SPECTRUM SCIENCES & SOFTWARE HOLDINGS INC
Form 10QSB
May 24, 2004

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-QSB

(Mark One)

[X] QUARTERLY REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

FOR THE QUARTERLY PERIOD ENDED: March 31, 2004

OR

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________ to __________

Commission file number _______________________

SPECTRUM SCIENCES & SOFTWARE HOLDINGS CORP.
(Exact name of small business issuer as specified in its charter)

DELAWARE	80-0025175
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

91 HILL AVENUE NW,
FORT WALTON BEACH, FLORIDA 32548
(Address of principal executive offices)
(Zip Code)

Issuer's telephone number (850) 796-0909

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 [X] No [ ]

As of May 21, 2004 there were 40,029,300 shares of the registrant's common stock, par value $0.0001, issued and outstanding.

Transitional Small Business Disclosure Format (check one):
Yes [ ] No [X]

SPECTRUM SCIENCES & SOFTWARE HOLDINGS CORP.
MARCH 31, 2004 QUARTERLY REPORT ON FORM 10-QSB

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SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

To the extent that the information presented in this Quarterly Report on Form 10-QSB for the quarter ended March 31, 2004, discusses financial projections, information or expectations about our products or markets, or otherwise makes statements about future events, such statements are forward-looking. We are making these forward-looking statements in reliance on the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Although we believe that the expectations reflected in these forward-looking statements are based on reasonable assumptions, there are a number of risks and uncertainties that could cause actual results to differ materially from such forward-looking statements. These risks and uncertainties are described, among other places in this Quarterly Report, in "Management's Discussion and Analysis or Plan of Operations."

In addition, we disclaim any obligations to update any forward-looking statements to reflect events or circumstances after the date of this Quarterly Report. When considering such forward-looking statements, you should keep in mind the risks referenced above and the other cautionary statements in this Quarterly Report

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SPECTRUM SCIENCES & SOFTWARE HOLDINGS CORP.
Consolidated Balance Sheet
March 31, 2004
(Unaudited)

ASSETS

Current assets:	
Cash and cash equivalents	$ 1,402,237
Receivables, net	2,114,878
Inventories	244,916
Prepaid expenses	126,554
Total current assets	3,888,585
Property, plant, and equipment, net	1,979,344
Deferred tax asset	40,034
Cash surrender value of life insurance	38,665
Other assets	13,802
Total assets	$ 5,960,430

LIABILITIES AND STOCKHOLDERS' EQUITY

Current liabilities:	
Accounts payable	$ 1,110,586
Accrued expenses	931,940
Contract deposits	58,306
Current portion of long-term debt	200,511
Due to related parties	379,238
Total current liabilities	2,680,581
Long-term liabilities:	
Long-term debt, less current portion	1,711,617

Total liabilities	4,392,198
Commitments and contingencies (Note 12)	
Stockholders' equity:	
Preferred stock, $0.0001 par value; 20,000,000 authorized, none issued	-
Common stock, $0.0001 par value; 80,000,000 shares authorized, 21,651,000 issued and outstanding	2,165
Additional paid-in capital	16,117,184
Accumulated deficit	(14,551,117)
Total stockholders' equity	1,568,232
Total liabilities and stockholders' equity	$ 5,960,430

See accompanying notes to the consolidated financial statements.

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SPECTRUM SCIENCES & SOFTWARE HOLDINGS CORP.
Consolidated Statements of Operations
For the three months ended March 31, 2004 and 2003
(Unaudited)

	2004	2003
Revenues	$ 3,596,578	$ 3,273,029
Cost of revenues	(3,274,381)	(3,090,799)
Gross profit	322,197	182,230
Operating expenses	(13,951,585)	(124,932)
Income (loss) from operations	(13,629,388)	57,298
Other income (expense):		
Building rent	49,560	45,351
Interest income	365	199
Other income	1,985	4,802
Interest expense	(63,851)	(66,752)
Other expense	(1,010)	(6,249)

Total other income (expense)	(12,951)	(22,649)
Income (loss) before provision for income taxes.	(13,642,339)	34,649
Income tax benefit	61,330	-
Net income (loss)	$(13,581,009)	$ 34,649
Weighted average common shares outstanding:		
Basic and diluted	19,316,934	16,276,222
Earnings (loss) per share:		
Basic and diluted	$ (0.70)	$ -

See accompanying notes to the consolidated financial statements.

