement was until December 31, 2007, and is automatically renewable for successive one-year terms.

In July, 2006, we entered into a Supply Agreement with Keltec Dispensing Systems USA, Inc., pursuant to which Keltec manufactured and supplied to us certain plastic components used on our product containers. The initial term of the Supply Agreement was for a period of 18 months, with a pricing adjustment possible for the last six months of the term. In addition, the Supply Agreement was renewable for an additional twelve months upon mutual consent of the parties provided the parties agree to renewal pricing based on guidelines in the Supply Agreement. The Supply Agreement could also be terminated by mutual agreement, upon a material breach of the

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terms, or upon 30-days notice by either party during any renewal period. This agreement was terminated by mutual agreement in late 2007, and thus we are manufacturing the plastic components.

Competition

Our business is highly competitive in both household and skin care products. The wood care, air freshener, and mold treatment product categories are dominated by three to five companies significantly larger than us, each of which produce several products. Irrespective of the foregoing, we maintain a visible position in the wood care category, but do not have sufficient information to make an accurate representation as to the market share of our products. Over the last several years, sales of our air freshener products have fallen off significantly and may continue to do so in the future.

The skin care category is also highly competitive. Several competitors are significantly larger than Scott's Liquid Gold-Inc., and each of these competitors produces several products. Some of these companies also produce retinol and alpha hydroxy acid products with which Alpha Hydrox must compete. Because of the number of varied products produced by competitors, we cannot make an accurate representation as to the market share of our skin care products. Irrespective of the foregoing, we currently have a national base of distribution for our Alpha Hydrox and other skin care products.

Conforming to our corporate philosophy, we compete on the basis of quality and distinguishing characteristics of our products.

Regulation

We are subject to various federal, state and local laws and regulations that pertain to the type of products we manufacture and sell. Our skin care products containing Alpha Hydroxy Acids (AHAs) are cosmetics within the definition of the Federal Food Drug and Cosmetic Act (FFDCA). The FFDCA defines cosmetics as products intended for cleansing, beautifying, promoting attractiveness or altering the appearance. Our cosmetic products are subject to regulation under the FFDCA and the Fair Packaging and Labeling Act (FPLA), and the regulations promulgated under these acts. The relevant laws and regulations are enforced by the U.S. Food and Drug Administration (FDA). Such laws and regulations govern the ingredients and labeling of cosmetic products and set forth good manufacturing practices for companies to follow. Although FDA regulations require that the safety of a cosmetic ingredient be substantiated prior to marketing, there is no requirement that a company submit the results of any testing performed or any other data or information with respect to any ingredient to the FDA. Prior to marketing our products, we conduct studies to demonstrate that our Alpha Hydrox products do not irritate the skin or eyes. Consistent with regulations, we do not submit the results of our studies to the FDA.

In July 1997, because of questions raised earlier by the FDA and as requested by the FDA, the Cosmetic Ingredient Review Expert Panel(CIR) sponsored by the cosmetic industry issued a report concerning the safety of alpha hydroxy acids. The final report, among other things, concluded that glycolic acid(the most common type of alpha hydroxy acid that we currently use) is safe for use at concentrations of up to 10%, with a pH level of no less than 3.5 and when directions for use includes the daily use of sun protection. In January 2005, the FDA issued a final guidance that products containing AHA's alert users that those products may increase skin

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sensitivity to sun and possible sunburn and the steps to avoid such consequences. All of our labeling reflects this guidance.

Since 2003, the FDA's National Center for Toxicological Research has been investigating the effect of long term exposure to AHAs. On December 31, 2003, the FDA published a call for data on certain ingredients in various products, including AHAs that are part of wrinkle remover products. Manufacturers were asked to submit any data supporting the reclassification of these cosmetic products as over-the-counter drugs. The study results were due in December 2004; however, these results have not yet been published. If the FDA should change the regulatory classification of our AHA products, there would be additional regulatory requirements applicable to our operation. The financial impact, if any, of additional regulatory requirements cannot be determined at this time.

Our advertising is subject to regulation under the Federal Trade Commission Act and related regulations, which prohibit false and misleading claims in advertising. Our labeling and promotional materials are believed to be in full compliance with applicable regulations.

Many chemicals used in consumer products, some of which are used in several of our product formulations, have come under scrutiny by various state governments and the Congress of the United States in connection with clean air laws. These chemicals are volatile organic compounds (VOCs) that are contained in various categories of consumer products. As a result of these VOC regulations, it has been necessary for us to reformulate some of our products, such as Touch of Scent, Scott's Liquid Gold Aerosol and Pourable, to conform to certain limits set by the California Air Resources Board (CARB), other states and the Environment Protection Agency. Our household chemical products currently meet the most stringent VOC regulations. CARB, in 2007, adopted changes to California's consumer product regulations that reduce VOC limits for Scott's Liquid Gold pourable formula from 7% to 3%, effective December 31, 2008. Therefore, this product is currently undergoing reformulation to comply with the new limit.

The CARB regulations concerning VOC content are relevant to our household products, and it appears that one of skin care products will be affected by new limits under CARB. CARB has proposed a VOC limit of 10% on skin toners/astringents which are not regulated by the FDA. If this limit is approved, it will go into effect on December 31, 2010. This will affect Alpha Hydrox Toner.

In the fall of 2007, Scott's Liquid Gold-Inc. was required to submit a consumer product survey to CARB, based on 2006 sales information. Scott's Liquid Gold-Inc. had to provide information for one product, Scott's Liquid Gold Aerosol. It is possible that CARB may require further VOC reductions for this aerosol product and/or for Touch of Scent (single phase air freshener). Any new or revised regulations of CARB could apply to our products and could potentially require additional reformulation of those products.

Limitations regarding the VOC content of consumer products by both state and federal agencies will continue to be a part of regulatory efforts to achieve compliance for ozone at or near ground level. Under the Clean Air Act Amendments of 1990, the Environmental Protection Agency (EPA) conducted a study on the contribution of consumer products to ozone problems and published regulations in 1998 designed to reduce the VOC content of consumer products. Various states, in addition to California, have enacted or are

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considering VOC regulations for consumer products. We are unable to predict how many or which other states might enact legislation regulating the VOC content of consumer products or what effect such legislation might have on our household products.

A group of twelve northeastern states and the District of Columbia collectively drafted the Ozone Transport Commission (OTC) Model Consumer Products Rule in 2001, which is a model that members may choose to adopt and which has standards that are substantially the same as the CARB consumer product VOC regulations. More than a majority of the OTC members have adopted the model rule. In September 2006, the OTC released a new draft model consumer products rule with an effective date of January 1, 2009. Scott's Liquid Gold products would not be affected by the changes in this new model rule, if states were to adopt the changes.

There are also potential regulations in a five state region covered by the Lake Michigan Air Directors Consortium (LADCO), which released an interim report detailing possible strategies for reducing VOC emissions. These states include Illinois, Michigan, Wisconsin, Ohio and Indiana. Michigan and Ohio are the two states in the LADCO group that have promulgated such regulations. Both Michigan's and Ohio's final rules were promulgated in 2007 and both are consistent with the OTC Model Rule.

In January 2008, Illinois EPA submitted a proposed consumer products regulation to the Illinois Pollution Control Board. This proposed regulation appears to be consistent with the OTC Model Rule and other states' regulations based on that model.

We believe that we have done all that is necessary to satisfy the current requirements of the Clean Air Act and laws of various state governments. Currently, all of our products may be sold in all areas of the United States.

Employees

We employ 77 persons (compared to 78 persons at the end of 2006), 37 in plant and production related functions and 40 in administrative, sales and advertising functions. No contracts exist between us and any union. We monitor wage and salary rates in the Rocky Mountain area and pursue a policy of providing competitive compensation to our employees. The compensation of our executive officers is under the review of the Compensation Committee of our Board of Directors. Fringe benefits for our employees include a medical and dental plan, life insurance, a 401(k) plan with matching contributions for lower paid employees (those earning \$35,000 or less per annum), an employee stock ownership (ESOP) plan, and a profit sharing plan. We consider our employee relations to be satisfactory.

