

ARISTOTLE CORP  
Form 10-Q  
November 14, 2008

AS FILED WITH THE SECURITIES AND EXCHANGE COMMISSION ON NOVEMBER 14, 2008

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

**Form 10-Q**

(MARK ONE)

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

**ACT OF 1934**

**FOR THE QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008**

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

**ACT OF 1934**

**FOR THE TRANSITION PERIOD FROM \_\_\_\_\_ TO \_\_\_\_\_**

*COMMISSION FILE NUMBER 0-14669*

**THE ARISTOTLE CORPORATION**

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

**DELAWARE**

(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

**06-1165854**

(I.R.S. EMPLOYER  
IDENTIFICATION NO.)

**96 CUMMINGS POINT ROAD, STAMFORD, CONNECTICUT**

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES)

**06902**

(ZIP CODE)

**(203) 358-8000**

(REGISTRANT'S TELEPHONE NUMBER, INCLUDING AREA CODE)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer", "accelerated filer", and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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Indicate by check mark whether registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ]  
No [X]

As of November 7, 2008, 17,962,875 shares of Common Stock, 1,081,427 shares of Series I Preferred Stock and 10,984,971 shares of Series J Preferred Stock were outstanding.

**THE ARISTOTLE CORPORATION**

**INDEX OF INFORMATION CONTAINED IN FORM 10-Q FOR THE  
QUARTERLY PERIOD ENDED SEPTEMBER 30, 2008**

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## PART I

## ITEM 1. FINANCIAL STATEMENTS

## THE ARISTOTLE CORPORATION AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except share and per share data)

| Assets                             | September<br>30,<br>2008<br>(unaudited) | December<br>31, 2007 | September<br>30,<br>2007<br>(unaudited) |
|------------------------------------|---|----------------------|---|
| Current assets:                    |   |                      |   |
| Cash and cash equivalents          | \$ 7,138                                | 5,604                | 3,173                                   |
| Marketable securities              | 2,480                                   | 3,335                | 2,886                                   |
| Investments                        | 21,991                                  | 18,150               | 15,761                                  |
| Accounts receivable, net           | 26,175                                  | 15,631               | 27,975                                  |
| Inventories, net                   | 42,388                                  | 42,297               | 40,046                                  |
| Prepaid expenses and other         | 4,000                                   | 9,611                | 5,084                                   |
| Deferred income taxes              | 1,788                                   | 2,484                | 2,634                                   |
| Total current assets               | 105,960                                 | 97,112               | 97,559                                  |
| Property, plant and equipment, net | 28,429                                  | 27,476               | 27,140                                  |
| Goodwill                           | 14,186                                  | 14,476               | 14,458                                  |
| Deferred income taxes              | 5,646                                   | 5,646                | 8,188                                   |
| Investments                        | 4,318                                   | 4,279                | 4,000                                   |

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|              |              |            |         |         |
|--------------|--------------|------------|---------|---------|
| Other assets |              | 817        | 446     | 391     |
|              | Total assets | \$ 159,356 | 149,435 | 151,736 |

**Liabilities and Stockholders Equity**

Current liabilities:

|  |                           |        |        |        |
|--|---------------------------|--------|--------|--------|
| Current installments of long-term debt | \$                        | 299    | 305    | 300    |
| Trade accounts payable                 |                           | 9,331  | 10,500 | 8,593  |
| Accrued expenses                       |                           | 7,537  | 6,765  | 6,814  |
| Income taxes                           |                           | 184    | -      | 4,434  |
| Accrued dividends payable              |                           | -      | 2,156  | -      |
|  | Total current liabilities | 17,351 | 19,726 | 20,141 |

|   |  |        |       |        |
|---|--|--------|-------|--------|
| Long-term debt, less current installments |  | 10,434 | 8,655 | 14,237 |
| Long term pension obligations             |  | 2,115  | 2,944 | 2,808  |
| Other long-term accruals                  |  | 2,458  | 2,429 | 2,424  |

Stockholders equity:

|   |  |            |         |         |
|---|--|------------|---------|---------|
| Preferred stock, Series I, 11% cumulative, \$6.00 stated value,<br>\$.01 par value;<br>2,400,000 shares authorized, 1,081,427 shares<br>issued and outstanding  |  | 6,489      | 6,489   | 6,489   |
| Preferred stock, Series J, 12% cumulative, \$6.00 stated value,<br>\$.01 par value;<br>11,200,000 shares authorized, 10,984,971 shares<br>issued and outstanding  |  | 65,760     | 65,760  | 65,760  |
| Common stock, \$.01 par value; 20,000,000 shares<br>authorized, 17,962,875,<br>17,946,705 and 17,943,975 shares issued and<br>outstanding at<br>September 30, 2008, December 31, 2007 and<br>September 30, 2007, respectively |  | 180        | 179     | 179     |
| Additional paid-in capital  |  | 7,685      | 7,580   | 6,867   |
| Retained earnings   |  | 46,985     | 34,964  | 31,866  |
| Accumulated other comprehensive earnings (loss)   |  | (101)      | 709     | 965     |
|   | Total stockholders equity                    | 126,998    | 115,681 | 112,126 |
|   | Total liabilities and stockholders<br>equity | \$ 159,356 | 149,435 | 151,736 |

The accompanying notes are an integral part of these condensed consolidated financial statements.

**THE ARISTOTLE CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS**

**(in thousands, except share and per share data)**

**(Unaudited)**

|                                    |    | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|------------------------------------|----|---------------------------|-------------|--------------------------|-------------|
|                                    |    | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                                    |    | <b>2008</b>               | <b>2007</b> | <b>2008</b>              | <b>2007</b> |
| Net sales                          | \$ | 64,976                    | 63,524      | 172,202                  | 167,950     |
| Cost of sales                      |    | 40,123                    | 39,017      | 105,116                  | 102,909     |
| Gross profit                       |    | 24,853                    | 24,507      | 67,086                   | 65,041      |
| Selling and administrative expense |    | 13,178                    | 12,133      | 36,795                   | 35,677      |
| Earnings from operations           |    | 11,675                    | 12,374      | 30,291                   | 29,364      |
| Other (expense) income:            |    |                           |             |                          |             |
| Interest expense                   |    | (260)                     | (393)       | (833)                    | (1,082)     |
| Other, net                         |    | (428)                     | 453         | 162                      | 1,216       |
|                                    |    | (688)                     | 60          | (671)                    | 134         |
| Earnings before income taxes       |    | 10,987                    | 12,434      | 29,620                   | 29,498      |
| Income taxes expense (benefit):    |    |                           |             |                          |             |
| Current                            |    | 4,234                     | 4,690       | 10,568                   | 8,596       |
| Deferred                           |    | (109)                     | 84          | 564                      | 2,623       |
|                                    |    | 4,125                     | 4,774       | 11,132                   | 11,219      |
| Net earnings                       |    | 6,862                     | 7,660       | 18,488                   | 18,279      |
| Preferred dividends                |    | 2,155                     | 2,154       | 6,467                    | 6,470       |
|                                    | \$ | 4,707                     | 5,506       | 12,021                   | 11,809      |



Net earnings applicable to  
common stockholders

Earnings per common share:

|         |    |     |     |     |     |
|---------|----|-----|-----|-----|-----|
| Basic   | \$ | .26 | .31 | .67 | .67 |
| Diluted | \$ | .26 | .31 | .67 | .67 |

Weighted average common shares outstanding:

|         |            |            |            |            |
|---------|------------|------------|------------|------------|
| Basic   | 17,962,875 | 17,927,671 | 17,962,209 | 17,552,073 |
| Diluted | 17,968,921 | 17,946,013 | 17,971,305 | 17,569,502 |

The accompanying notes are an integral part of these condensed consolidated financial statements.