SPECTRUM SCIENCES & SOFTWARE HOLDINGS CORP.
Consolidated Statement of Stockholders' Equity
For the three months ended March 31, 2004
(Unaudited)

	Common Stock				
	Shares	Amount	Additional paid-in capital	Accumulated deficit	Total
Balances at January 1, 2004	18,851,000	$ 1,885	$ 79,426	$ (970,108)	$ (888,797)
Stock options issued for consulting services	-	-	11,418,038	-	11,418,038
Exercise of stock options	2,800,000	280	4,619,720	-	4,620,000
Net loss	-	-	-	(13,581,009)	(13,581,009)
Balances at March 31, 2004.	21,651,000	$ 2,165	$ 16,117,184	$(14,551,117)	$ 1,568,232

See accompanying notes to the consolidated financial statements.

SPECTRUM SCIENCES & SOFTWARE HOLDINGS CORP.
Consolidated Statements of Cash Flows
For the three months ended March 31, 2004 and 2003
(Unaudited)

	2004	2003
Cash flows from operating activities:		
Net income (loss)	$(13,581,009)	$ 34,649
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Issuance of stock options to related party for consulting services	11,418,038	-
Investor relations expenses paid by a related party	2,065,000	-
Depreciation	32,327	38,082
Accrued interest payable due to related parties	7,792	-
Deferred income taxes	(28,594)	-
Amortization	445	445
(Increase) decrease in:		
Receivables	(386,994)	(77,004)
Inventories	(122,524)	66,309
Prepaid expenses	(107,831)	(75,358)
Other assets	-	1,000
Increase (decrease) in:		
Accounts payable	(160,273)	(62,103)
Accrued expenses	373,359	(111,792)
Contract deposits	8,306	(2,077)
Deferred revenues	(36,966)	-
Net cash used in operating activities	(518,924)	(187,849)
Cash flows from investing activities:		
Purchase of property and equipment	(7,817)	(30,204)
Net cash used in investing activities	(7,817)	(30,204)
Cash flows from financing activities:		
Payments on notes payable	(544,171)	(41,996)
Net repayments on bank line of credit	-	(108,596)
Repayment of short-term debt	(307,726)	-
Advances from related party	598,916	163,392
Repayments of advances from a related party	-	(200,061)
Proceeds from the exercise of stock options	1,485,000	-
Net cash provided by (used in) financing activities	1,232,019	(187,261)
Net increase (decrease) in cash and cash equivalents	705,278	(405,314)
Cash and cash equivalents, beginning of period	696,959	633,909
Cash and cash equivalents, end of period	$ 1,402,237	$ 228,595
Supplemental disclosures of cash flow information:		
Cash paid during the period for:		
Interest	$ 66,919	$ 73,512

Supplemental schedule of non-cash financing and investing activities:		
Reduction in due to related party in lieu of cash payment for exercise of stock options	$ 3,135,000	$ -
Reclasification of short-term debt to accrued expenses	$ 17,635	$ -

See accompanying notes to the consolidated financial statements.

SPECTRUM SCIENCES & SOFTWARE HOLDINGS CORP.
Notes to the Consolidated Financial Statements
Three months ended March 31, 2004 and 2003
(Unaudited)

1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES:

(A) ORGANIZATION AND NATURE OF BUSINESS

Silva Bay International, Inc., a Delaware corporation, was formed in 1998 for the purpose of locating and recovering rare and valuable aircraft. Silva Bay International, Inc. had no operations and no revenue from inception in 1998 to the time of the acquisition of Spectrum Sciences & Software, Inc. in April, 2003.

Spectrum Sciences & Software, Inc. was incorporated in the State of Florida on October 8, 1982. Headquartered in Fort Walton Beach, Florida, the Company has three reportable segments - management services, manufacturing, and engineering and information technology services. Management services include providing engineering, technical, and operational services in the area of defense range management specializing in bombing and gunnery training range operation and maintenance. Manufacturing operations include the design and construction of munitions ground support equipment and containers for the shipping and storage of munitions and equipment. The Company's engineering and information technology services segment consists of the sale of computer software developed to assist in hazard management and weapons impact analysis.

On April 2, 2003, Silva Bay International, Inc. acquired Spectrum Sciences & Software, Inc., a Florida corporation, in exchange for the issuance of 2,500,000 shares of common stock (taking into account the forward two for one stock split of April 9, 2003) (see Note 3). Spectrum Sciences & Software, Inc. is now the wholly owned subsidiary of Silva Bay International, Inc. (now collectively referred to as the "Company").

On April 8, 2003, Silva Bay International, Inc. changed its name to Spectrum Sciences & Software Holdings Corp. On April 9, 2003, the Company effectuated a two for one forward split of its common stock. On November 4, 2003, the Company's registration statement for the public trading of its shares became effective.

The Company's contracts are primarily fixed price contracts with the United States Department of Defense (DOD). The Company currently has contracts in Florida and Arizona. During the three months ended March 31, 2004 and 2003, 99% of the Company's revenues were derived from contracts with the DOD.