Patents and Trademarks

At present, we own one patent covering an ingredient used in some of our skin care products. Additionally, we actively use our registered trademarks for Scott's Liquid Gold, Liquid Gold, Touch of Scent, Alpha Hydrox, TriOxygen[®], and Neoteric in the United States and have registered trademarks in a number of additional countries. Our registered trademarks and pending trademark applications concern names and logos relating to our products as well as the design of boxes for certain of our products.

In December 2000 (amended October 1, 2003), we entered into a license agreement with TriStrata Technology, Inc. which owns patents dealing with the

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use of alpha hydroxy acids for the purpose of reducing the appearance of wrinkles or fine lines. Under the license agreement, Neoteric Cosmetics and its affiliates were granted a non-exclusive license for the life of the patents to make and sell skin care products using alpha hydroxy acids for, among other things, the reduction of the appearance of skin wrinkles and the reduction in the appearance of skin changes associated with aging. The license agreement covered a territory which includes the United States and certain foreign countries. In accordance with the license agreement, Neoteric Cosmetics paid a royalty on net sales of products covered by the agreement. This license agreement was part of the settlement of a lawsuit brought by TriStrata Technology against us and others alleging infringement of patents in selling and promoting skin care products which contain alpha hydroxy acid. By a notice sent to TriStrata Technology, we terminated this license agreement in October of 2007. We rely on a pass-through license from E.I. DuPont (our supplier) for our uses of glycolic acid regarding wrinkle reduction and anti-aging. The pass-through license applies to customers of DuPont. Although DuPont is a long-time supplier of ours, we have no contracts with DuPont other than orders for our purchases.

Available Information and Code of Ethics

We will make available free of charge through the website <http://www.businesswire.com/cnn/slzd.htm>, this annual report, our quarterly reports on Form 10-Q, our current reports on Form 8-K, and amendments to such reports, as soon as reasonably practicable after we electronically file or furnish such material with the Securities and Exchange Commission. These reports are also available through a link on our website. We will provide upon request and at no charge electronic or paper copies of these filings with the Securities and Exchange Commission (excluding exhibits).

We will provide to any person without charge, upon request, a copy of the code of business conduct and ethics which has been adopted by us and which applies to our principal executive officer, principal financial officer and principal accounting officer, among others.

A request for reports filed with the SEC or the code of business conduct and ethics may be made to: Corporate Secretary, Scott's Liquid

Gold-Inc., 4880 Havana Street, Denver, Colorado 80239.

Risk Factors

The following is a discussion of certain risks that may affect our business. These risks may negatively impact our existing business, future business opportunities, our financial condition or our financial results. In such case, the trading price of our common stock could also decline. Additional risks and uncertainties not presently known to us, or that we currently see as immaterial, may also negatively impact our business.

We need to increase our revenues in order to become profitable under our present cost structure.

We have experienced net losses in nine of our last ten years. These losses result primarily from declining sales of our skin care products and our primary household products. Maintaining or increasing our revenues is uncertain and involves a number of factors including consumer acceptance of our products, distribution of our products and other matters described below.

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Our cash flow is dependent upon operating cash flow.

Because we are dependent on our operating cash flow, any loss of a significant customer, any further decreases in the distribution of our skin care or household chemical products, new competitive products affecting sales levels of our products or any significant expense not included in our internal budget could result in the need to raise cash, such as through additional bank financing. Except for the existing bank debt, we have no arrangements for an external financing of debt or equity, and we are not certain whether any such financing would be available on acceptable terms. In order to improve our operating cash flow, we need to achieve profitability or change significantly our cost structure.

Sales of our existing products are affected by changing consumer preferences.

Our primary market is retail stores in the United States which sell to consumers or end users in the mass market. Consumer preferences can change rapidly and are affected by new competitive products. This situation is true for both skin care and household products and has affected our established products, most significantly our earlier established Alpha Hydrox products. For example, in the skin care area, we believe that our products with AHAs are effective in diminishing fine lines and wrinkles, but consumers may change permanently or temporarily to other products using other technologies or otherwise viewed as new. Any changes in consumer preferences can affect materially the sales and distribution of our products and thereby our revenues and results of operation.

In both skin care and household products, we compete every day against the largest consumer product companies in the United States.

Our large competitors regularly introduce new products and spend multiples of dollars more than we do on advertising, particularly television advertising. The distribution of our product and sales can be adversely impacted by the actions of our competitors.

We have limited resources to promote our products with effective advertising.

We sell our products in the consumer retail marketplace. Advertising, particularly television advertising, can be important in reaching consumers, although the effectiveness of any particular advertisement cannot be predicted.

Maintaining or increasing our revenues is dependent on the introduction of new products that are successful in the marketplace.

Sales of our Alpha Hydrox products, Scott's Liquid Gold for wood and Touch of Scent have declined in recent years, except for a small increase in the sale of Scott's Liquid Gold for wood in 2004 when we sold the product to additional retail stores. In order to address these declines, we have introduced new products, including Montagne Jeunesse sachets in 2001, the wood wipe and wood wash products in 2004 and 2005, our new Alpha Hydrox products in 2005, a value priced Alpha Hydrox White line in 2007, and our mold remediation product Mold Control 500 during the second quarter of 2006. We plan the introduction of additional products. If we are not successful in making ongoing sales of our newer products to retail store chains or these products are not well received by consumers, our revenues could be materially and adversely affected.

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A loss of one or more of our major customers could have a material adverse effect on our product sales.

For more than a majority of our sales, we are dependent upon sales to major customers, including Wal-Mart which is our largest customer. The easy access of consumers to our products is dependent upon major retail stores and other retail stores carrying our products, particularly mass merchandisers. The willingness of these customers (i.e., retail stores) to carry any of our products depends on various matters, including the level of sales of the product at the stores. Any declines in sales of a product to consumers can result in the loss of retail stores as our customers and the corresponding decreases in the distribution of the product. It is uncertain whether the consumer base served by these stores would purchase our products at other retail outlets. In the past, sales of our products have been affected by retail store chains which discontinue a product or carry the product in a lesser number of stores.

More than a majority of our sales of skin care product are represented by the Montagne Jeunesse products which depend upon the continuation of our distributorship agreement with Montagne Jeunesse.

Our distributorship agreement with Montagne Jeunesse is for a period of 18 months that ended in November, 2006 and continues in force after this initial term subject to the right of either party to terminate the agreement with three or six months notice. As a practical matter, we also believe that the distribution of Montagne Jeunesse sachets is dependent upon our good relationship with Montagne Jeunesse.

We face the risk that raw materials for our products may not be available or that costs for these materials will increase, thereby affecting our ability to either manufacture the products or our gross margin on the products.

We obtain our raw materials from third party suppliers, some of which are sole source suppliers. While there are two suppliers of glycolic acid, we use one supplier. We have no long term contracts with our suppliers; and, if a contract exists, it is subject to termination or cost increases. We may not have sufficient raw materials for production of products manufactured by us if there is a shortage in raw materials or one of our suppliers terminates our relationship. In addition, changing suppliers could involve delays that restrict our ability to manufacture or buy products in a timely manner to meet delivery requirements of our customers. Our suppliers of products which we distribute can also be subject to the same risk with their vendors.

Our sales are affected adversely by returns.

In our industry, retail stores have the ability to return products. These returns result in refunds, a reduction of our revenues and usually the need to dispose of the resulting inventory at discounted prices. Accordingly, the level of returns can significantly impact our revenues and cash flow. See information about returns in Note 12 to our Consolidated Financial Statements in this Report.

Changes in the regulation of our products, including environmental regulations, could have an adverse effect on the distribution, cost or function of our products.

Regulations affecting our products include requirements of the FDA for cosmetic products and environmental regulations affecting emissions from our products. The FDA has mentioned the treatment of AHA products as drugs,

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which could make more expensive or prohibitive our production and sale of certain Alpha Hydrox products. Also, in the past, we have changed the formulation of our household products to satisfy environmental regulations and will continue to do so as required.

Any adverse developments in litigation could have a material impact on us.