**THE ARISTOTLE CORPORATION AND SUBSIDIARIES**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)

(Unaudited)

|   | <b>Nine Months Ended</b> |             |
|---|--------------------------|-------------|
|   | <b>September 30,</b>     |             |
|   | <b>2008</b>              | <b>2007</b> |
| Cash flows from operating activities:   |                          |             |
| Net earnings  | \$ 18,488                | 18,279      |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |                          |             |
| Depreciation and amortization   | 1,525                    | 1,397       |
| Stock option compensation   | 12                       | 75          |
| Loss on sale of property, plant and equipment                                       | -                        | 3           |
| Earnings in equity method investment  | (840)                    | (1,175)     |
| Loss on sale of marketable securities   | 741                      | -           |
| Impairment loss on marketable securities  | 306                      | -           |
| Excess tax benefits from stock-based compensation                                   | (24)                     | (1,305)     |
| Deferred income taxes   | 563                      | 2,615       |
| Change in assets and liabilities:   |                          |             |
| Accounts receivable   | (10,544)                 | (12,517)    |
| Inventories   | (91)                     | (2,559)     |
| Prepaid expenses and other  | 5,611                    | 3,039       |
| Other assets  | (96)                     | (676)       |
| Trade accounts payable  | (1,169)                  | (847)       |
| Accrued expenses and other liabilities  | 719                      | 3,102       |
| Accrued pension obligations   | (829)                    | -           |
| Net cash provided by operating activities   | 14,372                   | 9,431       |
| Cash flows from investing activities:   |                          |             |
| Purchases of property, plant and equipment  | (2,942)                  | (2,450)     |
| Proceeds from the sale of plant, property and equipment                             | -                        | 6           |

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|  |          |         |
|--|----------|---------|
| Purchases of investments                                 | (3,040)  | (4,000) |
| Purchases of marketable securities                       | (1,635)  | (2,886) |
| Proceeds from the sale of marketable securities          | 1,506    | -       |
| Net cash used in investing activities                    | (6,111)  | (9,330) |
| Cash flows from financing activities:                    |          |         |
| Proceeds from issuance of long-term debt                 | 7,500    | 7,000   |
| Principal payments on long-term debt                     | (5,727)  | (4,735) |
| Proceeds from issuance of stock under stock option plans | 94       | 3,581   |
| Changes in other long-term accruals                      | 29       | 41      |
| Preferred dividends paid                                 | (8,623)  | (8,629) |
| Net cash used in financing activities                    | (6,727)  | (2,742) |
| Net increase (decrease) in cash and cash equivalents     | 1,534    | (2,641) |
| Cash and cash equivalents at beginning of period         | 5,604    | 5,814   |
| Cash and cash equivalents at end of period               | \$ 7,138 | 3,173   |
| Supplemental cash flow information                       |          |         |
| Cash paid during periods for:                            |          |         |
| Interest   | \$ 766   | 973     |
| Income taxes   | \$ 9,822 | 5,635   |

The accompanying notes are an integral part of these condensed consolidated financial statements.

**THE ARISTOTLE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2008**

(Unaudited)

1. Organization

The Aristotle Corporation ( Aristotle ) and its subsidiaries (together with Aristotle, the Company ), founded in 1986, and headquartered in Stamford, CT, is a leading manufacturer and global distributor of educational, health, medical technology and agricultural products. A selection of over 80,000 items is offered, primarily through more than 45 separate catalogs carrying the brand of Nasco (founded in 1941), as well as those bearing the brands of Life/Form®, Whirl-Pak®, Simulaids, Triarco, Spectrum Educational Supplies, Hubbard Scientific, Scott Resources, Haan Crafts, To-Sew, CPR Prompt®, Ginsberg Scientific and Summit Learning. Products include educational materials and supplies for substantially all K-12 curricula, molded plastics, biological materials and items for the agricultural, senior care and food industries. In addition, the Company offers medical simulators and manikins used for training in cardiopulmonary resuscitation and the fire and emergency rescue and patient care fields. The Company also markets proprietary product lines that provide exclusive distribution rights throughout all of its catalogs. The proprietary product lines are developed internally through the Company s research and development efforts and acquired externally by licensing rights from third parties.

Geneve Corporation ( Geneve ), a privately-held diversified financial holding company, and an affiliated entity held approximately 90% of Aristotle s voting power at September 30, 2008 and 2007.

2. Financial Statement Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) for interim financial information and the instructions to Form 10-Q and Rule 10-01 of Regulation S-X. Accordingly, the Condensed Consolidated Financial Statements do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation of financial position as of September 30, 2008 and 2007, results of operations for the three and nine months ended September 30, 2008 and 2007 and cash flows for the nine months ended September 30, 2008 and 2007, as applicable,

have been made. Operating results for the three and nine months ended September 30, 2008 are not necessarily indicative of results that may be expected for any other interim period or for the year ending December 31, 2008. For further information, refer to the consolidated financial statements and notes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

3. Principles of Consolidation

All significant intercompany balances and transactions have been eliminated in consolidation.

4. Recently Issued Accounting Pronouncements

In May 2008, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ( SFAS ) No. 162, *The Hierarchy of Generally Accepted Accounting Principles* ( SFAS No. 162 ). SFAS No. 162 identifies the sources of accounting principles and the framework for selecting the principles to be used in the preparation of financial statements of nongovernmental entities that are presented in conformity with GAAP. SFAS No. 162 directs the GAAP hierarchy to the entity, not the independent auditors, as the entity is responsible for selecting accounting principles for financial statements that are presented in conformity with GAAP. SFAS No. 162 is effective 60 days following the SEC's approval of the Public Company Accounting Oversight Board amendments to remove the GAAP hierarchy from the auditing standards. SFAS No. 162 is not expected to have an impact on the Company's financial statements.

In March 2008, FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities – an amendment to FASB Statement No. 133* ( SFAS No. 161 ), effective for fiscal years beginning after November 15, 2008, with early application encouraged. SFAS No. 161 amends and expands the disclosure requirements for derivative instruments and hedging activities by requiring enhanced disclosures about how and why the Company uses derivative instruments, how derivative instruments and related hedged items are accounted for, and how derivative instruments and related hedged items affect the Company's financial position, financial performance and cash flows. The adoption of SFAS No. 161 is not expected

**THE ARISTOTLE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2008**

(Unaudited)

to have a material effect on the Company's consolidated financial statements. Adoption of SFAS No. 161 by the Company is required in 2009.

In December 2007, FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ( SFAS No. 141R ), which replaces SFAS No. 141. SFAS No. 141R establishes principles and requirements for recognition and measurement in the Company's financial statements of identifiable assets acquired, liabilities assumed, any non-controlling interest in the acquired entity and goodwill acquired in a business combination. SFAS No. 141R also establishes disclosure requirements which will enable readers to evaluate the nature and financial effects of the business combination. SFAS No. 141R is effective for fiscal years beginning after December 15, 2008. The Company will apply the provisions of SFAS No. 141R to the accounting treatment of business acquisitions completed after December 31, 2008.

In December 2007, FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an Amendment of Accounting Research Bulletin No. 51* ( SFAS No. 160 ), which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. SFAS No. 160 also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interest of the parent and the interests of the noncontrolling owner. SFAS No. 160 is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the potential impact, if any, of the adoption of SFAS No. 160 on the Company's consolidated financial position, results of operations and cash flows.

In February 2007, FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an amendment of FASB Statement No. 115* ( SFAS No. 159 ), which allows an entity to elect, at specified election dates, to measure eligible financial instruments at fair value. An entity shall report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date, and recognize upfront costs and fees related to those items in earnings as incurred and not deferred. SFAS No. 159 applies to fiscal years beginning after November 15, 2007, with early adoption permitted for an entity that has elected to apply

the provisions of SFAS No. 157, *Fair Value Measurements*. An entity is prohibited from retrospectively applying SFAS No. 159, unless it chooses early adoption. The adoption of SFAS No. 159 did not have a material impact on the Company's financial position or results of operations.

5. Earnings per Common Share

Basic earnings per common share is calculated by dividing net earnings applicable to common stockholders by the weighted average number of common shares outstanding for the period. Diluted earnings per common share is calculated by dividing net earnings applicable to common stockholders by the weighted average number of common shares outstanding during the period and including each share that would have been outstanding assuming the issuance of common shares for all dilutive potential common shares outstanding during the period.

6. Marketable Securities

The Company invests in marketable equity securities, which the Company classifies as available-for-sale. The marketable securities are included in current assets, and are reported at fair value based on quoted market prices as of the reporting date. All unrealized gains or losses, which have not otherwise been recognized as other than temporary losses, are reflected net of tax in accumulated other comprehensive earnings (loss) within Stockholders' Equity.

