SPECTRUM LABORATORIES INC /CA
Form 10KSB/A
September 27, 2005

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-KSB/A

ANNUAL REPORT UNDER SECTION 13 OR 15(d)
OF THE SECURITIES EXCHANGE ACT OF 1934

For the Fiscal Year Ended December 25, 2004

Commission File No. 0-9478

SPECTRUM LABORATORIES, INC.
(Exact Name of small business registrant as specified in its charter)

Delaware	95-4718363
(State or other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
18617 Broadwick Street Rancho Dominguez, California	90220
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code: (310) 885-4600

Securities registered under Section 12(b) of the Exchange Act: None

Securities registered under Section 12(g) of the Exchange Act:

Common Stock
(Title of Class)

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 [ ]

Check if there is no disclosure of delinquent filers in response to Item 405 of Regulation S-B is not contained in this form and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendment to this Form 10-KSB [ ].

State issuer's revenues for its most recent fiscal year: $13,250,000

The aggregate market value of voting stock held by nonaffiliates of the registrant is $182,682 as of February 28, 2005, based on the $2.23 per share bid closing price for the Common Stock in the over-the-counter market on such date, representing 81,920 shares held by nonaffiliates.

Number of shares of Common Stock outstanding as of April 7, 2005: 5,312,468

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FOR THE YEAR ENDED DECEMBER 25, 2004
SPECTRUM LABORATORIES, INC.

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PART I

FORWARD LOOKING STATEMENTS

THIS ANNUAL REPORT ON FORM 10-KSB (THE REPORT) MAY BE DEEMED TO INCLUDE OR INCORPORATE FORWARD-LOOKING STATEMENTS WITHIN THE MEANING OF SECTION 27A OF THE SECURITIES ACT OF 1933 AND SECTION 21E OF THE SECURITIES EXCHANGE ACT OF 1934

THAT INVOLVE RISK AND UNCERTAINTY, INCLUDING FINANCIAL, BUSINESS ENVIRONMENT AND PROJECTIONS, AS WELL AS STATEMENTS THAT ARE PRECEDED BY, FOLLOWED BY, OR THAT INCLUDE THE WORDS "BELIEVES," "EXPECTS," "ANTICIPATES," "SHOULD" OR SIMILAR EXPRESSIONS, AND OTHER STATEMENTS CONTAINED HEREIN REGARDING MATTERS THAT ARE NOT HISTORICAL FACTS. ADDITIONALLY, THE REPORT CONTAINS FORWARD-LOOKING STATEMENTS RELATING TO FUTURE PERFORMANCE, GOALS, STRATEGIC ACTIONS AND INITIATIVES AND SIMILAR INTENTIONS AND BELIEFS, INTENTIONS AND THE LIKE REGARDING FUTURE SALES, EARNINGS, RETURN ON EQUITY, SHARE REPURCHASES, CAPITAL EXPENDITURES AND OTHER MATTERS. THESE STATEMENTS INVOLVE ASSUMPTIONS REGARDING THE COMPANY'S OPERATIONS, INVESTMENTS, ACQUISITIONS AND CONDITIONS IN THE MARKETS THE COMPANY SERVES. ALTHOUGH THE COMPANY BELIEVES ITS EXPECTATIONS ARE BASED ON REASONABLE ASSUMPTIONS, SUCH STATEMENTS ARE SUBJECT TO RISK AND UNCERTAINTIES, INCLUDING, AMONG OTHERS, CERTAIN ECONOMIC, POLITICAL AND TECHNOLOGICAL FACTORS. ACTUAL RESULTS COULD DIFFER MATERIALLY FROM THOSE STATED OR IMPLIED IN THE REPORT, DUE TO, BUT NOT LIMITED TO, SUCH FACTORS AS (1) CHANGES IN PRICING AND THE COMPETITIVE ENVIRONMENT, (2) OTHER CHANGES IN THE BUSINESS ENVIRONMENT IN WHICH THE COMPANY OPERATES, (3) CHANGES IN RESEARCH FUNDING, (4) UNCERTAINTIES SURROUNDING GOVERNMENT HEALTHCARE REFORM, (5) GOVERNMENT REGULATIONS APPLICABLE TO THE BUSINESS, (6) THE IMPACT OF FLUCTUATIONS IN INTEREST RATES AND FOREIGN CURRENCY EXCHANGE RATES, (7) THE EFFECTIVENESS OF THE COMPANY'S FURTHER IMPLEMENTATION OF ITS SOFTWARE SYSTEMS, (8) THE ABILITY TO RETAIN CUSTOMERS, SUPPLIERS AND EMPLOYEES (9) CHANGES IN WORLDWIDE TAX RATES OR TAX BENEFITS FROM INTERNATIONAL OPERATIONS.

ITEM 1. DESCRIPTION OF BUSINESS

GENERAL

Spectrum Laboratories, Inc. (the "Company" or "Spectrum") a Delaware Corporation was originally incorporated under the laws of the state of California in June 1980 as Immutron, Inc. In November 1982 the Company changed its name to Spectrum Laboratories, Inc. The Company reincorporated in Delaware in September 1998. The Company's principal executive offices are located at 18617 Broadwick Street, Rancho Dominguez, California 90220.

On March 21, 2005, the Company filed a Preliminary Information Statement with the Securities and Exchange Commission reporting that the Company decided to amend its Certificate of Incorporation to effectuate a 1 to 25,000 reverse stock split. As a result of the reverse stock split, the Company will have only three stockholders. The Company's common stock will cease to be listed on the OTC Bulletin Board after the reverse split, and the Company will cease to file periodic reports with the Securities and Exchange Commission. The reverse stock split was unanimously by the Board of Directors at a meeting on October 6, 2004 and by holders of 98.4% of the outstanding shares of Common Stock by written consent pursuant to the Delaware General Business Law. The Company plans to amend its certificate of incorporation once it has received clearance by the SEC and has mailed a Definitive Information Statement to its shareholders.

PRODUCT GROUPS

The Company consists of three product groups, Bioprocessing, scaled from laboratory bench top to manufacturing of diagnostics and pharmaceuticals, Original Equipment Manufacturing ("OEM") and Operating Room Disposables which define the company's approach to serving customers.