We are subject to lawsuits from time to time in the ordinary course of business. While we expect those lawsuits not to have a material effect on us, an adverse development in any such lawsuit or the insurance coverage for a lawsuit could materially and adversely affect our financial condition and cash flow.

Any loss of our key executives or other personnel could harm our business.

Our success has depended on the experience and continued service of our executive officers and key employees. If we fail to retain these officers, our ability to continue our business and effectively compete may be substantially diminished. Because of our size, we must rely in many departments within our company on one or two managers; the loss of any one of those could slow our product development, production of a product, and sale and distribution of a product.

Our stock price can be volatile and can decline substantially.

Our stock is traded on the OTC Bulletin Board. The volume of our stock varies but is relatively limited. As a result, any events affecting us can result in volatile movements in the price of our stock and can result in significant declines in the market price of our stock.

Item 2. Description of Property

Our facilities, located in Denver, Colorado, are currently comprised of three connected buildings and a parking garage (approximately 261,100 square feet in total) and about 16.2 acres of land, of which approximately 6 acres are available for future expansion. These buildings range in age from approximately 10 to 35 years (126,600 square feet having been added in 1995 and 1996). The Denver facility houses our corporate headquarters and all of our operations, and serves as one of several distribution points. We believe that our current space will provide capacity for growth for the foreseeable future. All of our land and buildings serve as collateral under a deed of trust for a \$5.2 million bank loan (\$4.9 million at December 31, 2007) consummated by us on June 26, 2006.

As indicated in this Report, the Company uses less than the capacity of its facilities and is also interested in reducing its expenses. As part of this process, starting as of July 2007, the Company has engaged a commercial real estate broker, The Staubach Company, in Denver to explore alternatives. These alternatives include the sale of all or part of the facilities, a sale of all or part of the facilities combined with a leaseback by the Company of the facilities, or a lease of all or part of the facilities by the Company to a third party. There is, however, no assurance that acceptable transactions will be offered or completed.

On March 28, 2006, we entered into a Lease Agreement with Keltec Dispensing Systems USA, Inc., a Delaware corporation, pursuant to which we leased to Keltec the space that is located in our Denver facility and had been used for the operations of the plastics equipment. The lease also

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included the use of certain common areas and equipment. The term of the Lease was three years beginning July 1, 2006. Keltec would have been able to renew the lease for an additional term of three years upon advance written notice under the same terms and conditions, except that during the renewal term the rent would have been increased by the same percentage as the increase in the CPI-Denver from the commencement date to the initial expiration date. This lease was terminated by mutual agreement at the end of 2007.

Item 3. Legal Proceedings

We are subject to incidental litigation in the ordinary course of our business. We expect that no pending legal proceeding will have a material adverse effect on us.

Item 4. Submission of Matters to a Vote of Security Holders

Not applicable.

PART II**Item 5. Market for Common Equity and Related Stockholder Matters.****Market Information**

Our \$0.10 par value common stock is listed on the OTC Bulletin Board (a regulated quotation service) under the ticker symbol **SLGD**. The high and low prices of Scott's Liquid Gold-Inc. common stock as traded on the OTC Bulletin Board were as follows. The over-the-counter market quotations reflect inter-dealer prices, without retail mark-up, mark-down or commission and may not necessarily represent actual transactions.

2007			2006		
Three Months Ended			Three Months Ended		
	High	Low		High	Low
March 31	\$0.87	\$0.75	March 31	\$1.15	\$0.66
June 30	\$0.95	\$0.73	June 30	\$1.01	\$0.78
September 30	\$1.12	\$0.72	September 30	\$1.00	\$0.80
December 31	\$0.95	\$0.54	December 31	\$0.94	\$0.73

Shareholders

As of January 23, 2008, we had approximately 950 shareholders of record.

Dividends

We did not pay any cash dividends during the two most recent fiscal years. No decision has been made as to future dividends. See Management's Discussion and Analysis or Plan of Operation Liquidity and Capital Resources for information concerning restrictions on dividends.

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Other

Current stock quotes, our SEC filings, quarterly earnings and press releases can be found at:
<http://www.businesswire.com/cnn/slgd.htm>.

Equity Plans

The following table provides, as of December 31, 2007, information regarding our equity compensation plans, which consist of the 1993, 1997, 1998, and 2005 Stock Option Plans. We also have an Employee Stock Ownership Plan which invests only in our common stock, but which is not included in the table below.

Plan Category	Number of securities to be	Weighted-average exercise price of outstanding options, warrants and rights	Number of securities remaining available for future issuance under equity compensation plans
	issued upon exercise of outstanding options, warrants and rights (a)		(excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	1,942,150	\$ 0.69	43,600
Equity compensation plans not approved by security holders			
Total	1,942,150	\$ 0.69	43,600

Stock Purchases

We did not make any repurchases of our outstanding shares during the fourth quarter of 2007.

Pursuant to board resolutions, on August 21, 2007 and November 29, 2007, we issued and contributed 27,000 shares and 15,000 shares, respectively, of our common stock to our Employee Stock Ownership Plan (the Plan). No consideration was paid by the Plan for these contributions. We believe that these contributions were not subject to the securities registration requirements of the Securities Act of 1933 because they did not involve a sale. The contributions of the shares to the Plan may also be exempt from such securities registration as a non-public offering under Section 4(2) of the Securities Act of 1933.

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Item 6. Management's Discussion & Analysis or Plan of Operation

General

We manufacture and market both household and skin care products. Our products are sold throughout the United States and Canada and insignificantly in other countries.

Critical Accounting Policies

We have identified the policies below as critical to our business operations and the understanding of our results of operations. These policies involve significant judgments, estimates and assumptions by our management. For a detailed discussion on the application of these and other accounting policies, see Note 1 in the Notes to the Consolidated Financial Statements.

Revenue Recognition

Our revenue recognition policy is significant because the amount and timing of revenue is a key component of our results of operations. We follow the guidance of Staff Accounting Bulletin No. 104 (SAB 104), which requires that a strict series of criteria are met in order to recognize revenue related to product shipment. If these criteria are not met, the associated revenue is deferred until the criteria are met. Generally, these criteria are that there be an arrangement to sell the product, we have delivered the product in accordance with that arrangement, the sales price is determinable, and collectibility is probable.

Our reserves for accounts receivable consist of a bad debt reserve and reserves for returns and customer allowances. Reserves for marketing rebates, pricing allowances and returns, coupons and certain other promotional activities involve estimates made by management based upon an assessment of historical trends, information from customers, and anticipated returns and allowances related to current sales activity. The level of returns and allowances are impacted by, among other things, promotional efforts performed by customers, changes in customers, changes in the mix of products sold, and the stage of the relevant product life cycle. Changes in estimates may occur based on actual results and consideration of other factors that cause returns and allowances. In the event that actual results differ from these estimates, results of future periods may be impacted.

Reserves for bad debts (\$62,900 at December 31, 2007 and \$62,000 at December 31, 2006) are recorded based on estimates by management including factors surrounding the credit risk of specific customers and historical trends. We have been exposed to potential losses on receivables due from specific customers that have suffered financial difficulties. We have provided reserves against certain receivables from such customers in addition to amounts related to unidentified losses. Those reserves are reduced as those accounts are settled or written off. In the event that actual losses differ from these estimates or there is an increase in exposure relating to sales to specific customers, results of future periods may be impacted.

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Income Taxes

As of December 31, 2007, we have net deferred income tax assets of \$2,451,800 which primarily relate to net operating loss carryforwards, expenses that are not yet deductible for tax purposes and tax credit carryforwards, offset by deferred income tax liabilities for differences in the book and tax bases of property and equipment. The net deferred tax asset is fully reserved by a valuation allowance. The valuation allowance represents management's determination that we will more likely than not be unable to realize the value of such assets due to the uncertainty of future profitability.

Inventory Valuation and Reserves

Our inventory is a significant component of our total assets. In addition, the carrying value of such inventory directly impacts the gross margins that we recognize when we sell the inventory and record adjustments to carrying values. Our inventory is valued at the lower of cost or market, cost being determined under the first-in, first-out method. We estimate reserves for slow moving and obsolete products and raw materials based upon historical and anticipated sales. In the event that actual results differ from these estimates, results of future periods may be impacted.