(B) INCOME TAXES

The Company accounts for income taxes utilizing the asset and liability method. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences attributable to temporary differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carryforwards. 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. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enacted date. Valuation allowances are

established when necessary to reduce deferred tax assets to the amount expected to be realized.

The Company currently has a net operating loss carryforward of approximately $10,900,000, which would equate to a deferred tax asset of approximately $3,700,000 at March 31, 2004. The Company has not recorded that federal tax benefit in the accompanying financial statements, as management does not have sufficient information to estimate when or if the Company will realize the future tax benefit.

(C) EARNINGS (LOSS) PER SHARE

The Company utilizes Financial Accounting Standards Board (FASB) Statement of Financial Accounting Standards No. 128, "Earnings Per Share", which requires the presentation of basic and diluted earnings (loss) per share on the face of the statement of operations. Basic earnings (loss) per share is computed by dividing the net income (loss) by the weighted average number of common shares outstanding for the period. Diluted net income (loss) per share reflects the potential dilution that could occur if stock options were exercised.

The Company's common stock equivalents consist of consultant stock options to purchase common stock. As of March 31, 2004, stock options to purchase 6,200,000 shares of the Company's common stock at an exercise price of the lesser of $1.65 per share or the fair market value at the time of exercise were not included in the computation of diluted earning per share for the three months ended March 31, 2004 because the effect of their exercise would have been anti-dilutive. The Company had no common stock equivalents as of March 31, 2003.

The weighted average number of common shares outstanding for computing basic and diluted earnings (loss) per share for the three months ended March 31, 2004 and 2003 was 19,316,934 and 16,276,222, respectively.

2. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements for the three months ended March 31, 2004 and 2003 have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and pursuant to the rules and regulations of the U.S. Securities and Exchange Commission for Form 10-QSB. Accordingly, they do not include all the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments, consisting only of normal recurring accruals, considered necessary for a fair presentation of the Company's financial position, results of operations, and cash flows for the periods presented.

The results of operations for the interim periods ended March 31, 2004 and 2003 are not necessarily indicative of the results to be expected for the full year. These interim consolidated financial statements should be read in conjunction with the December 31, 2003 consolidated financial statements and related notes included in the Company's Annual Report on Form 10-KSB for the year ended December 31, 2003.

SPECTRUM SCIENCES & SOFTWARE HOLDINGS CORP.
Notes to the Consolidated Financial Statements
Three months ended March 31, 2004 and 2003
(Unaudited)

3. ACQUISITION OF SPECTRUM SCIENCES & SOFTWARE, INC.:

On April 3, 2003, Spectrum Sciences & Software Holdings Corp. (formerly Silva Bay International, Inc.) entered into an amended and restated agreement and plan of merger with Spectrum Sciences & Software, Inc., pursuant to which Spectrum Sciences & Software, Inc. became Spectrum Sciences & Software Holdings Corp.'s wholly owned subsidiary. As part of this agreement, 2,500,000 shares of the Company's common stock was issued to the sole stockholder of Spectrum Sciences & Software, Inc., which was Donal Myrick.

The acquisition was accounted for under the purchase method of accounting; accordingly, the purchase price has been allocated to reflect the fair value of assets and liabilities acquired at the date of acquisition. Due to the composition of the majority of the governing body and senior management of the Company being the same as Spectrum Sciences & Software, Inc. prior to the April 3, 2003 acquisition, Spectrum Sciences & Software, Inc. has been deemed to be the accounting acquirer (a reverse acquisition).

The financial statements of the Company prior to April 3, 2003 are those of Spectrum Sciences & Software, Inc. The results of operation of the acquired business have been included in the accompanying consolidated financial statements from the date of acquisition.

4. RECEIVABLES:

Receivables, which are primarily comprised of amounts due to the Company for work performed on contracts directly related to the U.S. Department of Defense and through U.S. Department of Defense contractors, consisted of the following at March 31, 2004:

Contracts - billed	$ 1,851,541
Contracts - unbilled	263,337
Total receivables	$ 2,114,878

SPECTRUM SCIENCES & SOFTWARE HOLDINGS CORP.

Notes to the Consolidated Financial Statements
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5. INVENTORIES:

Inventories are valued at the lower of cost or market. Cost is determined using the first-in, first-out method. The major components of inventories at March 31, 2004 are summarized as follows:

Raw materials, net of reserve	$ 92,217
Work in progress	151,699
Finished goods	1,000
Total inventories	$ 244,916

6. PROPERTY AND EQUIPMENT:

A summary of property and equipment at March 31, 2004 is as follows:

Land	$ 175,000
Buildings and improvements	1,565,301
Manufacturing and other equipment	737,912
Investment property	220,900
Computer equipment	140,350
Software	60,353
Vehicles	34,890
Furniture and fixtures	28,721
Construction in progress	38,714
Total	3,002,141
Accumulated depreciation	(1,022,797)
Property and equipment, net	$ 1,979,344

7. ACCRUED EXPENSES:

The major components of accrued expenses at March 31, 2004 are summarized as follows:

Accrued payroll, payroll taxes and related benefits	$ 776,872
Accrued vacation and sick leave	121,662
Accrued interest payable	12,579
Accrued property taxes	8,165
Other	12,662
Total accrued expenses	$ 931,940

The major components of the accrued salaries and related benefits is $102,740 owed to Gila Bend employees for wage rates which were recalculated based on job conformity required by the Department of Labor in 2003, and wage increases of $365,094 for the Service Contract Act employees.