The Bioprocessing unit sells membranes, membrane devices and other products used by customers at universities, government institutions, non-profit organizations, pharmaceutical, diagnostic and biotechnology companies. These products are originally used for life science research and high technology applications with some applications growing into GMP ("Good Manufacturing Practices") for diagnostics and pharmaceuticals.

The Original Equipment Manufacturing (OEM) unit supplies separations devices to companies developing proprietary products for Cell Therapy, Cell Expansion, Implants and Molecular/ Micro filtration for in vivo and ex-vivo applications.

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The Disposable Operating Room unit sells orthopedic and arthroscopic drapes, sterile microscope covers, tissue carriers and other disposables to hospital and clinic operating rooms.

STATUS OF PRODUCTS

Due to continuing developments in life science, high technology and other scientific research, there can be no assurance of a continuing market for each of the Company's products; however, through on going reviews of technical literature, along with regular communications with customers, the Company's goal is to keep abreast of the trends in separations techniques. This information along with its own research technology, determines the Company's development of improved and new products.

Customers and potential customers, wherever located, are encouraged to communicate by the Company's toll free 800 telephone numbers or via the Company's website on (spectrumlabs.com) for technical staff consultation or for placing orders. Shipments are made five days a week from four locations. The Company strives to ship its products to customers in a timely and acceptable fashion. The Company maintains inventory levels which, it believes to be appropriate to meet its current demands.

1-2. SALES & DISTRIBUTION

During 2004, approximately 2,200 products were sold to over 1,000 direct user accounts and over 200 dealer accounts with end users including hospitals, universities, pharmaceutical, industrial, diagnostics and biotechnology companies and commercial laboratories as well as non-profit organizations and governmental institutions. Small orders in laboratory quantities averaging approximately $250 accounted for less than 5% of the Company's sales. The Company's orders received in excess of $5,000 accounted for over 50% of the sales in 2004.

1-3. PRODUCTION & PURCHASING

The Company has a membrane production facility in Rancho Dominguez, Operating Room Disposables are produced in Dallas and Chromatography instruments and columns are produced in Houston.

The Company manufactures greater than 90% of its products, which represented over 95% of the sales in 2004. Products not manufactured by the Company are purchased to its specifications from numerous manufacturing sources.

None of the Company suppliers accounted for more than 10% of the Company purchases in 2004. The Company has generally been able to obtain adequate supplies of products and materials to meet its needs. No assurance can be given that additional or other shortages not will occur in the future.

Whether a product is produced by the Company or purchased from outside suppliers, it is subjected to quality control procedures, including the verification of porosity and with certain products, the complete validation for GMP, FDA, CE and ISO 2001 compliance, prior to final packaging. Quality control is performed by a staff of technicians utilizing calibrated equipment.

1-4. PATENTS, TRADEMARKS & LICENSES

The Company holds approximately 47 granted or pending patents and has 3 licensing agreements. The Company's significant trademarks are brand names KrosFlo, SpectraPor, Cellmax and SpectraChrom. The brands are marketed worldwide. Their related registered logos, and the significant trademarks, which have various expiration dates, are expected to be renewed indefinitely.

The Company is aware of the desirability for patent and trademark protection for its products. The Company believes other than its brand names no single patent, license, trademark (or related group of patents and licenses, or trademarks) is material in relation to its business as a whole.

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In addition to patents, the Company relies on trade secrets and proprietary know-how. The Company seeks protection of these trade secrets and proprietary know-how, in part through confidentiality and proprietary information agreements. The Company makes efforts to require its employees, directors, consultants and advisors, outside scientific collaborators and sponsored researchers, other advisors and other individuals and entities to execute confidentiality agreements upon the start of employment, consulting or other contractual relationships with the Company. These agreements provide that all confidential information developed or made known to the individual or entity during the course of the relationship is to be kept confidential and not disclosed to third parties except in specific circumstances. In the case of employees and some other parties, the agreements provide that all inventions conceived by the individual will be the Company's exclusive property. These agreements may not provide meaningful protection for or adequate remedies to protect the Company's technology in the event of unauthorized use or disclosure of information. Furthermore, the Company's trade secrets may otherwise become known to, or be independently developed by, its competitors.

1-5. DEPENDENCE ON A SINGLE CUSTOMER OR PRODUCT

The Company does not believe that its business would be adversely affected by the loss of any individual customer or small group of customers. During the 2004 and 2003 fiscal years, two distributors individually accounted for 10% or more of the Company's total sales which were approximately 13% and 12%, respectively in fiscal 2004 while both distributors each accounted for approximately 13% of sales in fiscal 2003. No individual product accounted for 10% or more of sales in either fiscal 2004 or 2003.

1-6. BACKLOG

As of December 25, 2004 the Company had a current backlog of open orders of approximately $503,000 and $753,000 in orders from customers specifically requesting items that were to be shipped during fiscal 2005.

1-7. COMPETITION

Substantial competition exists in all of the Company's marketing and production areas.

In all product areas the Company competes primarily on the basis of customer service, products quality and price. The Company markets its products through its three business units; Bioprocessing, OEM and Operating Room Disposables. The Company has over 10,000 catalogs in the marketplace in 2004 for the Spectrum brands with customers and potential customers throughout the world. These catalogs are supplemented with advertisements in chemical and other scientific journals, though the use of mailing of special products brochures, personal visits by sales and technical representatives with customers and through its web site. The Company competes with several medium and small companies in each of its product categories. The Company also competes with several large companies such as Pall and Millipore. These competitors have greater financial resources, larger sales and marketing and product development departments, stronger name recognition, longer operating histories and benefit from greater economies of scale. These factors, among others, may enable our competitors to market their products at lower prices or on terms more advantageous to customers than those we could offer for our competitive products. These competitors may have a greater ability to procure product licenses, as well as to market and distribute products. Competition may result in price reductions, reduced gross margins and loss of market share, any of which could have a material adverse effect on our business, financial condition and results of operations.

1-8. GOVERNMENT REGULATIONS

The Company engages principally in the business of selling products, which are not foods or food additives, drugs or cosmetics within the meaning of the federal Food, Drug and Cosmetic Act, as amended (the "FDC Act").

The Company believes that it is in compliance in all material respects with federal, state and local regulations relating to the manufacture, sale and distribution of its products. The following are brief summaries of some of the federal law and regulations which may have an impact on the Company's business. These summaries are only illustrative of the extensive regulatory requirements of the federal, state and local governments and are not intended to provide the specific details of each law or regulation.