The carrying value of the marketable equity securities at September 30, 2008 and 2007 was \$2.5 million and \$2.9 million, respectively. Net unrealized loss, net of tax, included in accumulated other comprehensive income (loss) was \$.1 million at each of September 30, 2008, December 31, 2007 and September 30, 2007. In the quarter and nine months ended September 30, 2008, the Company recognized \$.3 million of losses related to marketable securities which were determined to be other than temporary.



**THE ARISTOTLE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2008**

(Unaudited)

7. Investments

Since October 2004, the Company has invested, as a limited partner, in a limited partnership, the general partner of which is an affiliate of the Company. The assets of this limited partnership, totaling \$37.4 million at September 30, 2008, are managed exclusively by a non-affiliate of the Company. The purpose of the limited partnership is to manage a diversified investment portfolio. The Company's investment is accounted for under the equity method of accounting, which equates the carrying value of the investment to the Company's equity in the partnership's underlying book value. The Company's equity earnings or loss is credited or charged, as appropriate, to other (expense) income within the Condensed Consolidated Statements of Earnings. The Company has determined that the limited partnership is a variable interest entity, of which the Company is not the primary beneficiary. The Company's maximum loss exposure is its investment in the limited partnership. For the three months ended September 30, 2008 and 2007, equity earnings amounted to \$.5 million and \$.3 million, respectively. For each of the nine months ended September 30, 2008 and 2007, equity earnings amounted to \$1.2 million. At September 30, 2008, December 31, 2007 and September 30, 2007, the net book value (and estimated fair value) of this investment was \$17.4 million, \$16.2 million and \$15.8 million, respectively. The assets of this limited partnership were invested in U.S Treasury bills at each of September 30, 2008, December 31, 2007 and September 30, 2007.

Since December 2007, the Company has invested, as a limited partner, in another limited partnership, the general partner of which is an affiliate of the Company. The assets of the limited partnership total \$37.9 million at September 30, 2008. The purpose of this limited partnership is to manage a diversified investment portfolio. The Company's investment is accounted for under the equity method of accounting. The Company has determined that the limited partnership is a variable interest entity, of which the Company is not the primary beneficiary. The Company's maximum loss exposure is its investment in the limited partnership. No investments were made into this limited partnership during the three months ended September 30, 2008 and September 30, 2007. During the nine months ended September 30, 2008 and 2007, the Company invested \$3.0 million and \$0, respectively, in this limited partnership. For the three months ended September 30, 2008, the equity loss amounted to \$.2 million. For the nine months ended September 30, 2008, the equity loss amounted to \$.4 million. At September 30, 2008, December 31, 2007 and September 30, 2007, the net book value (and estimated fair value) of this investment was \$4.6 million, \$2.0 million and \$0, respectively.

In 2007, the Company invested \$4.3 million to acquire a 4.9% ownership interest in a provider of interactive instructional assessment systems for K-12 and other education markets. The Company accounts for this investment under the cost method of accounting, which records the investment at the historical cost. Under the cost method, the Company will not estimate a fair value if there are not identifiable events or changes in circumstances that may have a significant adverse effect on the fair value of the investment. In accordance with the terms of this investment, the Company accrues an 8% preferred return thereon, which is included in other assets. At September 30, 2008, December 31, 2007 and September 30, 2007, the accrued and unpaid preferred return was \$.4 million, \$.2 million and \$.1 million, respectively.

## 8. Inventories

The classification of inventories is as follows (in thousands):

|                         | <b>September<br/>30,<br/>2008</b> | <b>December 31,<br/>2007</b> | <b>September<br/>30,<br/>2007</b> |
|-------------------------|-----------------------------------|------------------------------|-----------------------------------|
| Raw materials           | \$ 7,724                          | 7,028                        | 7,735                             |
| Work in process         | 2,004                             | 1,601                        | 1,755                             |
| Finished goods          | 34,319                            | 35,015                       | 31,946                            |
| Less inventory reserves | (1,659)                           | (1,347)                      | (1,390)                           |
| Net inventories         | \$ 42,388                         | 42,297                       | 40,046                            |

**THE ARISTOTLE CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****September 30, 2008**

(Unaudited)

**9. Long-term Debt**

On February 26, 2008, the Company and its primary lenders executed an amendment to the \$45.0 million Revolving Credit Facility. The primary provisions of the amendment: (i) extend the term of the Revolving Credit Facility from October 15, 2008 to January 31, 2013; (ii) provide the Company the option to expand the capacity of the facility from \$45.0 million to \$60.0 million during the term of the agreement; (iii) relieve the Company of certain monthly reporting obligations; (iv) modify the pricing structure to provide interest rates more favorable to the Company; and (v) update certain financial covenants to standards relevant to the Company's current financial condition.

**10. Stockholders' Equity and Comprehensive Earnings**

Changes in stockholders' equity for the nine months ended September 30 are as follows (in thousands):

|   | <b>2008</b> | <b>2007</b> |
|---|-------------|-------------|
| Balance at January 1  | \$ 115,681  | 94,391      |
| Net earnings  | 18,488      | 18,279      |
| Exercise of stock options, including related<br>tax benefit of \$24 and \$1,305 for<br>2008<br>and 2007, respectively | 94          | 3,581       |
| Stock option compensation   | 12          | 75          |
| Other comprehensive earnings:   | 221         | 181         |

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|  |            |         |
|--|------------|---------|
| Amortization of pension prior service cost and unrecognized net actuarial loss, net of tax |            |         |
| Change in unrealized losses on marketable securities, net of tax                           | 38         | (69)    |
| Foreign currency translation adjustment  | (1,069)    | 2,158   |
| Preferred dividends  | (6,467)    | (6,470) |
| Balance at September 30  | \$ 126,998 | 112,126 |

Comprehensive earnings for the three and nine months ended September 30 are as follows (in thousands):

|  | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|--|---------------------------|-------------|--------------------------|-------------|
|  | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|  | <b>2008</b>               | <b>2007</b> | <b>2008</b>              | <b>2007</b> |
| Net earnings   | \$ 6,862                  | 7,660       | 18,488                   | 18,279      |
| Amortization of pension prior service cost and unrecognized net actuarial loss, net of tax | 70                        | 60          | 221                      | 181         |
| Change in unrealized losses on marketable securities , net of tax                          | 249                       | (64)        | 38                       | (69)        |
| Foreign currency translation adjustment  | (660)                     | 997         | (1,069)                  | 2,158       |
| Comprehensive earnings   | \$ 6,521                  | 8,653       | 17,678                   | 20,549      |

**THE ARISTOTLE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2008**

(Unaudited)

11. Stock Options

The Company established the 2002 Employee, Director and Consultant Stock Plan in 2002 (the 2002 Plan ) under which employees, directors and consultants of the Company are eligible to receive nonincentive and incentive options and stock grants of up to 1,500,000 shares of Common Stock. Options granted under the 2002 Plan generally vest over a three year period and have an exercise term of no longer than five years from the issue date.

The fair value of each option granted is estimated on the date of grant using the Black-Scholes option pricing model. The risk-free interest rate is based on United States Treasury yields in effect at the date of grant consistent with the estimated life of the options. The estimated life of options granted represents the period of time that the options are expected to be outstanding. The expected volatility is based on an analysis of historical prices of the Company's stock over a period of time consistent with the estimated life of the options.

A summary of option activity during the nine months ended September 30, 2008 is presented below (in thousands, except share and per share data):

|                                  | <b>Number<br/>of<br/>Options</b> | <b>Weighted<br/>Average<br/>Exercise<br/>Price</b> | <b>Weighted<br/>Average<br/>Remaining<br/>Contractual<br/>Term</b> | <b>Aggregate<br/>Intrinsic<br/>Value</b> |
|----------------------------------|----------------------------------|--|--|--|
| Outstanding at December 31, 2007 | 65,045                           | \$ 6.08  |  |  |
| Granted                          | -                                | -  |  |  |
| Expired                          | -                                | -  |  |  |
| Forfeited                        | -                                | -  |  |  |

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|                                   |          |      |      |    |    |
|-----------------------------------|----------|------|------|----|----|
| Exercised                         | (16,170) | 4.35 |      |    |    |
| Outstanding at September 30, 2008 | 48,875   | 6.65 | 1.33 | \$ | 49 |
| Exercisable at September 30, 2008 | 48,875   | 6.65 | 1.33 |    | 49 |

No options were granted during each of the three and nine months ended September 30, 2008. The Company granted 2,000 options in the three and nine months ended September 30, 2007. The intrinsic value of options exercised during each of the three months ended September 30, 2008 and 2007 were \$0 and \$.1 million, respectively. The intrinsic value of options exercised during each of the nine months ended September 30, 2008 and 2007 totaled less than \$.1 million and \$1.2 million, respectively. Cash received from option exercises for each of the three months ended September 30, 2008 and 2007 totaled \$0 million and \$.2 million, respectively. Cash received from option exercises for the nine months ended September 30, 2008 and 2007 totaled \$.1 million and \$3.6 million, respectively.