Recently Issued Accounting Pronouncements

Please see Note 1 (p) of our Consolidated Financial Statements.

Table of Contents**Results of Operations**

During 2007, we experienced a decrease in sales of our household chemical products, while experiencing an increase in sales of our Montagne Jeunesse line of skin care products and a decrease in sales of our Alpha Hydrox skin care products. Our net loss for 2007 was \$1,310,800 versus a net loss of \$3,586,600 for 2006. The decrease in our loss for 2007 compared to 2006 results from an increase in sales, and a reduction in our operating costs and expenses, primarily the reduction of advertising.

Summary of Results as a Percentage of Net Sales

	Year Ended December 31,	
	2007	2006
Net sales		
Scott's Liquid Gold household products	44.9%	53.1%
Skin care products	55.1%	46.9%
Total net sales	100.0%	100.0%
Cost of sales	56.5%	57.4%
Gross profit	43.5%	42.6%
Other revenue	0.4%	1.0%
	43.9%	43.6%
Operating expenses	48.9%	63.8%
Interest expense	2.3%	2.0%
	51.2%	65.8%
Loss before income taxes	(7.3%)	(22.2%)

Our gross margins may not be comparable to those of other entities because some entities include all of the costs related to their distribution network in cost of sales and others, like us, exclude a portion of them (freight out to customers and nominal outside warehouse costs) from gross margin, including them instead in the selling expense line item. See Note 1(o), Operating Costs and Expenses Classification, to the Consolidated Financial Statements in this Report.

Year Ended December 31, 2007

Compared to Year Ended December 31, 2006

Comparative Net Sales

	2007	2006	Percentage Increase (Decrease)
Scott's Liquid Gold and other household products	\$ 7,021,800	\$ 7,238,700	(3.0%)
Touch of Scent	1,029,900	1,341,200	(23.2%)
Total household products	8,051,700	8,579,900	(6.2%)
Alpha Hydrox and other skin care	3,302,100	3,396,500	(2.8%)
Montagne Jeunesse and other skin care	6,564,700	4,167,200	57.5%

Total skin care products	9,866,800	7,563,700	30.4%
Total net sales	\$ 17,918,500	\$ 16,143,600	11.0%

Consolidated net sales for 2007 were \$17,918,500 versus \$16,143,600 for 2006, an increase of \$1,774,900 or about 11.0%. Average selling prices for 2007 were down by \$54,700 over those of the comparable period of 2006, prices

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of household products being up by \$114,400, while average selling prices of skin care products were down by \$169,100. This decrease was primarily due to price promotions on selected cosmetic products. Co-op advertising, marketing funds, slotting fees and coupon expenses (promotional allowances) paid to retailers were subtracted from gross sales in accordance with current accounting policies totaling \$2,294,700 in 2007 versus \$2,391,300 in 2006, a decrease of \$96,600 or about 4.0%. This decrease consisted of a decrease in coupon expense of \$110,700, an increase in co-op marketing funds of \$66,300 and a decrease in slotting fee expenses of \$52,200.

From time to time, our customers return product to us. For our household chemicals products, we permit returns only for a limited time, and generally only if there is a manufacturing defect. With regard to our skin care products, returns are more frequent under an unwritten industry standard that permits returns for a variety of reasons. In the event a skin care customer requests a return of product, the Company will consider the request, and may grant such request in order to maintain or enhance relationships with customers, even in the absence of an enforceable right of the customer to do so. Some retailers have not returned products to us. Return price credit (used in exchanges typically, or rarely, refunded in cash) when authorized is based on the original sale price plus a handling charge of the retailer that ranges from 8-10%. The handling charge covers costs associated with the return and shipping of the product. Additions to our reserves for estimated returns are subtracted from gross sales.

From January 1, 2005 through December 31, 2007, our product returns (as a percentage of gross revenue) have averaged as follows: household products 0.3%, Montagne Jeunesse products 3.4%, and our Alpha Hydrox and other skin care products 5.9%. The level of returns as a percentage of gross revenue for the household products and Montagne Jeunesse products have remained fairly constant as a percentage of sales over that period while the Alpha Hydrox and other skin care products return levels have fluctuated. More recently, as our sales of the skin care products have declined we have seen a decrease in returns as a percentage of gross revenues. The products returned in 2007 (indicated as a percentage of gross revenues) were: household products 0.1%, Montagne Jeunesse products 3.0%, and our Alpha Hydrox and other skin care products 7.3%. We are not aware of any industry trends, competitive product introductions or advertising campaigns at this time which would cause returns as a percentage of gross sales to be materially different for the current fiscal year than for the above averages. Furthermore, the Company's management is not currently aware of any changes in customer relationships that we believe would adversely impact anticipated returns. However, we review our reserve for returns quarterly and we regularly face the risk that the existing conditions related to product returns will change.

During 2007, net sales of skin care products accounted for 55.1% of consolidated net sales compared to 46.9% for 2006. Net sales of these products for those periods were \$9,866,800 in 2007 compared to \$7,563,700 in 2006, an increase of \$2,303,100 or about 30.4%.

Our decrease in sales of Alpha Hydrox and other skin care products was due to a decrease in distribution in 2007; however, this decrease was offset somewhat by the sales of our line of Neoteric Massage Oils, introduced earlier in 2007. With only the introduction underway, it is too early to tell about consumer acceptance of Neoteric Massage Oils. We have continued to experience a drop in unit sales of our more recently introduced Alpha Hydrox products and our earlier-established alpha hydroxy acid-based products due primarily to maturing in the market for alpha hydroxy acid-based skin care products, intense competition from producers of similar or alternative

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products, many of which are considerably larger than Neoteric Cosmetics, Inc. and reduced distribution of these products at retail stores in current and prior periods. For 2007, the sales of our Alpha Hydrox products accounted for 20.7% of net sales of skin care products and 11.4% of total net sales, compared to 13.4% of net sales of skin care products and 28.6% of total net sales in 2006. During 2007 we introduced four new items to the Alpha Hydrox line of products, it is too early to tell about consumer acceptance of these additions.

Net sales of Montagne Jeunesse products were \$6,564,700 in 2007 versus \$4,167,200 for the comparable period of 2006, an increase of \$2,397,500 or 57.5%. The increase reflects the product placement and sales in additional Wal-Mart stores which began late in the first quarter. This placement included significantly more stores and more sachet variants in the stores. We returned to two more national retail chains with placement of Montagne Jeunesse in the second half of 2007.

Sales of household products for 2007 accounted for 44.9% of consolidated net sales compared to 53.1% for the same period in 2006. These products are comprised of Scott's Liquid Gold wood care products (Scott's Liquid Gold for wood, a wood wash and wood wipes), mold remediation products, Touch of Scent and Odor Extinguisher. During 2007 sales of household products were \$8,051,700 as compared to \$8,579,900 for the same period in 2006, a decrease of \$528,200, or 6.2%. Sales of Scott's Liquid Gold wood care products decreased by \$173,100 in 2007 versus 2006. We believe this reduction to be a result of a decrease in media advertising of our wood care products in 2007 versus 2006. Mold Control 500 sales, which are shown in the sales for Scott's Liquid Gold and other household products, were \$849,700 for 2007 versus \$893,500 in 2006. Sales of air fresheners were down by \$311,300 or 23.2%, primarily due to a decrease in distribution in present and past quarters. During the third quarter of 2007, we introduced the Odor Extinguisher air fragrance product line; it is too early to tell about consumer acceptance of this addition.

As sales of a consumer product decline, there is the risk that retail stores will stop carrying the product. The loss of any significant customer for any skin care products, Scott's Liquid Gold wood care or mold remediation products, could have a significant adverse impact on our revenues and operating results. We believe that our future success is highly dependent on favorable acceptance and sales in the marketplace of Montagne Jeunesse products, our Alpha Hydrox products and our Scott's Liquid Gold wood care and mold remediation products.