The Food and Drug Administration (FDA) and the California Food and Drug Bureau (CFDB) regulate the manufacture and quality control procedures of certain of the Company's products. Compliance with FDA and CFDB regulations is a significant expense but the Company believes that such expenses are costs of doing business in the industry and that the Company's expenses are similar to those of other companies in the business.

The Clean Air Act (CAA), as amended, and the regulations promulgated there under, regulates the emission of harmful pollutants into the waters of the United States. Federal or state regulatory agencies may require companies to acquire permits, perform monitoring and install control equipment for certain pollutants.

The Clean Water Act (CWA), as amended, and the regulations promulgated there under, regulate the discharge of harmful pollutants into the waters of the United States. Federal or state regulatory agencies may require companies to acquire permits, perform monitoring and treat waste water before discharge to the waters of the Unites States or a Publicly Owned Treatment Works (POTW).

The Occupational Safety and Health Act of 1970 (OSHA), including the Hazard Communication Standard ("right to Know"), and the regulations promulgated there under, require the labeling of hazard substance containers, the supplying of Material Safety Data Sheets ("MSDS") on hazards products to customers and hazards substances to which an employee may be exposed in the workplace, the training of employees in the handling of hazardous substances and the use of the MSDS, along with other health and safety programs.

1-9. RESEARCH AND DEVELOPMENT

The Company incurred research and product development expenses of approximately $843,000 in 2004 and $868,000 in 2003. Research and product development functions are particularly important for the Company's future growth.

1-10. NUMBER OF PERSONS EMPLOYED

The Company had 116 employees as of December 25, 2004 of which 4 were part time employees. The total number employed in the United States was 113 with the remaining 3 employed by the Company's foreign subsidiary. The Company's employees and consultants have degrees in chemistry, biotechnology, engineering or other scientific disciplines, including approximately 6 with their doctorate degree.

1-11. FINANCIAL INFORMATION ABOUT GEOGRAPHIC AREAS

In the years ended December 25, 2004, approximately 25% of the Company's sales were customers outside the United States. The sales were made directly by the Company, through distributors and by a subsidiary located in the Netherlands.

For sales with final destinations in an international market, the Company uses Extraterritorial Income Exclusion (EIE), which provides certain Federal income tax advantages. The effect of the tax rules governing the EIE is to lower the effective Federal income tax rate on export income. The EIE resulting from the Company's U.S. export sales replaced the benefit previously provided by the Company's Foreign Corporation (FSC).

The Company's international operations and United States export sales are subject to certain risks such as changes in the legal and regulatory policies of foreign jurisdictions, local political and economic developments, currency fluctuations, exchange controls, changes in tariff restrictions, royalty and tax increases, export and import restrictions and restrictive regulations of foreign governments, among other factors inherent in these operations. The Company is unable to predict the extent to which its business may be affected in the future by these matters.

ITEM 2. DESCRIPTION OF PROPERTY

The Company's executive offices are located at 18617 Broadwick Street, Rancho Dominguez, California. All facilities used by the Company are leased, in good condition and are adequate for the Company's present operating requirements. Production and administrative facilities are located in California and Texas.

The Company has a sales and distribution facility in The Netherlands. The Company expects to continue to expand its production and distribution capabilities in selected markets. The Company now uses about 30% of its manufacturing capacity and expects to increase the utilization of its facilities in the future. The Company anticipates it will be extending its lease on its principal facility upon its current termination date of July 2005. Information regarding the Company's major facilities is as follows:

Location	Principal Usage	Sq. Feet	Lease Term. Date	Month Renta
Rancho Dominguez, CA	Administration and Manufacturing	55,000	7/05	$ 31,
Dallas, TX	Manufacturing	20,000	12/06	5,

Houston, TX	Manufacturing	9,975	8/06	4,
Breda, The Netherlands	Sales	1,400	12/06	2,

ITEM 3 LEGAL PROCEEDINGS

The Company is not currently aware of any formal legal proceedings or claims that the Company believes will have, individually or in the aggregate, a material adverse effect on the Company's financial position or results of operations.

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

No matters were submitted to the stockholders for a vote during the quarter ended 2004.

PART II

ITEM 5 MARKET FOR COMMON EQUITY AND RELATED SHAREHOLDER MATTERS AND SMALL BUSINESS ISSUERS PURCHASES OF EQUITY SECURITIES

The Company's Common Stock is currently traded on the Over the Counter (OTC) Bulletin Board, symbol SPTM.

The following table sets forth the high and low market prices for the last two years. The quotations shown represent inter-dealer prices without adjustment for retail markups, markdowns or commissions and do not necessarily reflect actual transactions.

2004	High	Low
First Quarter	$ 4.00	$ 1.70
Second Quarter	2.50	2.25
Third Quarter	2.10	2.05
Fourth Quarter	2.34	2.22

2003	High	Low
First Quarter	$ 0.55	$ 0.55
Second Quarter	2.95	0.65
Third Quarter	2.25	2.15
Fourth Quarter	2.50	1.60

DIVIDENDS

No dividends have been declared or paid by the Company since inception. Additionally, the Company's financing agreement with City National Bank prohibits the payment of dividends without the bank's approval. The Company intends to employ all available funds for development of its business and, accordingly, does not intend to pay cash dividends in the foreseeable future.

HOLDERS

As of December 25, 2004, the number of holders of record of the Company's Common Stock was 458.

REPURCHASE OF SECURITIES

The Company did not repurchase any of its comment equity during the fiscal year ended December 25, 2004.

RECENT SALES OF UNREGISTERED SECURITIES

The Company issued warrants to Technomedics Management & Systems, Inc. to purchase up to 125,000 shares of its common stock. The warrants were issued pursuant to an exemption provided by Section 4(2) of the Securities Act of 1933, as amended.

SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

The following table summarizes the securities authorized for issuance as of December 25, 2004 under the Company's 2000 Option Plan, the incentive agreement dated August 10, 1998 and the above mentioned warrants, the number of shares of our common stock issuable upon the exercise of outstanding options, the weighted average exercise price of such options and the number of additional shares of our common stock still authorized for issuance under such plan.