**THE ARISTOTLE CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****September 30, 2008**

(Unaudited)

A summary of the status of the Company's nonvested options at September 30, 2008, and changes during the nine months then ended, is presented below:

|                                 | <b>Number<br/>of<br/>Options</b> | <b>Weighted<br/>Average<br/>Grant<br/>Date Fair<br/>Value</b> |
|---------------------------------|----------------------------------|---|
| Nonvested at December 31, 2007  | 2,000                            | \$ 9.86   |
| Granted                         | -                                | -   |
| Vested                          | 2,000                            | 9.86  |
| Forfeited                       | -                                | -   |
| Nonvested at September 30, 2008 | -                                | -   |

At September 30, 2008, there were no unrecognized compensation costs related to options. Two thousand options vested during each of the three and nine months ended September 30, 2008.

Stock option compensation recognized within the Condensed Consolidated Statements of Earnings amounted to less than \$.1 million for each of the three and nine months ended September 30, 2008 and 2007.

12. Defined Benefit Pension Plan

On December 31, 2005, the Company froze the benefits under its pension plan for all hourly employees and certain salaried employees.

The Company contributed \$.5 million and \$1.6 million to the pension plan for the three months ended September 30, 2008 and 2007, respectively. The Company contributed \$1.0 million and \$1.9 million to the pension plan for the nine months ended September 30, 2008 and 2007, respectively. The Company expects to contribute a total of approximately \$1.2 million to the pension plan in 2008.

The following table presents the components of net periodic benefit cost for the three and nine months ended September 30 (in thousands):

|                                    | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|------------------------------------|---------------------------|-------------|--------------------------|-------------|
|                                    | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                                    | <b>2008</b>               | <b>2007</b> | <b>2008</b>              | <b>2007</b> |
| Service cost                       | \$ 70                     | 77          | 232                      | 230         |
| Interest cost                      | 239                       | 202         | 664                      | 604         |
| Expected return on plan assets     | (314)                     | (193)       | (719)                    | (580)       |
| Amortization of prior service cost | (1)                       | (1)         | (1)                      | (2)         |
| Recognized net actuarial loss      | 115                       | 99          | 365                      | 300         |
| Net periodic benefit cost          | \$ 109                    | 184         | 541                      | 552         |



**THE ARISTOTLE CORPORATION AND SUBSIDIARIES**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**September 30, 2008**

(Unaudited)

13. Fair Value Accounting

SFAS No. 157 was issued in September 2006 and adopted by the Company as of January 1, 2008. SFAS No. 157 defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. Fair value measurements are not adjusted for transaction costs. In addition, SFAS No. 157 establishes a three-tiered hierarchy for inputs used in measuring fair value of financial instruments that emphasizes the use of observable inputs over the use of unobservable inputs by requiring that the observable inputs be used when available. Observable inputs are ones that market participants would use in pricing a financial instrument. Unobservable inputs are ones that reflect the belief about the assumptions that market participants would use in pricing a financial instrument based on the best information available in the circumstances. The hierarchy is broken down into three levels based on the reliability of inputs as follows:

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**Level 1** : Valuations are based on unadjusted quoted prices in active markets for identical, unrestricted assets. Since valuations are based on quoted prices that are readily and regularly available in an active market, valuation of these assets does not involve any meaningful degree of judgment. For the Company, assets utilizing Level 1 inputs generally include marketable securities, including common and preferred stocks.

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**Level 2** : Valuations are based on quoted prices in markets that are not deemed to be sufficiently active, or involve direct or indirect observable market inputs, such as prices for similar securities.

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**Level 3** : Valuations are based on inputs that are unobservable and significant to the overall fair value measurement. Valuation under Level 3 generally involves a significant degree of judgment.

The estimated fair values (and carrying amounts) of the Company's invested assets as of September 30, 2008 are as follows (in thousands):

|                       | <b>Level 1</b> | <b>Level 2</b> | <b>Level 3</b> | <b>Total</b> |
|-----------------------|----------------|----------------|----------------|--------------|
| Marketable securities | \$ 2,480       | -              | -              | 2,480        |

The Company's investments in limited partnerships of \$22.0 million at September 30, 2008 are accounted for under the equity method of accounting, and, therefore, are not within the scope of SFAS No. 157.

#### 14. Segment Reporting

The Company's business activities are organized into two business segments, educational and commercial. The educational segment relates to instructional teaching aids and materials, which are distributed to educational institutions principally in North America, for kindergarten through grade 12 classes, and for nursing school and emergency medical instructors. Products in the educational segment are marketed primarily through catalogs. The growth potential of the educational segment is directly related to school enrollments and the strength of government funding of education. The commercial segment relates to agricultural products, sterile sampling containers and systems, materials for nursing home activities and novelty and gift products. Products in the commercial segment are marketed through catalogs nationwide and through a worldwide dealer network covering more than 60 countries. Market growth in the commercial segment is principally impacted by the general economic conditions of world agriculture, the increasing size of the aged population, as well as increasing global awareness of food and water quality standards. The Company evaluates the performance of these segments based on segment net sales and gross profit.

**THE ARISTOTLE CORPORATION AND SUBSIDIARIES****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****September 30, 2008**

(Unaudited)

The following table presents segment information for the three and nine months ended September 30 (in thousands):

|                      | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|----------------------|---------------------------|-------------|--------------------------|-------------|
|                      | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|                      | <b>2008</b>               | <b>2007</b> | <b>2008</b>              | <b>2007</b> |
| Net sales:           |                           |             |                          |             |
| Educational          | \$ 56,020                 | 55,067      | 146,062                  | 142,608     |
| Commercial           | 8,956                     | 8,457       | 26,140                   | 25,342      |
| Net sales            | \$ 64,976                 | 63,524      | 172,202                  | 167,950     |
| Gross profit:        |                           |             |                          |             |
| Educational          | \$ 22,007                 | 22,311      | 59,088                   | 58,400      |
| Commercial           | 3,650                     | 3,395       | 10,627                   | 10,189      |
| Other costs of sales | (804)                     | (1,199)     | (2,629)                  | (3,548)     |
| Gross profit         | \$ 24,853                 | 24,507      | 67,086                   | 65,041      |

Other costs of sales primarily include freight costs incurred in the procurement of inventories and shipment of customer orders not allocable to a particular segment.

The following table presents segment identifiable asset information as of September 30, 2008, December 31, 2007 and September 30, 2007 (in thousands):

|                        | <b>September<br/>30,<br/>2008</b> | <b>December<br/>31,<br/>2007</b> | <b>September<br/>30,<br/>2007</b> |
|------------------------|-----------------------------------|----------------------------------|-----------------------------------|
| Identifiable assets:   |                                   |                                  |                                   |
| Educational            | \$ 68,893                         | 72,942                           | 67,121                            |
| Commercial             | 6,473                             | 6,099                            | 6,458                             |
| Other corporate assets | 83,990                            | 70,394                           | 78,157                            |
| Identifiable assets    | \$ 159,356                        | 149,435                          | 151,736                           |

Educational assets include \$14.1 million, \$14.4 million and \$14.4 million of goodwill at September 30, 2008, December 31, 2007 and September 30, 2007, respectively. Commercial assets include \$.1 million of goodwill at each of September 30, 2008, December 31, 2007 and September 30, 2007.

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

### **GENERAL**

This discussion and analysis of financial condition and results of operations reviews the results of operations of the Company, on a consolidated basis, for the three and nine months ended September 30, 2008, as compared to the three and nine months ended September 30, 2007. This discussion and analysis of financial condition and results of operations has been derived from, and should be read in conjunction with, the unaudited Condensed Consolidated Financial Statements and Notes to Condensed Consolidated Financial Statements contained herein.