We also believe that the introduction of successful new products, including line extensions of existing products, such as the wood wash and our new mold remediation product, using the name Scott's Liquid Gold, are important in our efforts to maintain or grow our revenue. Late in the fourth quarter of 2006, we introduced two new items within our Alpha Hydrox cosmetic line of products. We have introduced, as mentioned above, new products in 2007. We do not have any additional products scheduled for introduction in early 2008. However, we review regularly possible additional products to sell through distribution agreements or to manufacture ourselves. To the extent that we manufacture a new product rather than purchase it from external parties, we are also benefited by the use of existing capacity in our facilities. The actual introduction of additional products, the timing of any additional introductions and any revenues realized from new products is uncertain.

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On a consolidated basis, cost of goods sold was \$10,117,600 for 2007 compared to \$9,270,000 for 2006, an increase of \$847,600 or 9.1%, on a sales increase of 11.0%. As a percentage of consolidated net sales, cost of goods sold was 56.5% in 2007 versus 57.4% in 2006. This decrease was the result of the decrease in sales promotion expenses which increased our revenues and thus affected our margins.

Operating Expenses, Interest Expense and Other Income

	2007	2006	Percentage Increase (Decrease)
Operating Expenses			
Advertising	\$ 332,800	\$ 1,558,800	(78.7%)
Selling	5,433,500	5,516,300	(1.5%)
General & Administrative	2,994,800	3,228,500	(7.2%)
Total operating expenses	\$8,761,100	\$10,303,600	(15.0%)
Interest Income and Other	\$ 72,300	\$ 161,300	(55.2%)
Interest Expense	\$ 422,900	\$ 315,700	34.0%

Operating expenses, comprised primarily of advertising, selling and general and administrative expenses, decreased \$1,542,500 in 2007, when compared to 2006. The various components of operating expenses are discussed below.

Advertising expenses for 2007 were \$332,800 compared to \$1,558,800 for the comparable period of 2006, a decrease of \$1,226,000 or 78.7%. A majority of that decrease was due to a decrease in television advertising expenses applicable to our Alpha Hydrox skin care products, Mold Control 500 product and Scott's Liquid Gold for wood.

Selling expenses for 2007 were \$5,433,500 compared to \$5,516,300 for the comparable period of 2006, a decrease of \$82,800 or 1.5%. That decrease was comprised of a decrease in salaries, fringe benefits and related travel expense of \$103,900 primarily because of a decrease in personnel in 2007 versus 2006, offset by a net increase in other selling expense, none of which by itself is significant, of \$21,100.

General and administrative expenses for 2007 were \$2,994,800 compared to \$3,228,500 for the comparable period of 2006, a decrease of \$233,700 or 7.2%. That decrease was primarily attributable to a decrease in salaries and fringe benefits and related travel expense resulting from a reduction in salaries and personnel of \$229,000, and a net decrease in other general and administrative expenses of \$4,700.

Interest expense for 2007 was \$422,900 versus \$315,700 for the comparable period of 2006. Interest expense increased because of higher interest rates and increased borrowing levels. Interest and other income for 2006 was \$161,300, which was comprised of \$67,100 of gain on sale of assets (that is, the sale of our plastic molding equipment and related machinery in July 2006) and \$94,200 of interest income as compared to \$72,300 of interest income for 2007, which consists of interest earned on our cash reserves in 2007 and 2006.

During 2007 and 2006, expenditures for research and development were not material (under 2% of revenues).

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Liquidity and Capital Resources

On June 28, 2006, we entered into a new loan with a fifteen year amortization with Citywide Banks for \$5,156,600 secured by the land, building and fixtures at our Denver, Colorado facilities. Interest on the bank loan (8.25% at December 31, 2007) is at the prime rate as published in The Wall Street Journal, adjusted annually each June. This loan requires 180 monthly payments of approximately \$50,500, which commenced on July 28, 2006. The loan agreement contains a number of covenants, including the requirement for maintaining a current ratio of at least 1:1 and a ratio of consolidated long-term debt to consolidated net worth of not more than 1:1. We may not declare any dividends that would result in a violation of either of these covenants. The foregoing requirements were met at the end of 2007.

During 2007, our working capital decreased by \$896,900, and concomitantly, our current ratio (current assets divided by current liabilities) decreased from 2.1:1 at December 31, 2006 to 1.9:1 at

December 31, 2007. This decrease in working capital is attributable to a net loss in 2007 of \$1,310,800, reduction in long-term debt of \$203,900, offset by depreciation in excess of capital additions of \$535,700.

At December 31, 2007, trade accounts receivable were \$1,004,900 versus \$743,700 at the end of 2006, largely because sales in the last two months of 2007 were more than those of the last two months of 2006. Accounts payable decreased from the end of 2006 through the end of 2007 by \$333,300 corresponding primarily with the decrease and timing of purchases of inventory over that period. At December 31, 2007 inventories were \$236,900 less than at December 31, 2006, primarily due to a decrease in household chemical products inventory as a result of a decrease in our Touch of Scent product sales and the timing of inventory purchases. Prepaid expenses increased from the end of 2006 by \$76,500 primarily due to an increase in prepaid promotional expenses.

We have no significant capital expenditures planned for 2008 and have no current plans for any external financing, other than our existing bank loan. We expect that our available cash and cash flows from operating activities will fund the next twelve months of operations.

Our dependence on operating cash flow means that risks involved in our business can significantly affect our liquidity. Any loss of a significant customer, any further decreases in distribution of our skin care or household products, any new competitive products affecting sales levels of our products, or any significant expense not included in our internal budget could result in the need to raise cash, such as through a bank financing. We have no arrangements for any additional external financing of debt or equity, and we are not certain whether any such financing would be available on acceptable terms. In order to improve our operating cash flow, we need to achieve profitability. Please see Risk Factors in Item 1 above.

The following table sets forth our contractual obligations in the aggregate. We have no capital lease obligations, unconditional purchase obligations or other long-term contractual obligations. Our long-term debt interest rate is a variable rate. The table below assumes an 8.25% annual interest rate for our long-term debt.

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	CONTRACTUAL OBLIGATIONS				
	Payments due by Period				After 5 Years
	Total	Less than 1-Year	1 3 Years	4 5 Years	
Long-term debt, including interest	\$8,132,500	\$606,200	\$1,818,400	\$1,212,300	\$4,495,600
Operating lease obligations	123,800	85,100	38,700		
Total Contractual Cash Obligations	\$8,256,300	\$691,300	\$1,857,100	\$1,212,300	\$4,495,600

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Item 7. Financial Statements

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Shareholders of Scott's Liquid Gold-Inc.

We have audited the accompanying consolidated balance sheets of Scott's Liquid Gold-Inc. and subsidiaries (the Company) as of December 31, 2007 and 2006, and the related consolidated statements of operations, shareholders equity and comprehensive income (loss), and cash flows for each of the years in the two-year period ended December 31, 2007. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company's internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Scott's Liquid Gold-Inc. and subsidiaries as of December 31, 2007 and 2006, and the results of their operations and their cash flows for each of the years in the two-year period ended December 31, 2007, in conformity with U.S. generally accepted accounting principles.

/s/ EHRHARDT KEEFE STEINER & HOTTMAN
PC

Denver, Colorado
March 10, 2008

Table of Contents**Consolidated Statements of Operations**

	Year ended December 31,	
	2007	2006
Net sales	\$ 17,918,500	\$ 16,143,600
Operating costs and expenses:		
Cost of sales	10,117,600	9,270,000
Advertising	332,800	1,558,800
Selling	5,433,500	5,516,300
General and administrative	2,994,800	3,228,500
	18,878,700	19,573,600
Loss from operations	(960,200)	(3,430,000)
Gain on disposal of assets		67,100
Interest income	72,300	94,200
Interest expense	(422,900)	(315,700)
Loss before income taxes	(1,310,800)	(3,584,400)
Income tax expense (Note 5)		(2,200)
Net loss	\$ (1,310,800)	\$ (3,586,600)
Net loss per common share (Note 7):		
Basic	\$ (0.12)	\$ (0.34)
Diluted	\$ (0.12)	\$ (0.34)
Weighted average shares outstanding:		
Basic	10,543,400	10,510,500
Diluted	10,543,400	10,510,500

See accompanying notes to consolidated financial statements.