Equity Compensation Plan Information

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights	Weighted-average exercise price of outstanding options, warrants and rights
Equity compensation plans approved by security holders	574,050	$1.95
Equity compensation plans not approved by security holders	390,624	$1.36
Total	964,674	

* Incentive plan with Company's Senior Vice President, includes anti-dilution rights to maintain 5% stock ownership.

ITEM 6 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following is management's discussion and analysis of certain significant factors that have affected the financial position and operating results during the periods included in the accompanying consolidated financial statements, as well as information relating to the current plans of the Company and its majority-owned subsidiaries, SLI Acquisition Corp. (SLIAC), Spectrum Europe B.V. (Spectrum B.V.) and Spectrum Chromatography, Inc. (Chromatography).

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES AND ESTIMATES

Determining Impairment on Long-lived Assets - The Company recognizes impairment losses for long-lived assets used in operations when indicators of impairment are present and the future undiscounted cash flows are not sufficient to recover the assets' carrying amount. Management believes there has been no impairment of the value of such assets. The analysis of indicators of impairment and future cash flows are estimates made by management.

Patents - The Company has acquired patents utilized within the various manufacturing processes. These patents are amortized over their respective lives, typically 17 years. Management believes there has been no impairment in the value of these patents.

Accounting for Stock-based Compensation - The Company accounts for stock-based employee compensation under the requirements of Accounting Principles Board (APB) Opinion No. 25, which does not require compensation to be recorded if the consideration to be received is at least equal to fair value at the measurement date. Nonemployee stock-based transactions are accounted for under the requirements of the Financial Accounting Standards Board's (FASB) Statement of Financial Accounting Standards (SFAS) No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION, which requires compensation to be recorded based on the fair value of the securities issued or the services received, whichever is more reliably measurable.

Estimates & Reserves - The Company's principal reserves relate to accounts receivable and inventory. A detailed review of these reserves is done annually with a general review quarterly. Based on the most recent annual review the Company believes these reserve are adequate and the amounts consistent with prior year's level. A significant estimate is made in the annual impairment testing of goodwill. Changes in management's estimate of fair value of the Company could result in future impairment charges.

RESULTS OF OPERATIONS - FISCAL YEAR 2004 COMPARED TO FISCAL YEAR 2003

Consolidated sales for 2004 of $13,250,000 were above 2003 fiscal sales by $706,000 (5.6%). From a product group perspective, OEM sales exceeded the prior year by $469,000 (23.5%), Bioprocessing/laboratory products were $224,000 (2.5%) ahead of prior year while Operating Room Disposable products were marginally ahead of 2003 sales by $13,000 (0.8%). The increase in OEM revenues is principally related to an increase in orders from one significant account in 2004, partially offset by a decrease in another OEM account. Sales of the Bioprocessing/laboratory products increased by $224,000 (2.5%) although a major portion of this increase related to Spectrum's European subsidiary that benefited from the year over year increase in the Euro exchange rate of 9.3%, resulting in an exchange rate positive impact on sales of $146,000. From a geographical perspective, sales increased within each region, as sales in the U.S. increased $397,000 (4.2%), Japan sales increased $62,000 (9.8%), and all other countries collectively, increased $101,000 (4.2%), exclusive of the aforementioned positive exchange impact.

Cost of sales increased $937,000 (13.8%), versus the above discussed sales increase of 5.6%, resulting in gross margin percent in 2004 of 41.7% versus 2003 gross margin percentage of 45.8%. The decline in margin principally relates to product mix within the Company's OEM product line.

Research and development expenses in 2004 were $843,000, a decrease of $25,000 (2.9%) from 2003. The decrease primarily relates to lower salary and related expenditures partially offset by increased engineering consulting related expenses.

Selling, general and administrative expenses (SG&A) were $3.908,000 in 2004 a decrease of $509,000 (11.5%). The decrease in SG&A expenses principally related to advertising related expenditures, with a decrease of $318,000. The decrease in advertising was principally attributable to the company incurring limited catalog amortization during 2004 and no newsletter expenditures during the current year as Spectrum did not issue any BioProcessor newsletters in 2004 versus the three newsletters issued in 2003. Spectrum also incurred lower salary and related expenditures of approximately $110,000 in 2004 versus 2003.

LIQUIDITY AND CAPITAL RESOURCES

During fiscal 2004, the Company generated approximately $1,410,000 of cash from operating activities. Net working capital utilized $10,000 in cash during 2004 as the increase in inventory was principally offset by the decrease in prepaids, while the decrease in accounts payable was more than offset by the increase in accrued expenses. The Company expended $383,000 on fixed assets and did pay $960,000 in debt payments during 2004 although it increased its total debt by $4,215,000 in December of 2004.

The City National Bank credit agreement does restrict the use of the cash proceeds to certain purposes as defined in the agreement. The credit agreement prohibits the payment of cash dividends without prior bank approval.

In December of 2001 Spectrum entered into a specific research, licensing, manufacturing and supply agreements (the "Agreements") with an unrelated company, now known as Arbios Systems, Inc. ("Arbios"). These Agreements, among other aspects, resulted in Spectrum being granted 362,669 shares of Arbios. Arbios became a public company on October 30, 2003 and is listed on the OTC Bulleting Board under the symbol of ABOS.OB. Arbios is an early-stage biomedical device company engaged in the discovery, acquisition and development of proprietary liver assist devices and new technologies useful in the diagnosis and treatment of acute liver failure. In compliance with FAS115 based on the listed trade price of $2.65 per share Spectrum has allocated $961,000 as the fair market value reflecting this amount as comprehensive income on its balance sheet. Spectrum has classified this amount as a non current asset as it realizes there have been limited trades in Arbios and the potential to sell the stock may be limited. Arbios being an early stage developmental company this investment may be subject to significant adjustments. Spectrum's Chairman of the Board of Directors and Chief Executive Officer is also a member of the Board of Directors of Arbios.

The Company's management believes that cash on hand plus cash anticipated to be generated from operations will be sufficient to meet the Company's cash requirements for 2005.

A summary of our contractual cash obligations at December 25, 2004 is as follows:

Contractual Obligation	Total	2005	2006	2007	2008 there
Debt	$6,000,000	$ 935,000	$1,020,000	$1,185,000	$2,86
Leases	672,000	566,000	106,000	--	
Open Purchase Commitments	325,000	325,000	--	--	
Total	$6,672,000	$1,501,000	$1,126,000	$1,185,000	$2,86

OFF BALANCE SHEET ARRANGEMENTS

The Company does not have any off balance sheet arrangements.