SPECTRUM SCIENCES & SOFTWARE HOLDINGS CORP.
Notes to the Consolidated Financial Statements
Three months ended March 31, 2004 and 2003
(Unaudited)

8. LONG TERM DEBT

Long-term debt consisted of the following:

	March 31, 2004
Priority loans payable to a bank, due in monthly installments of $50,000 including interest at prime plus 2.00% (6.00% at March 31, 2004). Final payment due April 1, 2005. Cross-collateralized with non-priority real estate loans and personal guarantee of the former Company President, held by the same bank. Collateral includes two real estate mortgages, security agreement, assignment of contracts and assignment of rents and leases.	(1) $ 90,549
Non-priority loan payable to a bank, due in monthly installments of $14,870, including interest at 8.50%. Final balloon payment of $1,473,662 due April 1, 2005, collateralized by real estate and a personal guarantee of the former Company President. Cross-collateralized with priority loans.	1,526,018
Non-priority loan payable to a bank, due in monthly installments of $1,588, including interest at 8.75%. Final balloon payment of $186,457 due April 1, 2005, collateralized by a condominium and a personal guarantee of the former Company President. Cross-collateralized with priority loans.	189,123
Non-priority loan payable to a bank, due in monthly installments of $4,347, including interest at prime + .25% (4.25% at March 31, 2004). Final balloon payment of $49,661 due April 1, 2005, collateralized by equipment and inventory. Cross-collateralized with priority loans.	(2) 96,548
Other	(1) 9,890
	1,912,128
Less current portion	(200,511)
Total long-term debt	$ 1,711,617

(1) Final payment was made on April 5, 2004.

(2) Final payment was made on May 5, 2004.

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SPECTRUM SCIENCES & SOFTWARE HOLDINGS CORP.
Notes to the Consolidated Financial Statements
Three months ended March 31, 2004 and 2003
(Unaudited)

9. DUE TO RELATED PARTIES AND RELATED PARTY TRANSACTIONS:

$52,000 due to the spouse of the President of the Company including accrued interest of $500. Interest at 12% per annum. The payable is due upon demand, is unsecured, and was paid in full on April 7, 2004.	$ 52,500
$326,738 due to a stockholder of the Company. Represents net amount due as a result of the stockholder paying certain investor relations expenses on behalf of the Company. This payable does not bear interest, is payable upon demand, and is unsecured.	326,738
	$ 379,238

The Company was provided management consulting services by Endeavor Capital Group, LLC, which is owned by Robert Genovese. The terms of the original consulting agreement between Endeavor Capital Group, LLC and the Company were from March 1, 2003 to March 1, 2004. Consulting fees of $4,000 a month for January and February, 2004 and expenses of $15,106 are reported as consulting fees in the accompanying financial statements.

On March 11, 2004, the Company entered into a new consulting agreement with Mr. Genovese. The term of the agreement is for a one year period, and Mr. Genovese is tasked with bringing to the Company's attention potential or actual opportunities which meet its business objectives or logical extensions thereof, alert the Company to new or emerging high potential forms of production and distribution, comment on corporate development, identify respective suitable merger or acquisition candidates and related due diligence and other such planning and development services as shall be requested by the Company.

Mr. Genovese received 9,000,000 stock options of the Company's common stock at an exercise price of equal to the lesser of $1.65 or the fair market value at the time of exercise as a result of the execution of the agreement. In accordance with FASB Statement of Financial Accounting Standards No. 123, "Accounting for Stock-based Compensation", the Company has recorded consulting expense of $11,418,038 based on the fair value of the stock options at the date of grant using the Black-Scholes pricing model in the accompanying financial statements.

Mr. Genovese exercised 2,800,000 of the options during the first quarter of 2004. The Company received $1,485,000 of cash from Mr. Genovese and converted outstanding debt of $3,135,000 owed to Mr. Genovese and related companies in lieu of cash for exercise of these options.