The Company is a leading manufacturer and global distributor of educational, health, medical technology and agricultural products, primarily offered through more than 45 separate catalogs.

The following is a summary of key events for the three and nine months ended September 30, 2008:

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increase in net sales of 2.3% and 2.5% in the three and nine months ended September 30, 2008, respectively, as compared to the same periods in 2007;

§

increase in gross profit of 1.4% and 3.1% in the three and nine months ended September 30, 2008, respectively, as compared to the same periods in 2007;

§

decrease in earnings before income taxes of 11.6% in the three months ended September 30, 2008, and increase in earnings before taxes of .4% in the nine months ended September 30, 2008, as compared to the same periods in 2007;

§

decrease in net earnings of 14.5% in the three months ended September 30, 2008 and increase in net earnings of 1.8% in the nine months ended September 30, 2008, as compared to the same periods in 2007; as a percentage of net sales, net earnings amounted to 10.6% in the third quarter of 2008, compared to 12.1% in the same period in 2007; as a percentage of net sales, net earnings amounted to 10.7% in the nine months ended September 30, 2008, compared to 10.9% in the same period in 2007;

§

diluted earnings per common share of \$.67 in each of the nine months ended September 30, 2008 and 2007; diluted earnings per common share of \$.26 in the three months ended September 30, 2008, compared to diluted earnings per common share of \$.31 in the same period of 2007;

§

increase in the weighted average number of diluted common shares outstanding of .1% and 2.3% in the three and nine months ended September 30, 2008, respectively, as compared to the same periods in 2007;

§

cash investments of \$0 and \$3.0 million during the three and nine months ended September 30, 2008, respectively, in limited partnerships, compared to \$0 cash investment in limited partnerships in the three and nine months ended September 30, 2007;

§

semi-annual dividend payments on March 31, 2008 and September 30, 2008, totaling \$8.6 million on the Company's Series I Preferred Stock and Series J Preferred Stock.

A key strength of the Company's business is its ability to generate cash consistently. The Board of Directors and management use cash generated as a measure of the Company's performance. The Company uses the cash generated from operations to strengthen the balance sheet, including making investments in marketable securities and limited partnerships and reducing liabilities such as pension and debt obligations, paying dividends on its preferred stocks and completing prudent acquisitions. The Company's management believes that examining the ability to generate cash provides investors with additional insight into the Company's performance.



The following table sets forth selected financial data (i) as a percentage of net sales for the three and nine months ended September 30, 2008 and 2007 and (ii) the percentage change in those reported items from the comparable period in 2007:

|                                    | Three Months Ended September 30, |         |          | Nine Months Ended September 30, |         |          |
|------------------------------------|----------------------------------|---------|----------|---------------------------------|---------|----------|
|                                    | 2008                             | 2007    | % Change | 2008                            | 2007    | % Change |
| Net sales                          | 100.0 %                          | 100.0 % | 2.3 %    | 100.0 %                         | 100.0 % | 2.5 %    |
| Cost of sales                      | 61.8                             | 61.4    | 2.8      | 61.0                            | 61.3    | 2.1      |
| Gross profit                       | 38.2                             | 38.6    | 1.4      | 39.0                            | 38.7    | 3.1      |
| Selling and administrative expense | 20.3                             | 19.1    | 8.6      | 21.4                            | 21.2    | 3.1      |
| Earnings from operations           | 17.9                             | 19.5    | (5.6)    | 17.6                            | 17.5    | 3.2      |
| Other (expense) income:            |                                  |         |          |                                 |         |          |
| Interest expense                   | (.4)                             | (.6)    | (33.8)   | (.5)                            | (.6)    | (23.0)   |
| Other, net                         | (.7)                             | .7      | ***      | .1                              | .7      | (22.7)   |
|                                    | (1.1)                            | .1      | ***      | (.4)                            | .1      | ***      |
| Earnings before income taxes       | 16.8                             | 19.6    | (11.6)   | 17.2                            | 17.6    | 0.4      |
| Income taxes:                      |                                  |         |          |                                 |         |          |
| Current                            | 6.5                              | 7.4     | (9.7)    | 6.1                             | 5.1     | 22.9     |
| Deferred                           | (.2)                             | .1      | ***      | 0.3                             | 1.6     | (78.5)   |
|                                    | 6.3                              | 7.5     | (13.6)   | 6.4                             | 6.7     | (0.8)    |
| Net earnings                       | 10.6 %                           | 12.1 %  | (10.4) % | 10.7 %                          | 10.9 %  | 1.1 %    |

\*\*\*

Not meaningful



## **FLUCTUATIONS IN QUARTERLY RESULTS OF OPERATIONS**

The Company is subject to seasonal influences with peak levels occurring in the second and third quarters of the fiscal year primarily due to increased educational shipments coinciding with the start of new school years in the Fall. As a result, the Company typically recognizes approximately 60% of its annual net earnings in the second and third quarters of its fiscal year. Inventory levels increase in March through June in anticipation of the peak shipping season. The majority of shipments are made between June and August and the majority of cash receipts are collected from August through October.

Quarterly results may also be materially affected by the timing of acquisitions, the timing and magnitude of costs related to such acquisitions, variations in costs of products sold, the mix of products sold and general economic conditions. Results for any fiscal quarter are not indicative of the results for any subsequent fiscal quarter or for a full fiscal year.

## **RESULTS OF OPERATIONS - THREE MONTHS ENDED SEPTEMBER 30, 2008 AS COMPARED TO THREE MONTHS ENDED SEPTEMBER 30, 2007**

### Net Sales

Net sales for the third quarter of 2008 increased 2.3% to \$65.0 million from \$63.5 million for the comparable period in 2007. The growth in net sales for the third quarter of 2008 is attributable to organic growth of existing product lines in the Company's domestic, Canadian and international markets. Export shipments to foreign accounts accounted for 11.2% of third quarter 2008 revenue compared to 11.6% in the third quarter of 2007.

Net sales in the educational segment were \$56.0 million in the third quarter of 2008, increasing 1.7% from \$55.1 million in the comparable period in 2007. Educational sales experienced balanced growth across most curriculum offerings, with health and fitness product lines achieving growth at rates above the average for the educational segment. Net sales in the commercial segment totaled \$9.0 million in the third quarter of 2008, increasing 5.9% from the second quarter of 2007. Commercial sales



growth in the third quarter was supported by favorable international orders of agricultural and sterile laboratory sampling products. Sales growth in both the educational and commercial segments relates to organic growth in existing product lines, including the Company's proprietary products.

### Gross Profit

Gross profit for the third quarter of 2008 increased 1.4% to \$24.9 million from \$24.5 million for the comparable period in 2007. The increase in gross profit for the third quarter of 2008 is primarily attributable to: (i) the 2.3% increase in net sales; (ii) growth in net sales of higher-margin proprietary product lines; and (iii) inventory purchasing strategies initiated in the fourth quarter of 2007 and first quarter of 2008 designed to maximize returns on inventory investments and to limit effects of petroleum-based cost increases. The gross profit realized in the third quarter of 2007 included a \$.4 million recovery related to an historical insurance claim. The gross profit margin decreased to 38.2% in the third quarter of 2008 from 38.6% in the comparable period in 2007. The positive effect of the insurance recovery on the third quarter 2007 gross profit margin was 60 basis points.

The educational segment gross profit for the third quarter of 2008 decreased 1.4% to \$22.0 million from \$22.3 million for the comparable period in 2007. The decline in gross profit is attributed to the insurance recovery realized in the third quarter of 2007 that did not recur in the 2008 quarter. The educational segment gross profit margin was 39.3% in the third quarter of 2008, compared to 40.5% in the same quarter of 2007. The commercial segment gross profit for the third quarter of 2008 increased 7.5% to \$3.7 million from \$3.4 million for the comparable period in 2007. The commercial segment produced a gross profit margin of 40.8% in the third quarter of 2008 as compared to 40.1% in the third quarter of 2007. The increase in the commercial segment gross profit margin is attributed to strength in proprietary sales which have higher gross margins, particularly the sterile laboratory sample product lines.