ITEM 7 FINANCIAL STATEMENTS

The financial statements in response to this Item are submitted in a separate section of this Report. The Index to the financial statements is as follows:

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ITEM 8 CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

Spectrum filed two Forms 8-K reports during the quarter ended December 25, 2004 relating the resignation of the Company's independent accountant. The reports were filed on November 18, 2004 and November 24, 2004.

Other than the disagreement with Spectrum's former independent registered public accounting firm, as disclosed on applicable Form 8-Ks, noted above, there are no disagreements with Accountants on Accounting and Financial Disclosures.

8A. CONTROLS AND PROCEDURES

(a) Evaluation of Disclosure Controls and Procedures. The Company's Chief Executive Officer and its Chief Financial Officer , after evaluating the effectiveness of the Company's disclosure controls and procedures (as defined in Securities Exchange Act of 1934 Rules 13a-14(c) and 15d-14(c) as of a date within 90 days of the filing date of this annual report on Form 10-KSB (the "Evaluation Date")), have concluded that as of the Evaluation Date, the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company would be made known to them by others within the Company, particularly during the period in which this annual report on Form 10-KSB was being prepared.

The Company's prior President, Mr. Jesus Martinez, has been named Vice President and will be principally responsible for developing new products relating to Spectrum's OEM market.

(b) Changes in Internal Controls. There were no significant changes in the Company's internal controls or in other factors that could significantly affect the Company's disclosure controls and procedures subsequent to the Evaluation Date, nor any significant deficiencies or material weaknesses in such disclosure controls and procedures requiring corrective actions. As a result no corrective actions were taken.

8B. OTHER INFORMATION

Mr. Anthony MacDonald was named the Company's President on September 7, 2004.

Mr. MacDonald comes to Spectrum from Pall Corporation where he served for several years as Vice President of Sales and Marketing for Life Science TFF products division until 2000. Most recently, Mr. MacDonald was Vice President of Sales and Marketing for SolmeteX where he helped to refocus the Company from an R&D development company to a commercial success. He brings to Spectrum over 18 years experience in sales and marketing of filtration and separations related products. Mr. MacDonald entered into a three year employment agreement dated December 17, 2004 thru August 31, 2007, subject to potential earlier termination, as provided within the agreement. The material terms of the employment agreement are as follows; annual base salary of $175,000 increasing to $200,000 upon his family relocating to California, an annual $50,000 bonus potential based on criteria developed by the Board of Directors, 125,000 stock options to be issued at fair market value and normal fringe benefits provided Spectrum's employees.

Dr. Whitescarver, due to a recent policy instituted by his employer, restricting employees from being a member of a board of directors for outside companies, resigned from Spectrum's Board of Director's effective April 9, 2005.

PART III

ITEM 9. DIRECTORS, AND EXECUTIVE OFFICERS, OF THE REGISTRANT

The following table and text set forth the names of all directors and executive officers of our Company as of April 7, 2005. The Board of Directors is comprised of only one class. All of the directors will serve until the next annual meeting of shareholders and until their successors are elected and qualified, or until their earlier death, retirement, resignation or removal. Executive officers serve at the discretion of the Board of Directors, and are appointed to serve until the first Board of Directors meeting following the annual meeting of shareholders. Also provided herein are brief descriptions of the business experience of each director and executive officer.

Name	Age	Director Since	Posit
Roy T. Eddleman	65	July 30, 1982	Chairman, CEO
Brian A. Watts	57	----	CFO - Vice Pr
Walter J. Lack, J.D.	57	January 2, 1999	Secretary & D
Thomas V. Girardi, J.D.	65	January 2, 1999	Director
Jay Henis, Ph.D.	66	January 2, 1999	Director
Anthony J. MacDonald	43	----	President
F. Jesus Martinez	65	----	Senior Vice P
William R. Martin	50	----	Vice Presiden

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BUSINESS EXPERIENCE OF DIRECTORS AND EXECUTIVE OFFICERS

Roy T. Eddleman was elected Chairman of the Board and Chief Executive Officer of the Company on July 30, 1982. Mr. Eddleman has been engaged primarily as a private investor and entrepreneur for more than twenty years.

Brian Watts joined the Company in April 2002 as Chief Financial Officer and Vice President of Finance. Mr. Watts held similar positions with Frank Schaffer Publications and Ideal School Supply Corporation. Mr. Watts, a Certified Public Accountant, began his business career with Coopers & Lybrand and was subsequently employed by The Marmon Group, rising to the position of Assistant Treasurer.

Walter Lack has been employed as an attorney in private practice for over twenty years. He is also a Director of HCCH Holdings, Inc., Microvision, Inc. and Supergen, Inc. Mr. Lack also serves as Chairman of the Audit Committee.

Thomas Girardi has been employed as an attorney in private practice for over twenty years. Mr. Girardi also serves on the Company's Audit Committee.

Jay Henis is a practicing scientist and for ten years has been President and CEO of Henis Technologies, Inc. He is also President and CEO of Orex Pharmaceuticals.

Anthony MacDonald joined the Company as President effective September 7, 2004. Mr. MacDonald comes to Spectrum from Pall Corporation where he served for several years as Vice President of Sales and Marketing for Life Science TFF products division until 2000. Most recently, Mr. MacDonald was Vice President of Sales and Marketing for SolmeteX where he helped to refocus the Company from an R&D development company to a commercial success. He brings to Spectrum over 18 years experience in sales and marketing of filtration and separations related products.

F. Jesus Martinez is now a Senior Vice President and was formerly Chief Operating Officer and President of the Company from September, 1995 thru September 6, 2004. Mr. Martinez held the position of Vice President of R&D and Operations from August 1989 to September 1995. He has held senior management positions at Baxter Healthcare Corporation, National Medical Care, Minntech Corporation and is inventor or co-inventor of over twenty patents in medical devices.

William Martin joined the Company in April of 2002 as Vice President of Manufacturing. Mr. Martin has over twenty years of experience and several patents in the medical devices field. Prior to joining the Company, Mr. Martin held the position of Director of Operations at Endocare, Inc. and as Product Development Manager for the Company from 1990 to 1998. Mr. Martin attended the Hennepin County Technical College and the University of California, Irvine.