The Company owed Mr. Genovese $792,030 at December 31, 2003. Mr. Genovese advanced the Company $598,916 during the first quarter of 2004 to pay operating expenses, and the Company had accrued interest of $7,792 on two interest-bearing notes. In addition, Mr. Genovese paid for certain investor relations expenses totaling $2,065,000 during the first quarter of 2004 on behalf of the Company. Mr. Genovese debt totaled $3,461,738 prior to the conversion of $3,135,000 of this debt. At March 31, 2004, the Company owed Mr. Genovese $326,738 for investor relations expenses that had not been converted by option exercise at the end of the first quarter.

(Unaudited)

10. STOCK OPTION PLAN:

On March 11, 2004 the board of directors approved and adopted a 2004 Non-Statutory Stock Option Plan for 10,000,000 common stock to be granted to employees, non-employee Directors, consultants and advisors. Vesting and term of all options is determined by the Board of Directors and may vary by optionee; however, the term may be no longer than 10 years from the date of grant.

At March 31, 2004, 9,000,000 options had been granted to a non-employee stockholder who provides consulting services to the Company. FASB Statement of Financial Accounting Standards No. 123, "Accounting for Stock-based Compensation", requires these options be valued at fair value at the date of grant. The fair value of these options was estimated at the date of grant using the Black-Scholes option pricing model with the following weighted-average assumptions: risk-free interest rate of 1%; no dividend yields; volatility factors of the expected market price of our common stock of 0.62; and an expected life of the options of 2 years. This generates a fair value of $1.27 per option at the date of grant, which was March 11, 2004. As a result, $11,418,038 of consulting expense and additional paid-in capital was recorded at the date of grant.

At March 31,2004, 9,000,000 options had been granted and 2,800,000 had been exercised at a strike price of $1.65 per option.

11. SEGMENT INFORMATION:

Segment information has been presented on a basis consistent with how business activities are reported internally to management. Management solely evaluates operating profit by segment by direct costs of its products and services with an allocation of indirect costs. The Company has three operating segments - management services, manufacturing, and engineering and information technology. Management services include providing engineering, technical, and operational services in the area of defense range management specializing in bombing and gunnery training range operation and maintenance. Manufacturing operations include the design and construction of munitions ground support equipment and containers for the shipping and storage of munitions and equipment. The Company's engineering and information technology segment consists of the sale of computer software developed to assist in hazard management and weapons impact analysis.

The following is a summary of certain financial information related to the three segments during the three months ended March 31, 2004 and 2003:

	Three months ended March 31 2004	2003
Total revenues by segment		
Management Services.	$ 2,641,031	$2,293,100

Engineering and Information Technology	320,090	329,353
Manufacturing	635,457	650,576
Total revenues by segment	$ 3,596,578	$3,273,029
Operating profit (loss) by segment		
Management Services	$ 17,546	$ 63,391
Engineering and Information Technology	151,792	80,532
Manufacturing	152,859	38,307
Operating expenses	(13,951,585)	(124,932)
Interest income (expense) net	(63,486)	(66,553)
Other income (expense), net	50,535	43,904
Net income (loss) before income tax benefit	(13,642,339)	34,649
Income tax benefit	61,330	-
Net income (loss)	$(13,581,009)	$ 34,649

During the three months ended March 31, 2004 and 2003, all of the Company's revenue was generated in the United States of America (USA). As of March 31, 2004, all of the Company's long-lived assets are located in the USA.

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SPECTRUM SCIENCES & SOFTWARE HOLDINGS CORP.
Notes to the Consolidated Financial Statements
Three months ended March 31, 2004 and 2003
(Unaudited)

12. COMMITMENTS AND CONTINGENCIES:

IRS Tax Lien

On March 17, 2004, the Company made its final payment to the IRS and received its release of lien of March 19, 2004.

Legal Matters

In December 2002, three Spectrum Sciences and Software, Inc. employees each filed complaints for violation of civil rights, discrimination, harassment, hostile work environment and retaliation in the United States District Court, District of Arizona. The case numbers for these complaints are: CIV '02 2621 PHX MHM; CIV '02 2619 PHX DKD; and CIV '02 2620 PHX FJM. In January 2003, Spectrum filed answers to all three complaints, denying all allegations of wrongdoing. All three plaintiffs are claiming "undue stress and anxiety" from Spectrum's actions. There are no damage amounts specified in any of the actions. The plaintiffs are requesting the following: Compensatory damages, plus special incidental damages in such a sum as may be proven at trial; punitive damages in such a sum as may be proven at trial; for cost for the suit; for attorney's fees; and for other such relief as the Court deems just and proper. The Company intends to vigorously defend its position. As of May 13, 2004, the cases have progressed through the establishment of a case management plan with the courts and a consolidation of all the cases into a single action. Plaintiff and Defendant Depositions were taken and additional discovery is ongoing. The Company currently does not know what the outcome of this litigation will be.