Table of Contents**Consolidated Balance Sheets**

	December 31,	
	2007	2006
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 1,483,300	\$ 2,804,100
Investment securities	50,400	51,100
Trade receivables, net of allowance of \$62,900 and \$62,000 for doubtful accounts	1,004,900	743,700
Other receivables	32,500	55,500
Inventories, net (Note 2)	3,054,500	3,291,400
Prepaid expenses	238,100	161,600
Total current assets	5,863,700	7,107,400
Property, plant and equipment, net (Note 3)	12,624,000	13,159,700
Other assets	55,400	59,700
	\$18,543,100	\$20,326,800
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$ 1,560,300	\$ 1,893,600
Accrued payroll and benefits	866,200	866,400
Other accrued expenses	390,500	417,100
Current maturities of long-term debt (Note 4)	204,900	191,600
Total current liabilities	3,021,900	3,368,700
Long-term debt, net of current maturities (Note 4)	4,671,600	4,875,500
Total liabilities	7,693,500	8,244,200
Commitments and contingencies		
(Notes 4, 6, 9 and 10)		
Shareholders' equity (Note 6):		
Common stock; \$.10 par value, authorized 50,000,000 shares; issued and outstanding 10,575,000 shares (2007), and 10,533,000 shares (2006)	1,057,500	1,053,300
Capital in excess of par	5,090,100	5,015,800
Accumulated comprehensive income	400	1,100
Retained earnings	4,701,600	6,012,400
Shareholders' equity	10,849,600	12,082,600
	\$18,543,100	\$20,326,800

Table of Contents**Consolidated Statements of Shareholders Equity and Comprehensive Income (Loss)**

Years ended December 31,	Common Stock		Capital in Excess of Par	Accumulated Comprehensive Income (loss)	Retained Earnings	Comprehensive Income (loss)
2007, 2006	Shares	Amount	of Par			
Balance, December 31, 2005	10,503,000	\$ 1,050,300	\$ 4,994,200	\$ 1,900	\$ 9,599,000	
Stock purchase for contribution to ESOP (Note 6)	(50,000)	(5,000)	(43,700)			
Stock issued to ESOP Plan (Note 6)	80,000	8,000	65,300			
Unrealized loss on investment securities				(800)		\$ (800)
Net loss					(3,586,600)	(3,586,600)
Balance, December 31, 2006	10,533,000	1,053,300	5,015,800	1,100	6,012,400	
Total comprehensive loss						\$ (3,587,400)
Stock issued to ESOP Plan	42,000	4,200	31,400			
Stock options granted			42,900			
Unrealized loss on investment securities				(700)		\$ (700)
Net loss					(1,310,800)	(1,310,800)
Balance, December 31, 2007	10,575,000	\$ 1,057,500	\$ 5,090,100	\$ 400	\$ 4,701,600	
Total comprehensive loss						\$ (1,311,500)

See accompanying notes to consolidated financial statements.

Table of Contents**Consolidated Statements of Cash Flows**

	Year ended December 31,	
	2007	2006
Cash Flows from Operating Activities:		
Net loss	\$(1,310,800)	\$(3,586,600)
Adjustments to reconcile net loss to net cash provided (used) by operating activities:		
Depreciation and amortization	603,400	650,600
Stock issued to ESOP	35,600	73,300
Stock options granted	42,900	
Gain on disposition of assets		(67,100)
Change in assets and liabilities:		
Trade and other receivables, net	(238,200)	889,200
Inventories, net	236,900	(106,800)
Prepaid expenses and other assets	(76,500)	153,600
Accounts payable and accrued expenses	(360,100)	37,400
Total adjustments to net loss	244,000	1,630,200
Net Cash Used by Operating Activities	(1,066,800)	(1,956,400)
Cash Flows from Investing Activities:		
Proceeds from sale of equipment		93,800
Purchases of property, plant and equipment	(63,400)	(83,300)
Net Cash Provided (Used) by Investing Activities	(63,400)	10,500
Cash Flows from Financing Activities:		
Proceeds from long-term borrowings		5,156,600
Principal payments on long-term borrowings	(190,600)	(1,983,900)
Loan origination fees and other costs		(64,700)
Proceeds (payments) on short-term borrowings, net		(570,000)
Purchase of stock for contribution to ESOP		(48,700)
Net Cash Provided (Used) by Financing Activities	(190,600)	2,489,300
Net Increase (Decrease) in Cash and Cash Equivalents	(1,320,800)	543,400
Cash and Cash Equivalents, beginning of year	2,804,100	2,260,700
Cash and Cash Equivalents, end of year	\$ 1,483,300	\$ 2,804,100
Supplemental disclosures:		
Cash paid during the year for:		
Interest	\$ 423,000	\$ 319,400

Income taxes	\$	3,600	\$	1,100
See accompanying notes to consolidated financial statements.				
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Note 1. Organization and Summary of Significant Accounting Policies

(a) Company Background

Scott's Liquid Gold-Inc. (a Colorado corporation) was incorporated on February 15, 1954. Scott's Liquid Gold-Inc. and its wholly owned subsidiaries (collectively, we or our) manufacture and market quality household and skin care products, and we fill, package and market our Mold Control 500 product. Since the first quarter of 2001, we have acted as a distributor in the United States of beauty care products contained in individual sachets and manufactured by Montagne Jeunesse and certain other products. Our business is comprised of two segments, household products and skin care products.

(b) Principles of Consolidation

Our consolidated financial statements include our accounts and those of our wholly-owned subsidiaries. All intercompany accounts and transactions have been eliminated.

(c) Use of Estimates

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, the disclosure of contingent 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. Significant estimates include, but are not limited to, realizability of deferred tax assets, reserves for slow moving and obsolete inventory, customer returns and allowances, coupon redemptions, and bad debts.

(d) Cash Equivalents

We consider all highly liquid investments with an original maturity of three months or less at the date of acquisition to be cash equivalents.

(e) Investments in Marketable Securities

We account for investments in marketable securities in accordance with Statement of Financial Accounting Standards (SFAS) No. 115 Accounting for Certain Investments in Debt and Equity Securities , which requires that we classify investments in marketable securities according to management's intended use of such investments. We invest our excess cash and have established guidelines relative to diversification and maturities in an effort to maintain safety and liquidity. These guidelines are periodically reviewed and modified to take advantage of trends in yields and interest rates. We consider all investments as available for use in our current operations and, therefore, classify them as short-term, available-for-sale investments. Available-for-sale investments are stated at fair value, with unrealized gains and losses, if any, reported net of tax, as a separate component of shareholders' equity and comprehensive income (loss). The cost of the securities sold is based on the specific identification method. Investments in corporate and government securities as of December 31, 2007, are scheduled to mature within one year.

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(f) Inventories

Inventories consist of raw materials and finished goods and are stated at the lower of cost (first-in, first-out method) or market. We record a reserve for slow moving and obsolete products and raw materials. We estimate reserves for slow moving and obsolete products and raw materials based upon historical and anticipated sales. Amounts are discussed in Note 2.

(g) Property, Plant and Equipment

Property, plant and equipment are recorded at historical cost. Depreciation is provided using the straight-line method over estimated useful lives of the assets ranging from three to forty-five years. Building structures and building improvements are estimated to have useful lives of 35 to 45 years and 3 to 20 years, respectively. Production equipment and production support equipment are estimated to have useful lives of 15 to 20 years and 3 to 10 years, respectively. Office furniture and office machines are estimated to have useful lives 10 to 20 and 3 to 5 years, respectively. Carpeting, drapes and company vehicles are estimated to have useful lives of 5 to 10 years. Maintenance and repairs are expensed as incurred. Improvements that extend the useful lives of the assets or provide improved efficiency are capitalized.