There are no family relationships between any of the Company's directors and officers. There are no arrangements or understandings between any director and any other person pursuant to which any person was elected or nominated as a director.

The Company sponsors no pension, retirement, annuity, savings or similar benefit plans that it was required to fund in 2004. The Company does sponsor an employee only contributory 401K Plan. Directors are not compensated for their services on the Company's Board of Directors.

AUDIT COMMITTEE AND AUDIT COMMITTEE EXPERT

Spectrum has a separately-designated audit committee. The Board of Directors has instructed the Audit Committee to meet periodically with the company's management and independent accountants to, among other things, review the results of the annual audit and quarterly reviews and discuss the financial statements, recommend to the Board the independent accountants to be retained, and receive and consider the accountants' comments as to controls, adequacy of staff and management performance and procedures in connection with audit and financial controls. The Audit Committee is also authorized to review related party transactions for potential conflicts of interest. The Audit Committee is chaired by Mr. Lack, and Mr. Girardi is a member. Each individual is a non-employee director. Spectrum has not elected an Audit Committee Expert.

CODE OF ETHICS

The Board of Directors adopted a Code of Business Conduct and Ethics (Code of Ethics) at its meeting on February 12, 2004. The Code of Ethics stresses all employees, but especially the CEO, CFO and Senior Financial Officers are to act with honesty & integrity, comply with rules and regulations of all governing bodies and provide information that is accurate, complete, relevant, timely and understandable in all reporting aspects.

SECTION 16(a) BENEFICIAL OWNERSHIP REPORTING COMPLIANCE

Based solely upon a review of Forms 3 and 4 and amendments thereto furnished to us pursuant to Rule 16a-3(e) under the Securities Exchange Act of 1934 during our most recent fiscal year and Forms 5 and amendments thereto furnished to us with respect to our most recent fiscal year, all officers, directors and owners of 10% or more of our outstanding shares have filed all Forms 3, 4 an 5 required by Section 16(a) of the Securities Exchange Act of 1934, as amended with the exception of Mr. Anthony MacDonald who failed to timely file Form 3 when he was appointed President in September 2004.

ITEM 10. EXECUTIVE COMPENSATION

The following table sets forth aggregate amounts of compensation paid or accrued to the Chief Executive Officer and the other four most highly compensated executive officers (the "Named Executive Officers") whose annual expected compensation exceeded $100,000 as of December 25, 2004.

	ANNUAL COMPENSATION			LONG TERM COMPENSATION		
Name and Position	Year	Salary	Bonus	RESTRICTED STOCK AWARDS	STOCK OPTIONS	LT
Roy T. Eddleman	2004	$ 120,192				
Chief Executive Officer	2003	160,000	162,500			
	2002	160,000	140,000			
F. Jesus Martinez	2004	132,452				
President	2003	145,000				
	2002	145,000	35,000			
Brian A. Watts	2004	109,615				
Chief Financial Officer	2003	120,000				
Chief Financial Officer	2002	120,000	30,000		200,000	

(1) Royalties based are at 7% on sales of certain products.

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The following table sets forth information relating to stock options held by the Company's executive officers as of December 25, 2004:

Name	Number of Securities Underlying Unexercised Options Exercisable/Unexercisable	Value of Unexercise In-the-Money Option Exercisable/Unexercis
Anthony J. MacDonald President	548/124,452	$1,150/$261,350
F. Jesus Martinez Senior Vice President	265,624/0	$319,000/$0
Brian A. Watts Chief Financial Officier	89,166/110,834	$136,424/$169,57
William R. Martin Vice President of Manufacturing	11,146/13,854	$17,053/$21,197

Option/SAR Grants in 2004

Individual Grants				
Name	Number of Securities Underlying Options/SARs Granted	% of Total Options/SARs Granted to Employees in 2004	Exercise Price	Expirat Date
Anthony J. MacDonald	125,000	83.3	$ 2.10	12/17/2

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ITEM 11 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS

The following table sets forth certain information regarding the beneficial ownership of the Company's Common Stock at December 25, 2004 by (i) all persons known by management to be beneficial owners of more than 5% of its Common Stock, (ii) all directors and nominees and (iii) all directors and nominees and officers of the Company as a group:

Name and Address	Amount and Nature of Beneficial Ownership	

Roy T. Eddleman 18617 Broadwick Street Rancho Dominguez, CA 90220	4,320,128	
Thomas V. Girardi, J.D. 1126 Wilshire Blvd. Los Angeles, CA 90017	800,002	
Jay Henis, Ph.D. 501 Marford Drive St. Louis, MO 63141	17,000	(2)
Walter J. Lack, J.D. 10100 Santa Monica Blvd. Los Angeles, CA 90067	109,918	
Jack Whitescarver, Ph.D. 4301 Massachusetts Ave. NW #6002 Washington, D.C. 20016	17,000	(2) (3)
F. Jesus Martinez 18617 Broadwick Street Rancho Dominguez, CA 90220	265,624	(1)
Brian A. Watts 18617 Broadwick Street Rancho Dominguez, CA 90220	80,000	(1)
All directors and officers as a group (7 in number)	5,609,672	(4)

(1) Amounts are based on total common shares outstanding of 5,312,468 unless noted.
(2) Entire amount is comprised of exercisable stock options.
(3) Individual resigned from Board of Director's effective April 9, 2005.
(4) Includes 379,624 exercisable stock options.

ITEM 12 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Pursuant to the terms of a royalty agreement with the Company, Mr. Eddleman, our Chief Executive Officer, receives a 7% royalty payment on certain of the products sold by the Company. In 2004, Mr. Eddleman received $304,613.

	2004	2003
7% royalty on certain products sold by the Company	$ 304,613	$ 311,617

Mr. Eddleman has personally guaranteed the Company's bank loan up to $3,500,000.