In April 1, 2004, the Company paid the final payment of $10,000 to Business & Commercial Brokerage Inc. and obtained a signed release acknowledging the receipt of all sums for full compromise settlement against the previously filed suit. On April 7, 2004, a Notice of Voluntary Dismissal was filed in the Circuit Court for Escambia County Florida.

Letter of Intent to Acquire Inland Fabricators

On March 31, 2004, the Company signed a Letter of Intent (LOI) to acquire all of the issued and outstanding membership interests (the "Members") of Inland Fabricators, LLC, a Limited Liability Company organized under the laws of Louisiana ("IFAB"), or its nominees or assignees, or acquire IFAB by merger with a subsidiary of Acquiror. The LOI is not binding, and the transaction is subject to the execution of a definitive acquisition agreement by both parties and is further described in Part II, Item 1 of this filing.

Pursuant to the LOI, if the acquisition goes forward, the Company is to issue shares of its common stock to the Members in consideration for their interests in IFAB. The Company will place 4,000,000 shares of common stock in escrow and the shares will be released from escrow in amounts and from time to time as based on an agreed formula.

On May 6, 2004, the Company provided guarantees in the amount of $500,000 to secure an Irrevocable Letter of Credit ("LOC") in favor of a major international construction firm. The LOC provided the necessary performance guarantee for IFAB under a previously negotiated Purchase Order with that major international construction firm.

On May 6, 2004, a creditors group consisting of Modern Valve, Inc., Thomas Pipe & Steel, L.L.C., Radnor Alloys, Inc., Portable Machine Works, Inc., Analytic Stress Relieving, Inc. and Custom Blast Services, Inc. filed suit no. 519924 in the 19th Judicial District court, Parish of East Baton Rouge, State of Louisiana against various individuals and Members of IFAB. Spectrum Sciences & Software Holdings Corporation was not named as a party to the suit, however, mention was made of Spectrum's LOI for a purchase of Inland Fabricators, L.L.C. The suit alleges among other issues that IFAB as successor to Thomas Inland Marine L.L.C., Pipeworks, Inc., Pipeworks Reserve, Inc., and Pipeworks Venezuela owes certain sums to the Creditor Group based on debt incurred by Thomas Inland Marine and Pipeworks et al. Due diligence is continuing on the planned Spectrum/IFAB merger. The potential outcome of the Creditors suit and its impact on the potential merger is undetermined at this time.

13. SUBSEQUENT EVENTS:

On April 16, 2004, the Board of Directors amended and restated the stock option plan to increase the number of shares from 10,000,000 to 30,000,000.

On April 16, 2004, the Company and Robert Genovese amended and restated their March 11, 2004 consulting agreement (the "Amended Agreement"). The Amended Agreement extended the term of the contract for an additional year to April 19, 2006 and added an exclusivity provision. As part of the Amended Agreement, Mr. Genovese was issued options to acquire an additional 9,000,000 shares of common stock at an exercise price of the greater of $1.95 or 60% of the closing price on the day preceding notice to exercise. In addition, Mr. Genovese was issued an option to acquire 5,000,000 shares of the Company's common stock at the lesser of $1.65 or the fair market value of the shares at the time of the exercise as a result of his role in the IFAB transaction.

On April 20, 2004, the Company awarded 677,500 stock options to certain employees, officers and directors for services rendered.

On April 28, 2004, the Company was informed that the SEC was conducting an informal inquiry into the Company as further described in Part II, Item 5 of this filing.

In light of this inquiry and pending further review, the Company's Board of Directors elected to suspend the current consulting agreement between the Company and Robert Genovese.

As of May 21, 2004, Mr. Genovese and related companies had submitted expense reimbursement claims in addition to those reflected on the Interim Consolidated Financial Statements as of March 31, 2004 of $900,000 under the Amended Agreement. The Company is reviewing the validity of those claims.

Between March 31, 2004 and May 21, 2004, Mr. Genovese has exercised 18,378,300 options. Of these options, 11,200,000 were exercised at a strike price of $1.65 per option, and 7,178,300 were exercised at a strike price of $1.95 per option. Total proceeds payable to the Company relating to the exercise of these options were $32,477,685. The Company received $29,232,685 of cash from Mr. Genovese. In addition, Mr. Genovese and his related companies cancelled expense reimbursement claims of $1,100,000 in lieu of cash for exercise of these options. As a result, the Company believes that Mr. Genovese and his related companies have no outstanding reimbursement claims as of May 21, 2004.

Between January 1, 2004 and May 21, 2004, Mr. Genovese has exercised 21,178,300 options. Of these options, 14,000,000 were exercised at a strike price of $1.65 per option, and 7,178,300 were exercised at a strike price of $1.95 per option. Total proceeds payable to the Company relating to the exercise of these options were $37,097,685. The Company received $30,717,685 of cash from Mr. Genovese and Mr. Genovese and related companies cancelled expense reimbursement claims of $4,035,000 in lieu of cash for exercise of these options.