(h) Financial Instruments

Financial instruments which potentially subject us to concentrations of credit risk include cash and cash equivalents, investments in marketable securities, and trade receivables. We maintain our cash balances in the form of bank demand deposits with financial institutions that management believes are creditworthy. As of the balance sheet date and periodically throughout the year, the Company has maintained balances in various operating accounts in excess of federally insured limits. We establish an allowance for doubtful accounts based upon factors surrounding the credit risk of specific customers, historical trends and other information. We have no significant financial instruments with off-balance sheet risk of accounting loss, such as foreign exchange contracts, option contracts or other foreign currency hedging arrangements.

The recorded amounts for cash and cash equivalents, receivables, other current assets, and accounts payable and accrued expenses approximate fair value due to the short-term nature of these financial instruments. The fair value of investments in marketable securities is based upon quoted market value. Our long-term debt bears interest at a fixed rate that adjusts annually on the anniversary date to a then prime rate. The carrying value of long-term debt approximates fair value as of December 31, 2007 and December 31, 2006.

(i) Long-Lived Assets

We account for long-lived assets in accordance with the provisions of SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. This Statement requires that long-lived assets and certain identifiable intangibles be reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds the fair value of the assets.

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Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

(j) Income Taxes

We account for income taxes in accordance with the provisions of SFAS No. 109, *Accounting for Income Taxes*, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences attributable to differences between the financial statement carrying amounts of assets and liabilities and their respective income tax bases. A valuation allowance is provided when it is more likely than not that some portion or all of a deferred tax asset will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during the period in which related temporary differences become deductible. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled.

(k) Revenue Recognition

Revenue is recognized when an arrangement exists to sell our product, we have delivered such product in accordance with that arrangement, the sales price is determinable, and collectibility is probable. Reserves for estimated market development support, pricing allowances and returns are provided in the period of sale as a reduction of revenue. Reserves for returns and allowances are recorded as a reduction of revenue, and are maintained at a level that management believes is appropriate to account for amounts applicable to existing sales. Reserves for coupons and certain other promotional activities are recorded as a reduction of revenue at the later of the date at which the related revenue is recognized or the date at which the sales incentive is offered. At December 31, 2007 and 2006 approximately \$695,700 and \$649,000, respectively, had been reserved as a reduction of accounts receivable, and approximately \$27,000 and \$50,000, respectively, had been reserved as current liabilities. Co-op advertising, marketing funds, slotting fees and coupons are deducted from gross sales and totaled \$2,294,700, and \$2,391,300 in 2007 and 2006, respectively.

(l) Advertising Costs

Advertising costs are expensed as incurred.

(m) Stock-based Compensation

At December 31, 2007, we had four stock-based employee compensation plans. During the first quarter of fiscal 2006, we adopted the provisions of, and account for stock-based compensation in accordance with, the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards No. 123 revised 2004 (SFAS 123R), *Share-Based Payment* which replaced Statement of Financial Accounting Standards No. 123 (SFAS 123), *Accounting for Stock-Based Compensation* and supersedes APB Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees*. Under the fair value recognition provisions of this statement, stock-based compensation cost is measured at the grant date based on the fair value of the award and is recognized as expense on a straight-line basis over the requisite service period, which is the vesting period. We elected the modified-prospective method, under which prior periods are not revised for comparative purposes. The valuation provisions of SFAS 123R apply to new grants and to grants that were outstanding as of the effective date and are subsequently modified. All outstanding options were fully vested as of December 31, 2005. No grants occurred in 2006 subsequent to the adoption of SFAS 123R.

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Prior to January 1, 2006, we accounted for the plans described above under the recognition and measurement principles of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations. No stock-based employee compensation cost is reflected in net income prior to January 1, 2006, as all options granted under those plans had an exercise price not less than the market value of the underlying common stock on the date of grant.

During the first quarter of 2007, we granted 448,550 options for shares of our common stock (268,500 to employees and 180,000 to non-employee directors) at \$0.82 per share. During the third quarter of 2007 we granted options for 92,000 shares of our common stock at \$0.82 per share and 2,000 shares of our common stock at \$0.85 per share to employees. The options which vest ratably over forty-eight months, or upon a change in control, and which expire after five years, were granted at or above the market value as of the date of grant.

The weighted average fair market value of the options granted in 2007 was estimated on the date of grant, using a Black-Scholes option pricing model with the following assumptions:

Expected life of options (using the simplified method)	4.5 years
Risk-free interest rate	4.2% to 4.46%
Expected volatility of stock	57% to 58%
Expected dividend rate	None

Compensation cost related to stock options recognized in operating results (included in general and administrative expenses) under SFAS 123R was \$42,900 in the year ended December 31, 2007. Approximately \$186,400 of total unrecognized compensation costs related to non-vested stock options is expected to be recognized over the next forty-four months. In accordance with SFAS 123R, there was no tax benefit from recording the non-cash expense as relates to the options granted to employees as these were qualified stock options which are not normally tax deductible. With respect to the non-cash expense associated with the options granted to the non-employee directors, no tax benefit was recognized due to the existence of as yet unutilized net operating losses. At such time as these operating losses have been utilized and a tax benefit is realized from the issuance of non-qualified stock options, a corresponding tax benefit may be recognized.

(n) Comprehensive Income

We follow SFAS No. 130, Reporting Comprehensive Income which establishes standards for reporting and displaying comprehensive income and its components. Comprehensive income includes all changes in equity during a period from non-owner sources.

(o) Operating Costs and Expenses Classification

Cost of sales includes costs associated with manufacturing and distribution including labor, materials, freight-in, purchasing and receiving, quality control, internal transfer costs, repairs, maintenance and other indirect costs, as well as warehousing and distribution costs. We classify shipping and handling costs comprised primarily of freight-out and nominal outside warehousing costs as a component of selling expense on the accompanying Consolidated Statement of Operations. Shipping and handling costs totaled \$1,596,500 and \$1,482,000, for the years ended December 31, 2007 and 2006, respectively.

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Selling expenses consist primarily of shipping and handling costs, wages and benefits for sales and sales support personnel, travel, brokerage commissions, promotional costs, as well as other indirect costs.

General and administrative expenses consist primarily of wages and benefits associated with management and administrative support departments, business insurance costs, professional fees, office facility related expenses, and other general support costs.

(p) Recently Issued Accounting Pronouncements

In December 2007 the Financial Accounting Standards Board (FASB) issued SFAS No. 141R, *Business Combinations*. This statement replaces SFAS 141 and defines the acquirer in a business combination as the entity that obtains control of one or more businesses in a business combination and establishes the acquisition date as the date that the acquirer achieves control. SFAS No. 141R requires an acquirer to recognize the assets acquired, the liabilities assumed, and any noncontrolling interest in the acquiree at the acquisition date, measured at their fair values as of that date. SFAS No. 141R also requires the acquirer to recognize contingent consideration at the acquisition date, measured at its fair value at that date. This statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. The adoption of this statement is not expected to have a material effect on the Company's financial statements.

In December 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an Amendment of ARB No. 51*. This statement amends ARB 51 to establish accounting and reporting standards for the Noncontrolling interest in a subsidiary and for the deconsolidation of a subsidiary. This statement is effective for fiscal years, and interim periods within those fiscal years, beginning on or after December 15, 2008. Earlier adoption is prohibited. The adoption of this statement is not expected to have a material effect on the Company's future reported financial position or results of operations.

In February 2007, the Financial Accounting Standards Board (FASB) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities – Including an Amendment of FASB Statement No. 115*. This statement permits entities to choose to measure certain financial instruments and liabilities at fair value. Most of the provisions of SFAS No. 159 apply only to entities that elect the fair value option. However, the amendment to SFAS No. 115 *Accounting for Certain Investments in Debt and Equity Securities* applies to all entities with available-for-sale and trading securities. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. Early adoption is permitted as of the beginning of a fiscal year that begins on or before November 15, 2007, provided the entity also elects to apply the provision of SFAS No. 157, *Fair Value Measurements*. The adoption of this statement is not expected to have a material effect on the Company's financial statements.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157). This Statement defines fair value as used in numerous accounting pronouncements, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP) and expands disclosure related to the use of fair value measures in financial statements. SFAS No. 157 does not expand the use of

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fair value measures in financial statements, but standardizes its definition and guidance in GAAP. The Standard emphasizes that fair value is a market-based measurement and not an entity-specific measurement based on an exchange transaction in which the entity sells an asset or transfers a liability (exit price). SFAS No. 157 establishes a fair value hierarchy from observable market data as the highest level to fair value based on an entity's own fair value assumptions as the lowest level. SFAS No. 157 is effective in fiscal years beginning after November 15, 2007.