Other cost of sales, which the Company does not allocate by segment, including freight costs incurred in the procurement of inventories and shipment of customer orders, declined \$.4 million in the third quarter of 2008 compared to 2007 primarily as a result of long term efforts to control net shipping costs, including: (i) increases in customer shipping and handling rates; (ii) greater consolidation of incoming and outgoing shipments; and (iii) the negotiation of favorable vendor shipping contract terms.

### Selling and Administrative Expense

Selling and administrative expense for the third quarter of 2008 increased 8.6% to \$13.2 million from \$12.1 million in the comparable period in 2007. As a percent of net sales, selling and administrative expense amounted to 20.3% and 19.1% for the third quarters of 2008 and 2007, respectively. Selling and administrative expense includes advertising

and catalog costs, warehouse and shipping activities, customer service and general administrative functions. Selling and administrative expense for the third quarter of 2008 was primarily impacted by: (i) an increase in salaries and wages of \$.5 million, as a result of increases in annual employee compensation, employee performance incentives, Canadian currency exchange rates and changes in the number of employees; (ii) an increase in group health care costs of \$.2 million; and (iv) an increase in catalog and advertising costs of \$.7 million, related to revised amortization schedules for catalog costs.

The Company recorded less than \$.1 million in compensation expense for each of the third quarters of 2008 and 2007 related to grants of stock options to certain employees and directors.

The Company incurred expenses of \$.3 million to Geneve for certain administrative services for each of the quarters ended September 30, 2008, and 2007.

#### Interest Expense

Interest expense for the third quarter of 2008 decreased 33.8% to \$260 thousand from \$393 thousand for the third quarter of 2007. The decrease in interest expense is principally due to the decrease in the average effective interest rate on outstanding debt under the Company's primary line of credit to 3.5% during the third quarter of 2008, compared to 7.0% during the third quarter of 2007. Interest expense of \$.1 million in each of the third quarters of 2008 and 2007 relates to other long-term accruals established in the fourth quarter of 2006 in connection with the transfer of ownership of certain assets.

Weighted average interest rates related to the Company's credit agreements were 4.3%, 6.8% and 7.2% at September 30, 2008, December 31, 2007 and September 30, 2007, respectively.

#### Income Tax Provision

Aristotle and its qualifying domestic subsidiaries are included in the Federal income tax return and certain state income tax returns of Geneve. The provision for income taxes for the Company is determined on a separate return basis in accordance with the terms of a tax sharing agreement with Geneve, and payments for current Federal and certain state income taxes are made to Geneve.

The income tax provision for the third quarter of 2008 was \$4.1 million versus \$4.8 million for the comparable period in 2007. These tax provisions reflect effective tax rates of 37.5% and 38.4 % for the third quarters of 2008 and 2007, respectively. For each of the third quarters of 2008 and 2007, the difference between the Federal statutory income tax rate of 35% and the effective income tax rate results principally from state income taxes, net of the Federal tax benefit, certain manufacturing tax deductions provided by Section 199 of the Internal Revenue Code, and the differential between the Federal tax rate and the tax rates in the foreign jurisdictions in which the Company operates.

## **RESULTS OF OPERATIONS - NINE MONTHS ENDED SEPTEMBER 30, 2008 AS COMPARED TO NINE MONTHS ENDED SEPTEMBER 30, 2007**

### Net Sales

Net sales for the nine months ended September 30, 2008 increased 2.5% to \$172.2 million from \$168.0 million for the comparable period in 2007. The growth in net sales for the nine months ended September 30, 2008 is attributable to organic growth of existing product lines in the Company's domestic, Canadian and international markets. Export shipments to foreign accounts, which accounted for more than 12% of revenue in the first nine months of 2008, increased 9.2% year to date compared to 2007.

Net sales in the educational segment were \$146.1 million, increasing 2.4% in the nine months ended September 30, 2008 from \$142.6 million in the comparable period in 2007. The commercial segment recorded net sales of \$26.1 million in the nine months ended September 30, 2008, increasing 3.1% from \$25.3 million in the comparable period in 2007. Sales growth in both the educational and commercial segments relates to organic growth in existing product lines, including the Company's proprietary products, and each segment benefited from the growth in export sales.

### Gross Profit

Gross profit for the nine months ended September 30, 2008 increased 3.1% to \$67.1 million from \$65.0 million for the comparable period in 2007. The increase in gross profit for the nine months ended September 30, 2008 is primarily attributable to: (i) the 2.5% increase in net sales; (ii) growth in net sales of higher-margin proprietary product lines; and (iii) inventory purchasing strategies initiated in the fourth quarter of 2007 and first quarter of 2008 designed to maximize returns on inventory investments and to limit effects of petroleum-based cost increases. The gross profit realized in the nine months ended September 30, 2007 included a \$.4 million recovery related to an historical insurance claim. The gross profit margin increased to 39.0% in the nine months ended September 30, 2008 from 38.7% in the comparable period in 2007. The increase in consolidated gross margin is attributed to the sales strength of the Company's proprietary product lines, which have higher gross margins, and the Company's inventory purchasing strategies. The positive effect of the insurance recovery on the 2007 gross profit margin was 20 basis points.

The educational segment gross profit for the nine months ended September 30, 2008 increased 1.2% to \$59.1 million from \$58.4 million for the comparable period in 2007. The 2007 educational segment gross profit included the \$.4 million insurance recovery. The educational segment gross profit margin was 40.5% and 41.0% in the nine months ended September 30, 2008 and 2007, respectively. The commercial segment gross profit for the nine months ended September 30, 2008 increased 4.3% to \$10.6 million from \$10.2 million for the comparable period in 2007. The commercial segment gross profit margin increased to 40.7% in the nine months ended September 30, 2008, as compared to 40.2% in the nine months ended September 30, 2007. The increase in the commercial segment gross profit margin is primarily attributable to an increase in the sales mix of certain proprietary commercial products, which have higher gross margins, and the Company's inventory purchasing strategies.

Other cost of sales, which the Company does not allocate by segment, including freight costs incurred in the procurement of inventories and shipment of customer orders, declined \$.9 million in the nine months ended September 30, 2008 compared to 2007 primarily as a result of long term efforts to control net shipping costs, including: (i) increases in customer shipping and handling rates; (ii) greater consolidation of incoming and outgoing shipments, and (iii) the negotiation of favorable vendor shipping contract terms.

### Selling and Administrative Expense

Selling and administrative expense for the nine months ended September 30, 2008 increased 3.1% to \$36.8 million from \$35.7 million in the comparable period in 2007. As a percent of net sales, selling and administrative expense amounted to 21.4% for the nine months ended September 30, 2008 as compared to 21.2% in the comparable period of 2007. Selling and administrative expense includes advertising and catalog costs, warehouse and shipping activities, customer service and general administrative functions. Selling and administrative expense for the nine months ended September 30, 2008 was primarily impacted by: (i) an increase in salaries and wages of \$.9 million, or 5.3%, as a result of increases in annual employee compensation, employee performance incentives, Canadian currency exchange rates and changes in the number of employees; (ii) an insurance recovery of \$.7 million; (iii) an increase in group health care costs by \$.3 million; and (iv) an increase in catalog and advertising costs of \$.7 million, related to revised amortization schedules for catalog costs.

The Company recorded less than \$.1 million in compensation expense for each of the nine months ended September 30, 2008 and 2007 related to grants of stock options to certain employees and directors.

The Company incurred expenses of \$.8 million and \$.7 million to Geneve for certain administrative services for the nine months ended September 30, 2008 and 2007, respectively.

### Interest Expense

Interest expense for the nine months ended September 30, 2008 decreased to \$.8 million from \$1.1 million for the comparable period in 2007. The decrease in interest expense is principally due to the decrease in the average effective interest rate on outstanding debt under the Company's primary line of credit to 4.0% during the first nine months of 2008, compared to 6.8% during the first nine months of 2007. Interest expense of \$.3 million in each of the nine months ended September 30, 2008 and 2007 relates to other long-term accruals established in the fourth quarter of 2006 in connection with the transfer of ownership of certain assets.

Weighted average interest rates related to the Company's credit agreements were 4.3%, 6.8% and 7.2% at September 30, 2008, December 31, 2007 and September 30, 2007, respectively.