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SPECTRUM SCIENCES & SOFTWARE HOLDINGS CORP.
Notes to the Consolidated Financial Statements
Three months ended March 31, 2004 and 2003
(Unaudited)

As of May 21, 2004, the Company has not received payment from Genovese in the amount of $1,815,000 with respect to an exercise of 1,100,000 options at a strike price of $1.65 per share on or about April 15, 2004. Additionally, with respect to exercise of 1,100,000 options on or about April 26, 2004, the Company received payment based on a strike price of $1.65 per share rather than the $1.95 per share as provided for in the Amended Agreement. As a result, Mr. Genovese owes the Company an additional $330,000 with respect to that exercise. Under the terms of the relevant option agreements and assuming the validity of cancelled claims, total payment owed to the Company from Mr. Genovese relating to these option exercises is $2,145,000.

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ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATIONS

The Company's discussion and analysis of its financial condition and results of operations are based upon its Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of financial statements requires management to make estimates and assumptions which affect the amounts reported in the financial statements and determine whether contingent assets and liabilities, if any, are disclosed in the financial statements. On an ongoing basis, we evaluate our estimates and assumptions, including those related to long-term contracts, product returns, bad debts, inventories, fixed asset lives, income taxes, environmental matters, litigation and other contingencies. We base our estimates and assumptions on historical experience and on various factors that are believed to be reasonable under the circumstances, including current and expected economic conditions, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ materially from our estimates under different assumptions or conditions.

We believe that the following critical accounting policies, among others, affect our more significant estimates and assumptions used in the preparation of our financial statements:

Revenue recognition. We recognize revenue and profit on substantially all of our contracts using the percentage-of-completion method of accounting, which relies on estimates of total expected contract revenues and costs. We follow this method since reasonably dependable estimates of the revenues and costs applicable to various stages of the contracts can be made. Recognized revenues and profit are subject to revisions as the projects progress to completion. Revisions to the profit estimates are charged to income in the period in which the facts that give rise to the revisions become known.

Inventory Valuation. We review our inventory balances to determine if inventories can be sold at amounts equal to or greater than their carrying value. The review includes identification of slow-moving inventories, obsolete inventories, and discontinued products or lines of products. The identification process includes analysis of historical performance of the inventory and current operational plans for the inventory as well as industry and customer-specific trends. If our actual results differ from management expectations with respect to the selling of our inventories at amounts equal to or greater than our carrying amounts, we would be required to adjust our inventory values accordingly.

Net operating loss carryforwards. We have not recognized the benefit in our consolidated financial statements with respect to the approximately $10,900,000 net operating loss carryforward for federal income tax purposes as of March 31, 2004. This benefit was not recognized due to the possibility that the net operating loss carryforward would not be utilized, for various reasons, including the potential that we might not have sufficient profits to use the carryforward or that the carryforward may be limited as a result of changes in our equity ownership. We intend to use this carryforward to offset our future taxable income. If we were to use any of this net operating loss carryforward to reduce our future taxable income and the Internal Revenue Service were to then successfully assert that our carryforward is subject to limitation as a result of capital transactions occurring in 2003 or otherwise, we may be liable for back taxes, interest and, possibly, penalties prospectively.

Impairment of Long-Lived Assets. We assess the impairment of long-lived assets on an ongoing basis and whenever events or changes in circumstances indicate that the carrying value may not be recoverable based upon an estimate of future undiscounted cash flows. Factors we consider that could trigger an impairment review include the following: (i) significant underperformance relative to expected historical or projected future operating results;(ii) significant changes in the manner of our use of the acquired assets or the strategy for our

overall business; (iii) significant negative industry or economic trends;(iv) significant decline in our stock price for a sustained period; and (v) our market capitalization relative to net book value. When we determine that the carrying value of any long-lived asset may not be recoverable based upon the existence of one or more of the above indicators of impairment, we measure impairment based on the difference between an asset's carrying value and an estimate of fair value, which may be determined based upon quotes or a projected discounted cash flow, using a discount rate determined by our management to be commensurate with our cost of capital and the risk inherent in our current business model, and other measures of fair value.

You should read the following discussion and analysis in conjunction with the unaudited financial statements (and notes thereto) and other financial information of our company appearing elsewhere in this report.