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ITEM 13 EXHIBITS, LIST AND REPORTS ON FORM 8-K

(a) Exhibits

Exhibit No.	Description
3.1	Articles of Incorporation of Registrant (incorporated by reference to Exhibit 4.1 filed with Registrant's Registration Statement on Form S-2, Registration No. 2-68999)
3.2	Amendment to Article I of the Articles of Incorporation of Registrant (incorporated by reference to Exhibit 3.2 filed with Registrant's Report on Form 10-K for the fiscal year ended December 31, 1982, Commission File No. 0-9478)
3.3	Bylaws of Registrant (incorporated by reference to Exhibit 4.2 filed with Registrant's Registration Statement on Form S-2, Registration No. 2-68999)
3.4	Amendment to Article III, section 2 of Registrant's Bylaws (incorporated by reference to Exhibit 3.3 filed with Registrant's Report on Form 10-K for the fiscal year ended May 31, 1982, Commission File No. 0-9478)
3.5	Amendment to Article IV, Section 6 and Section 7 of the Registrant's Bylaws (incorporated by reference to Exhibit 3.4 filed with Registrant's Report on Form 10-K for the fiscal year ended May 31, 1982, Commission File No. 0-9478)
3.6	Articles of Amendment to Registrant's Articles of Incorporation increasing authorized stock to 25,000,000 shares (incorporated by reference to Registrant's Schedule 14C-2 Information Statement, Exhibit A, filed with the Commission on October 19, 1996, Commission File No. 0-9478)
3.7	Certificate of Ownership of Microgon into Spectrum Laboratories (incorporated by reference to Exhibit 2B to the Registrant's Form 8-K/A on October 15, 1996, Commission File No. 0-9478)
3.8	Reorganization Agreement, dated September 30, 1998, between Spectrum Laboratories, Inc., and Spectrum Medical Industries, Inc. (incorporated by reference to Exhibit 2 to the Registrant's Form 8-K/A filed November 18, 1998, Commission File No. 0-9478)
10.1	Amendment to Investment and Loan Agreement dated August 1, 1995 among the Company, Microgon and certain preferred shareholders of Microgon (incorporated by reference to Exhibit 2A to the Registrant's Form 8K/A filed on October 15, 1995, Commission File No. 0-9478)
10.2	Stock Option Plan adopted October 11, 1996 (incorporated by reference to Exhibit B to Registrant's filing of Schedule 14-2, filed with the Commission on October 9, 1996)
10.3	Registrant's purchase agreement of Cellco, Inc. (incorporated by reference to Exhibit 10.14 with Registrant's Form 8-K dated November 1, 1996, Commission File No. 0-9478)
10.4	Credit agreement, dated as of December 22, 1998, between Registrant and City National Bank (incorporated by reference to Exhibit 10.18 filed with Registrant's report on Form 10-KSB for fiscal year ended January 2, 1999, Commission File No. 0-9478)

10.5	Incentive Agreement dated August 10, 1998, between Spectrum Medical Industries, Inc., the Registrant and F. Jesus Martinez and Roy T. Eddleman (incorporated by reference to Exhibit 10.19 filed with Registrant's report on Form 10-KSB for fiscal year ended January 2, 1999, Commission File No. 0-9478)
10.6	Sublease agreement dated January 19, 1999 between Millipore Corporation and Spectrum Laboratories, Inc. (incorporated by reference to Exhibit 10.20 filed with Registrant's report on Form 10-KSB for fiscal year ended January 1, 2000, Commission File No. 0-9478)
10.7	First amendment, dated July 14, 1999, to the credit agreement, dated December 22, 1998, between the Company and City National Bank (incorporated by reference to Exhibit 10.21 filed with Registrant's report on Form 10-KSB for fiscal year ended January 1, 2000, Commission File No. 0-9478)
10.8	Second amendment, dated July 1, 2000, to the credit agreement, dated December 22, 1998, between the Company and City National Bank (incorporated by reference to Exhibit 10.8 filed with Registrant's report on Form 10-KSB for fiscal year ended December 30, 2000, Commission File No. 0-9478)
10.9	The Registrant's Year 2000 Stock Option Plan (incorporated by reference to Exhibit 10.9 filed with Registrant's report on Form 10-KSB for fiscal year ended December 30, 2000, Commission File No. 0-9478)
10.10	Third amendment, dated January 8, 2001, to the credit agreement, dated December 22, 1998, between the Company and City National Bank (incorporated by reference to Exhibit 10.10 filed with Registrant's report on Form 10-KSB for fiscal year ended December 30, 2000, Commission File No. 0-9478)
10.11	Royalty Agreement, dated June 1, 1976, between Roy T. Eddleman and Spectrum Medical Industries (incorporated by reference to Exhibit 10.11 filed with Registrant's report on Form 10-KSB for fiscal year ended December 30, 2000, Commission File No. 0-9478)
10.12	Fourth amendment, dated December 14, 2001, to the credit agreement, dated December 22, 1998, between the Company and City National Bank (incorporated by reference to Exhibit 10.12 filed with Registrant's report on Form 10-KSB for fiscal year ended December 29, 2001, Commission File No. 0-9478)
10.13	Amended and Restated Credit Agreement, dated December 26, 2002, between the Registrant and City National Bank (incorporated by reference to Exhibit 10.13 filed with Registrant's report on Form 10-KSB for fiscal year ended December 28, 2002, Commission File No. 0-9478)
10.14	Second Amendment to Amended and Restated Credit Agreement, dated December 14, 2004, between the Registrant and City National Bank.
21	Subsidiaries of the Registrant (incorporated by reference to Exhibit 21 filed with Registrant's report on Form 10-KSB for fiscal year ended January 2, 1999, Commission File No. 0-9478)
31.1	Rule 13a-14(a)/15d-14(a) Certifications

31.2	Rule 13a-14(a)/15d-14(a) Certifications
32.1	18 U.S.C. Section 1350 Certifications
32.2	18 U.S.C. Section 1350 Certifications

(b) Reports on 8-K

Spectrum filed two Forms 8-K reports on during the quarter ended December 25, 2004. The reports were filed on November 18, 2004 and November 24, 2004 relating to the resignation of Company's independent accountant.

ITEM 14 PRINCIPAL ACCOUNTANT FEES AND DISCLOSURES

Aggregate fees for professional services rendered for us by Stonefield Josephson, Inc. for the year ended December 25, 2004 and by McGladrey & Pullen LLP and its affiliated entity, RSM McGladrey, Inc., for the year ended December 27, 2003 were as follows:

Services Provided	2004	2003
Audit Fees	$ 72,240	$ 104,440
Tax Fees	1,255	52,950
	$ 73,495	$ 157,390

AUDIT FEES

The aggregate fees billed for the years ended December 25, 2004 and December 27, 2003 were for the audits of our financial statements and review of our interim financial statements included in our annual and quarterly reports and fees related to filing other SEC reports.