Income Tax Provision

Aristotle and its qualifying domestic subsidiaries are included in the Federal income tax return and certain state income tax returns of Geneve. The provision for income taxes for the Company is determined on a separate return basis in accordance with the terms of a tax sharing agreement with Geneve, and payments for current Federal and certain state income taxes are made to Geneve.

The income tax provision for the nine months ended September 30, 2008 was \$11.1 million versus \$11.2 million for the comparable period in 2007. These tax provisions reflect effective tax rates of 37.6% and 38.0% for the nine months ended September 30, 2008 and 2007, respectively. For each of the nine months ended September 30, 2008 and 2007, the difference between the Federal statutory income tax rate of 35% and the effective income tax rate results principally from state income taxes, net of the Federal tax benefit, certain manufacturing tax deductions provided by Section 199 of the Internal Revenue Code, and the differential between the Federal tax rate and the tax rates in the foreign jurisdictions in which the Company operates. Cash of \$1.3 million from operations was retained in the Company primarily as a result of the utilization of Federal net operating tax loss carryforwards ( NOLs ) during the nine months ended September 30, 2007. In the first nine months of 2007, the Company generated Federal taxable income in an amount sufficient to utilize the remaining balance of NOLs. The Company no longer has NOLs; thus, the Company will utilize cash to pay its Federal income tax obligations.



## LIQUIDITY AND CAPITAL RESOURCES

At September 30, 2008, the Company had working capital of \$88.6 million, increasing from \$77.4 million at December 31, 2007. At September 30, 2007, the Company also had working capital of \$77.4 million. Cash and cash equivalents increased \$1.5 million in the nine months ended September 30, 2008, ending the period at \$7.1 million.

The increase in the generation of cash and cash equivalents during the nine months ended September 30, 2008 as compared to the same period in 2007 is primarily due to the following:

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The Company generated cash of \$14.4 million from operations during the nine months ended September 30, 2008 compared to \$9.4 million for the comparable period of 2007. The increase in cash generated from operations in the nine months ended September 30, 2008 compared to the same period in 2007 was principally the result of: (i) a \$2.0 million increase in net earnings; (ii) a \$2.4 million decrease in cash used to purchase inventory; (iii) a \$2.0 million decrease in cash used to fund accounts receivable, (iv) a \$2.0 million decrease in deferred tax asset utilization; and (v) other changes in working capital.

The changes in current assets and liabilities are typical for the first nine months of the fiscal year as the Company completes its peak business cycle, which occurs during the second and third quarters of the fiscal year. For more information on the seasonality of the Company's business, please refer to the "Fluctuations in Quarterly Results of Operations" section above.

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The Company used cash of \$6.2 million for investing activities in the nine months ended September 30, 2008, compared to \$9.3 million for the comparable period in 2007. In the nine months ended September 30, 2008, the Company used \$2.9 million to fund the purchase of fixed assets, including \$1.2 million for renovation of an existing facility. In the nine months ended September 30, 2007, the Company used \$2.4 million to fund fixed asset additions, including \$.8 million of cash to fund a portion of the construction of a 60,000 square foot facility for Nasco's plastics operations.

Capital expenditures to replace and upgrade existing capital equipment and install new equipment and fixtures to provide additional operating efficiencies totaled \$1.7 million in each of the nine months ended September 30, 2008 and 2007, respectively.

During the nine months ended September 30, 2008 and 2007, the Company invested \$.1 and \$2.9 million, respectively, in marketable securities (see Note 6 of the Notes to Condensed Consolidated Financial Statements included in Item 1 of this Form 10-Q). Also during these comparable nine month periods, the Company invested \$3.0 million and \$0, respectively, in limited partnerships (see Note 7 of the Notes to Condensed Consolidated Financial Statements included in Item 1 of this Form 10-Q). In addition, the Company invested \$4.0 million during the nine months ended September 30, 2007 to acquire a 4.9% ownership interest in a provider of interactive instructional and assessment systems for K-12 and other education markets (see Note 7 of the Notes to Condensed Consolidated Financial Statements included in Item 1 of this Form 10-Q).

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Financing activities used cash of \$6.7 million and \$2.7 million in the nine months ended September 30, 2008 and 2007, respectively. In the nine months ended September 30, 2008, net proceeds from borrowings under the Company's primary credit facility of \$2.2 million was due to seasonal working capital requirements, including the payment of Preferred Stock cash dividends on March 31 and September 30, 2008. In the nine months ended September 30, 2007, net proceeds from borrowings under the Company's primary credit facility of \$2.5 million was also due to seasonal working capital requirements and the Preferred Stock cash dividends on March 31 and September 30, 2007.

Proceeds from the exercise of stock options totaled less than \$.1 million in the nine months ended September 30, 2008 compared to \$3.6 million in the six months ended June 30, 2007.

The Company paid dividends of \$8.6 million in each of the nine months ended September 30, 2008 and 2007 on its Series I Preferred Stock and Series J Preferred Stock.

On October 15, 2003, the Company entered into a five-year, non-amortizing, \$45.0 million Revolving Credit Facility. The Revolving Credit Facility provides the Company with seasonal working capital, letters of credit and funds for appropriate acquisitions of businesses similar in nature to the Company's current business segments. This debt carries a variable rate of interest that is based on Prime or LIBOR rates plus applicable margins. On February 26, 2008, the Company and its primary lenders executed an amendment to the Revolving Credit Facility. The primary provisions of the amendment: (i) extend the term of the Revolving Credit Facility from October 15, 2008 to January 31, 2013; (ii) provide the Company the option to expand the capacity of the facility from \$45.0 million to \$60.0 million during the term of the agreement; (iii) relieve the Company of certain monthly reporting obligations; (iv) modify the pricing structure to provide interest rates more favorable to the Company; and (v)

update certain financial covenants to standards relevant to the Company's current financial condition. At September 30, 2008, the weighted average interest rate on this debt was 3.7%. The Revolving Credit Facility currently has a committed weighted average rate of interest (including applicable margins) of approximately 3.7%. Such rate commitment expired on dates through October 20, 2008. Subsequent to that date, the rate commitments were renewed at interest rates based on the then-current LIBOR rates or the lender's then-current prime rate of interest. The Company's Revolving Credit Facility is collateralized by certain accounts receivable, inventories and property, plant and equipment, and shares of a certain subsidiary's outstanding capital stock and ownership interests of certain of the Company's limited liability subsidiaries. The Revolving Credit Facility contains various financial and operating covenants, including, among other things, requirements to maintain certain financial ratios and restrictions on additional indebtedness, common stock dividend payments, capital disposals and intercompany management fees. The Company was in compliance with all financial covenants as of September 30, 2008.

In 2008, capital expenditures to replace and upgrade existing equipment and install new equipment and fixtures to provide additional operating efficiencies are expected to approximate \$2.3 million.

Capital resources in the future are expected to be used for the development of catalogs and product lines, to acquire additional businesses and for other investing activities. The Company anticipates that there will be sufficient financial resources to meet projected working capital and other cash requirements for at least the next twelve months. Management of the Company believes it has sufficient capacity to maintain current operations and support a sustained level of future growth.

## **INFLATION**

Inflation has had only a minor effect on the Company's operating results and its sources of liquidity. Inflation, including as it related to the increased cost of fuel and plastic materials, did not significantly impact the Company's operating results and its sources of liquidity in each of the three and nine months ended September 30, 2008 and 2007.

## **SIGNIFICANT ACCOUNTING POLICIES**

The preparation of the Condensed Consolidated Financial Statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Condensed Consolidated Financial Statements and notes thereto. Actual results could differ from those estimates. The Company believes the following accounting policies affect the more significant judgments and estimates used in the preparation of the Condensed Consolidated Financial Statements:

Prepaid Catalog Costs and Amortization - The Company accumulates all direct costs, less applicable vendor rebates, incurred in the development, production and circulation of catalogs on the Condensed Consolidated Balance Sheets until the related catalog is mailed, at which time such catalog costs are amortized into selling and administrative expense over the estimated sales realization cycle of one year, using the ratio of current period revenues to the total of current and future period revenues for each catalog.