CONSOLIDATED OVERVIEW:

	For the three months ended March 31			
	2004		2003	
Revenues. . .	$ 3,596,578	100.0%	$ 3,273,000	100.0%
Cost of revenues	3,274,381	91.0%	3,091,000	94.4%
Gross Profit.	$ 322,197	9.0%	$ 182,000	5.6%

Overall, revenues for the three-months ended March 31, 2004 increased by 10% compared to the same period in 2003 due to increased marketing activity and the Management Services segment's growth of 15%. Gross profit as a percentage of sales was 9% for the 3-month period ended March 31, 2004. The increases in revenue are primarily due to scheduled increases in reimbursable labor cost under the Service Contract Act in the management services division and additional company-wide cost controls put in place.

MANAGEMENT SERVICES

	For the three months ended March 31			
	2004		2003	
Revenues. . .	$ 2,641,031	100.0%	$ 2,293,000	100.0%
Cost of revenues	2,623,485	99.3%	2,230,000	97.3%
Gross Profit.	$ 17,546	.7%	$ 63,000	2.7%

Revenues in the Management Services segment increased approximately 15% for the three-month period ended March 31, 2004 compared to 2003. The increases in revenue and expenses are primarily due to the scheduled increases in reimbursable labor cost under the Service Contract Act and collective bargaining agreement for Spectrum's largest subcontractor, Washington Group International.

ENGINEERING AND INFORMATION TECHNOLOGY SERVICES

	For the three months ended March 31			
	2004		2003	
Revenues. . . .	$320,090	100.0%	$ 329,000	100.0%
Cost of revenues	168,298	52.6%	248,000	75.4%
Gross Profit. .	$151,792	47.4%	$ 81,000	24.6%

Revenues in the Engineering and Information Technology Services segment decreased 2.8% for the period ended March 31, 2004 as compared to the same period in 2003. This slight decrease in revenues resulted from planned internal suspension of production schedules due to staff travel overseas undertaken to client sites and scheduled completion of backlog software development tasks for the Safe-Range program.

Gross profit as a percent of sales was 47.4%, an increase of 87%. This increase in gross profit was due to reductions of management salary costs due to the departure of Donald Garrison, Vice President, and additional cost controls put in place during the first quarter of 2004 as compared to the first quarter of 2003.

MANUFACTURING SEGMENT

	For the three months ended March 31,			
	2004		2003	
Revenues. . .	$635,457	100.0%	$651,000	100.0%
Cost of revenues	482,598	75.9%	613,000	94.2%
Gross Profit.	$152,859	24.1%	$ 38,000	5.8%

Revenues in the Manufacturing segment decreased 2% for the three-month period ended March 31, 2004 as compared to the same period in 2003.

Gross profit improved significantly to 24.1% due to the streamlining in manufacturing processes brought about by the Company obtaining longer term contracts, which led to cost efficiencies in both overhead labor, purchasing and production.

OPERATING EXPENSES

	Three months ended March 31, 2004	Three months ended March 31, 2003	Increase
Selling, general and administrative expenses	$ 13,951,585	$ 124,900	11070%

SELLING, GENERAL AND ADMINISTRATIVE EXPENSES - Selling, general and administrative ("SG&A") expenses increased 11070% for the three-month period ended March 31, 2004 as compared to the same period in 2003.

During the quarter ended March 31, 2004, there was $11,418,038 recorded for stock-based consulting compensation. The impact caused an expense to the Company. However, the grant of the options to Mr. Robert Genovese also increased additional paid-in capital by $11,418,038. In addition, the Company recorded approximately $2,065,000 of investor relations expenses during the first quarter of 2004. These expenses relate to the implementation of the initial investor awareness/relations services such as broker/analyst meetings, contracts, mailings to brokers and analysts, investment advisors and individual investors.

The wholly-owned subsidiary, Spectrum Sciences & Software, Inc. also had increased legal and accounting costs of $162,720. This is due to costs associated with the filings with the Securities and Exchange Commission.

These types of expenses were not present in the quarter ended March 31, 2003.

OTHER INCOME AND EXPENSES

INTEREST INCOME AND EXPENSE, NET - Net interest expense was $63,486 and $66,553 for the three-month period ended March 31, 2004 and 2003, respectively. The reduction of $3,067 is due to the decrease of principal balances due.

OTHER INCOME AND EXPENSE, NET - Net other income was $50,535 and $43,904 for the three-month period ended March 31, 2004 and 2003, respectively. The increase of $6,631 is attributed primarily to the increase in monthly rental income from L-3 Communications which was $15,117 per month in 2003 to $16,520 per month in 2004.

CAPITAL RESOURCES AND LIQUIDITY

Cash and cash equivalents increased $705,278 as of March 31, 2004, as compared to December 31, 2003. At March 31, 2004, cash and equivalents totaled $1,402,237, as compared with $696,959 at December 31, 2003. As of May 18, 2004, the Company had $28,848,525 in a money market account as a result of the exercise of stock options.

At March 31, 2004, working capital was $1,208,004, as compared to negative working capital of