Adoption of this statement is not expected to materially impact our results of operations or financial position.

Also in September 2006, the FASB released Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans, an amendment of FASB Statements No. 87, 88, 106, and 132(R) (SFAS No. 158). Under the new standard, companies must recognize a net liability or asset to report the funded status of their defined benefit pension and other postretirement benefit plans on their balance sheets. We do not have such plans therefore the adoption of the provisions of SFAS 158 did not affect our results of operations or financial position.

Note 2: Inventories

Inventories, consisting of materials, labor and overhead at December 31 were comprised of the following:

	2007	2006
Finished goods	\$2,178,000	\$2,435,400
Raw Materials	1,284,200	1,337,200
Inventory reserve for obsolescence	(407,700)	(481,200)
	\$3,054,500	\$3,291,400

Note 3: Property, Plant and Equipment

Property, plant and equipment at December 31 were comprised of the following:

	2007	2006
Land	\$ 1,091,500	\$ 1,091,500
Buildings	16,308,900	16,307,000
Production equipment	6,023,000	6,023,000
Office furniture and equipment	1,634,800	1,633,600
Other	240,600	181,200
	25,298,800	25,236,300
Less accumulated depreciation	(12,674,800)	(12,076,600)
	\$ 12,624,000	\$ 13,159,700

Depreciation expense for the years ended December 31, 2007 and 2006, was \$599,100 and \$622,100, respectively.

Note 4: Debt

We have a term loan agreement in the original amount of \$5,156,600 with a commercial bank. The loan agreement with our bank contains affirmative and negative covenants, including the requirement for maintaining a current ratio of at least 1:1 and a ratio of consolidated long-term debt to consolidated net worth of not more than 1:1 and limits the payment of dividends on common stock.

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Long-term debt at December 31 is presented below:

	2007	2006
First mortgage loan, secured by land and buildings due June 28, 2021, principal and interest of \$50,500 payable monthly, the interest rate is based on prime rate as published in the Wall Street Journal and is adjusted annually in June. The interest rate on this loan at December 31, 2007 was 8.25%	\$4,876,500	\$5,067,100
Less current maturities	204,900	191,600
Long-term debt	\$4,671,600	\$4,875,500

Maturities of long-term debt for the years 2008 through 2012 are \$204,900, \$223,900, \$243,300, \$264,500, and \$286,500 respectively.

Note 5: Income Taxes

The provision for income tax for the years ended December 31 is as follows:

	2007	2006
Current provision (benefit):		
Federal	\$	\$
State		2,200
Total current provision (benefit)		2,200
Deferred provision (benefit):		
Federal	(373,500)	(1,234,800)
State	(32,200)	(111,700)
Valuation allowance	405,700	1,346,500
Total deferred provision (benefit)		
Provision (benefit):		
Federal		
State		2,200
Total provision (benefit)	\$	\$ 2,200

Income tax expense (benefit) at the statutory tax rate is reconciled to the overall income tax expense (benefit) as follows:

	2007	2006
Federal income tax at statutory rates	\$(445,700)	\$(1,219,400)
State income taxes, net of federal tax effect	(40,100)	(109,600)
Change in unrecognized benefit	77,500	
Other	2,600	(15,300)

Total	(405,700)	(1,344,300)
Change in valuation allowance	405,700	1,346,500
Provision for income taxes	\$	\$ 2,200

Deferred income taxes are based on estimated future tax effects of differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amount used for income tax purposes given the provision of enacted tax laws. The net deferred tax assets and liabilities as of December 31, 2007 and 2006 are comprised of the following:

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	2007	2006
Deferred tax assets:		
Net operating loss carryforwards	\$ 2,797,500	\$ 2,440,300
Tax credit and other carryforwards	193,600	177,600
Trade receivables	23,300	23,000
Inventories	132,300	154,300
Accrued vacation	247,400	252,000
Accrued payroll		2,600
Other	6,700	800
Total deferred tax assets	3,400,800	3,050,600
Deferred tax liability:		
Accelerated depreciation for tax purposes	(949,000)	(1,004,500)
Total deferred tax liabilities	(949,000)	(1,004,500)
Net deferred tax asset, before allowance	2,451,800	2,046,100
Valuation allowance	(2,451,800)	(2,046,100)
Net deferred tax asset	\$	\$

At December 31, 2007, we had federal net operating loss carryforwards of approximately \$7,000,000 and federal tax credit carryforwards related to research and development efforts of approximately \$193,600, both of which expire over a period ending in 2027. State tax loss carryforwards at December 31, 2007 are approximately \$13,400,000 expiring over a period ending in 2027.

A valuation allowance was established due mainly to the uncertainty relating to the future utilization of net operating loss carryforwards. The valuation allowance was further increased by \$405,700 and \$1,346,500 for 2007 and 2006, respectively, primarily related to uncertainty as to realization of our operating losses and tax credits for these years. The amount of the deferred tax assets considered realizable could be adjusted in the future based upon changes in circumstances that result in a change in our assessment of our ability to realize those deferred tax assets through the generation of taxable income or other tax events.

On January 1, 2007, we adopted the provisions of FASB Interpretation No. 48 (FIN 48) Accounting for Uncertainty in Income Taxes, an interpretation of FASB Statement No. 109, Accounting for Income Taxes . FIN 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. It requires that we recognize in our consolidated financial statements, only those tax positions that are more-likely-than-not of being sustained as of the adoption date, based on the technical merits of the position. As a result of the implementation of FIN 48, we performed a comprehensive review of our material tax positions in accordance with recognition and measurement standards established by FIN 48.

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As a result of this review, we identified certain deferred tax assets that need to be adjusted. As of January 1, 2007, the date of adoption of FIN 48, our uncertain tax benefits totaled approximately \$295,200. As of December 31, 2007, this amount had reduced to approximately \$209,200.

Balance at January 1, 2007	\$ 295,200
Additions based on tax positions related to current year	
Additions for tax positions of prior years	
Reductions for tax positions of prior years	(86,000)
Balance at December 31, 2007	\$ 209,200

Due to our net operating loss position and valuation allowance against our net deferred tax assets, the recognition of the unrecognized tax benefits detailed above would not affect our effective tax rate. We do not expect that the amount of unrecognized benefits will change significantly within the next 12 months.

Our policy is to recognize interest and penalties related to uncertain tax benefits in income tax expense. As a result of our net operating loss carryforward position, we have no accrued interest or penalties related to uncertain tax positions as of January 1, 2007 or December 31, 2007.

We and our subsidiaries are subject to the following material taxing jurisdictions: U.S. federal and Colorado. The tax years that remain open to examination by the U.S. Internal Revenue Service are years 2004 through 2007. The tax years that remain open to examination by the state of Colorado are years 2003 through 2007.

However, due to net operating loss (NOL), carryforwards from prior periods, the Internal Revenue Services (IRS) could potentially review the losses related to NOL-generating years back to 2000.

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Note 6: Shareholders Equity

In 1993, a non-qualified stock option plan was adopted for the outside directors and in 1997, an incentive stock option plan was adopted for our employees. The 1993 plan expired in January of 2003, and the 1997 plan expired on November 7, 2007 accordingly no shares are available for option under those plans. In 1998 and 2005, stock option plans for our employees, officers and directors were adopted. All of the plans permitted us to grant options up to an aggregate of 2,400,000 shares of common stock. Options are granted at not less than fair market value of the stock on the date of grant and are exercisable for up to ten years from the grant date. All options granted through 2006 have been vested on the date of grant. The options granted in 2007 are vested over a four-year period.