Deferred Income Taxes - The Company accounts for income taxes under the asset and liability method, wherein deferred income tax assets and liabilities are recognized for the future tax consequences attributable to differences between the consolidated financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred income 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 income tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

Goodwill - The Company evaluates goodwill for impairment annually, or more frequently if events or circumstances indicate that the assets may be impaired, by applying a fair value based test and, if impairment occurs, the amount of impaired goodwill is written off immediately. The Company evaluates goodwill for impairment based on the expected future cash flows or earnings projections. Goodwill is deemed impaired if the estimated discounted cash flows or earnings projections do not substantiate the carrying value. The estimation of such amounts requires significant management judgment with respect to revenue and expense growth rates, changes in working capital and selection of an appropriate discount rate, as applicable. The use of different assumptions would increase or decrease discounted future operating cash flows or earnings projections and could, therefore, change the impairment determination. The Company evaluated its goodwill at December 31, 2007, and determined that there was no impairment of goodwill.

Defined Benefit Plans - The Company accounts for the benefits under its defined benefit pension plan using actuarial models required by SFAS No. 87, *Employers Accounting for Pensions*. These models use an attribution approach that generally spreads individual events over the service lives of the employees in the plan. Examples of events are plan amendments and changes in actuarial assumptions such as discount rate, expected return on plan assets and rate of compensation increases. The principle underlying the required attribution approach is that employees render service over their service lives on a relatively consistent basis and, therefore, the statement of earnings effects of pension benefits are earned in, and should be expensed in, the same pattern.

In calculating net periodic benefit cost and the related benefit obligation, the Company is required to select certain actuarial assumptions. These assumptions include discount rate, expected return on plan assets and rate of compensation increase. The discount rate assumptions reflect the prevailing market rates for long-term, high-quality, fixed-income debt instruments that, if the obligation was settled at the measurement date, would provide the necessary future cash flows to pay the benefit obligation when due. The Company uses long-term historical actual return experience with consideration of the expected investment mix of the plan's assets, as well as future estimates of long-term investment returns, to develop its assumptions of the expected return on plan assets. The rate of compensation increase is based on historical experience and the Company's long-term plans for such increases.

Revenues - Customarily applying FOB-shipping point terms, the Company recognizes revenue upon shipment of products to its customers, which corresponds to the time when risk of ownership transfers. The point of shipment is typically from one of the Company's distribution centers or, on occasion, a vendor's location as a drop shipment. All drop shipment sales are recorded at gross selling price as the Company acts as principal in the transactions.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's financial instruments include cash and cash equivalents, marketable securities, investments, accounts receivable, accounts payable, accrued liabilities and debt. As described below, credit risk, market risk and interest rate risk are the primary sources of risk in the Company's accounts receivable, marketable securities, investments and debt.

#### **QUALITATIVE**

**Credit Risk:** The Company provides credit in the normal course of business to its customers, which are primarily educational institutions or distributors. No single customer accounted for more than 10% of the Company's sales in each of the three and nine months ended September 30, 2008 and 2007. The Company performs ongoing credit evaluations of its customers, maintains allowances for potential credit losses and generally does not require collateral

to support its accounts receivable balances.

**Market Risk:** The Company's exposure to market risk relates to the quality of holdings of its marketable securities and limited partnership investment. The fair market values of the marketable securities and limited partnerships investments are subject to increases or decreases in value resulting from the performance of the securities issuers, from upgrades or downgrades in the credit worthiness of the securities issuers and from changes in general market conditions. The Company may be required to record losses on marketable securities when the market value of such securities falls below cost and the loss is considered other than temporary. The Company seeks to manage its exposure to market risk by investing in accordance with standards established by the Investment Committee of the Board of Directors. The standards of the Investment Committee are: (i) preservation of capital; (ii) provision of adequate liquidity to meet projected cash requirements; (iii) minimization of risk of principal loss through diversified short and medium term investments; and (iv) maximization of yields in relationship to the guidelines, risk, market conditions and tax considerations.

**Interest Rate Risk:** Changes in interest rates can potentially impact the Company's profitability and its ability to realize assets and satisfy liabilities. Interest rate risk is resident primarily in debt, which typically has variable interest rates based on Prime or LIBOR rates. Assuming no other change in financial structure, an increase of 1% in the Company's variable interest rate for debt would decrease pre-tax earnings for 2008 by approximately \$.1 million. This amount is determined by considering the impact of a 1% increase in interest rates on the average debt estimated to be outstanding in 2008.

**QUANTITATIVE**

The Company's debt as of September 30, 2008 is as follows (in millions, except percentage data):

|                                | <b>MATURITY<br/>LESS<br/>THAN ONE<br/>YEAR</b> | <b>MATURITY<br/>GREATER<br/>THAN ONE<br/>YEAR</b> |
|--------------------------------|--|---|
| Amount                         | \$ .3  | \$ 10.4   |
| Weighted average interest rate | 4.9%   | 4.4%  |
| Fair market value              | \$ .3  | \$ 10.4   |

The fair market value of debt equals the face amount of debt outstanding because the underlying rate of interest on substantially all of the Company's debt is variable based upon Prime or LIBOR rates

**ITEM 4T. CONTROLS AND PROCEDURES**

The President and the Chief Financial Officer of the Company (its principal executive officer and principal financial officer, respectively) have concluded, based on their evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q, that the Company's disclosure controls and procedures are effective to ensure that information required to be disclosed by the Company in the reports filed or submitted by it under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission (SEC) rules and forms, and include controls and procedures designed to ensure that information required to be disclosed by the Company in such reports is accumulated and communicated to the Company's management, including the President and the Chief Financial Officer, as appropriate, and allow timely decisions regarding required disclosure.

There have not been any changes in the Company's internal control over financial reporting during the fiscal quarter ended September 30, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

## **PART II**

### **ITEM 1. LEGAL PROCEEDINGS**

The Company is not a party to any material legal proceedings.

### **ITEM 1A. RISK FACTORS**

#### **FORWARD-LOOKING STATEMENTS**

The Company believes that this Quarterly Report on Form 10-Q may contain forward-looking statements within the meaning of the "safe-harbor" provisions of the Private Securities Litigation Reform Act of 1995. Forward looking statements include statements concerning plans, objectives, goals, strategies, future events or performance, expectations, predictions, and assumptions and other statements which are other than statements of historical facts.

These forward-looking statements are based on management's current expectations and are subject to, and are qualified by, risks and uncertainties that could cause actual results or business conditions to differ materially from those projected or suggested in such forward-looking statements.

The Company cautions investors that there can be no assurance that actual results or business conditions will not differ materially from those projected or suggested in such forward-looking statements as a result of various factors including, but not limited to, the following: (i) the ability of the Company to obtain financing and additional capital to fund its business strategy on acceptable terms, if at all; (ii) the ability of the Company on a timely basis to find, prudently negotiate and consummate additional acquisitions; (iii) the ability of the Company to manage any to-be acquired businesses; (iv) there is not an active trading market for the Company's securities and the stock prices thereof are highly volatile, due in part to the relatively small percentage of the Company's securities which is not held by the Company's majority stockholder and members of the Company's Board of Directors and/or management; (v) the ability of the Company to retain its Federal net operating tax loss carryforward position; and (vi) other factors identified below or in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2007. As a result, the Company's future development efforts involve a high degree of risk. For further information, please see the Company's filings with the SEC, including its Forms 10-K, 10-K/A, 10-Q and 8-K.





There have been no material changes from the risk factors previously disclosed in Item 1A of the Company's Annual Report on Form 10-K for the year ended December 31, 2007.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to a vote of the Company's security holders during the third quarter of 2008.

**ITEM 5. OTHER INFORMATION**

None

**ITEM 6. EXHIBITS**

The following exhibits are filed as part of this report:

| <b>EXHIBIT<br/>NUMBER</b> | <b>DESCRIPTION</b>  |
|---------------------------|---|
| 31.1                      | Rule 13a-14(a)/15d-14(a) Certifications.  |
| 31.2                      | Rule 13a-14(a)/15d-14(a) Certifications.  |
| 32.1                      | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 32.2                      | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

**SIGNATURES**

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

Date: November 14, 2008

/s/ Steven B. Lapin

Steven B. Lapin

President and Chief Operating Officer

(Principal Executive Officer)

Date: November 14, 2008

/s/ Dean T. Johnson

Dean T. Johnson

Senior Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)





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