AUDIT RELATED FEES

There were no fees billed for the years ended December 25, 2004 and December 27, 2003 were for the audit or review of our financial statements that are not reported under Audit Fees.

TAX FEES

The aggregate fees billed for the years ended December 25, 2004 and December 27, 2003 were for professional services for tax compliance, tax advice and tax planning. These services include preparation of original tax returns and advice regarding our international operations.

ALL OTHER FEES

There were no All Other Fees billed for the years ended December 25, 2004 and December 27, 2003.

AUDIT COMMITTEE PRE-APPROVAL POLICIES AND PROCEDURES

The Company's Audit Committee's policy is to pre-approve all audit and permissible non-audit services provided by our independent auditors. These services may include audit services, audit-related services, tax services and other services. Pre-approval is generally provided for up to one year and any pre-approval is detailed as to the particular service or category of services. The independent auditor and management are required to periodically report to the Audit Committee regarding the extent of services provided by the independent auditor in accordance with this pre-approval.

SIGNATURES

In accordance with Section 13 or 15(d) of the Exchange Act, the Registrant caused this report to be signed on its behalf by the undersigned, thereunto duly authorized, on September 19, 2005.

SPECTRUM LABORATORIES, INC.

By: /s/ Roy T. Eddleman

Roy T. Eddleman
Chairman, Chief Executive Officer and Director

By: /s/ Jay Henis

Jay Henis
Director

By: /s/ Tom Girardi

Tom Girardi
Director

By: /s/ Walter Lack

Walter Lack
Director

By: /s/ Brian A. Watts

Brian A. Watts
Chief Financial Officer and Vice President of Finance

SPECTRUM LABORATORIES, INC.

CONSOLIDATED FINANCIAL STATEMENTS

DECEMBER 25, 2004

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Stockholders
of Spectrum Laboratories, Inc. and its subsidiaries:

We have audited the accompanying consolidated balance sheet of Spectrum Laboratories, Inc. and its subsidiaries (the "Company") as of December 25, 2004, and the related consolidated statement of operations, stockholders' equity, and cash flows for the year then ended. Our audit also included the financial statement schedule listed at the index as of and for the year ended December 25, 2004. These consolidated financial statements and schedules are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements and schedule based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosure in the estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The consolidated financial statements referred to above present fairly, in all material respects, the financial position of Spectrum Laboratories, Inc. and its subsidiaries as of December 25, 2004, and the results of their operations and their cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, the financial statement schedule when considered in relation to the basic consolidated financial statements, taken as a whole, presents fairly, in all material respects, the information set forth therein.

/s/ STONEFIELD JOSEPHSON, INC.

CERTIFIED PUBLIC ACCOUNTANTS
Santa Monica, California
April 6, 2005

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors of Spectrum Laboratories, Inc.
Rancho Dominguez, California

We have audited the consolidated statements of income, stockholders' equity, and cash flows of Spectrum Laboratories, Inc. and its subsidiaries (the "Company") for the year ended December 27, 2003. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the results of operations and cash flows of Spectrum Laboratories, Inc. and its subsidiaries for the year ended December 27, 2003, in conformity with accounting principles generally accepted in the United States of America.

/s/ MCGLADREY & PULLEN

CERTIFIED PUBLIC ACCOUNTANTS
Irvine, California
March 12, 2004, except for the third paragraph of Note 5, which is dated March 25, 2004

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SPECTRUM LABORATORIES, INC.

CONSOLIDATED BALANCE SHEET

	DECEMBER 2004
ASSETS	

CURRENT ASSETS:	
Cash and cash equivalents	$ 8,119
Accounts receivable, less allowances for bad debts & sales returns of $196,000	1,653
Inventories	2,816
Prepaid expenses	86
Deferred income taxes	525
Total current assets	13,199
INVESMENT IN MARKETABLE SECURITIES	961
EQUIPMENT AND LEASEHOLD IMPROVEMENTS, net	1,399
PATENTS, net of accumulated amortization of $242,000	508
GOODWILL, net	1,122
DEFERRED INCOME TAXES	1,080
OTHER ASSETS - Principally Artwork of $986,000	1,027
TOTAL ASSETS	$ 19,296
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES:	
Current maturities of long-term debt	$ 935
Accounts payable	514
Accrued expenses:	
Compensation	387
Other	145
Total current liabilities	1,981
LONG-TERM DEBT, net of current maturities	5,065
PREFERRED STOCK of SUBSIDIARY - SLI ACQUISITION CORP	1,755
STOCKHOLDERS' EQUITY:	
Preferred stock, par value $.01; 10,000,000 shares authorized; none issued and outstanding	$
Common stock, $.01 par value, 25,000,000 shares authorized; 5,312,468 shares issued and outstanding	53
Additional paid-in capital	8,633
Accumulated other comprehensive income	577
Retained earnings	1,232
Total stockholders' equity	10,495
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	$ 19,296

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

SPECTRUM LABORATORIES, INC.

CONSOLIDATED STATEMENTS OF INCOME

	FISCAL YEARS ENDED	
	2004	2003
NET SALES	$ 13,250,000	$ 12,544,000
COSTS AND EXPENSES		
Cost of sales	7,731,000	6,794,000
Selling, general and administrative, (including royalty expense to a majority stockholder of $304,000 and $312,000 in fiscal years 2004 and 2003, respectively)	3,908,000	4,417,000
Research and development	843,000	868,000
Expense related to warrants and stock options	142,000	12,000
Other expenses, primarily interest	81,000	121,000
Total costs and expenses	12,705,000	12,212,000
Income before provision for income taxes	545,000	332,000
Provision (benefit) for income taxes	143,000	(100,000)
Net income	$ 402,000	$ 432,000
Earnings per share:		
Basic	$ 0.08	$ 0.08
Diluted	$ 0.07	$ 0.08
Weighted average shares outstanding:		
Basic	5,312,468	5,312,468
Diluted	5,563,172	5,381,834

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

SPECTRUM LABORATORIES, INC.

CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY

	Common stock		Additional Paid-in Capital	Comprehensive Income
	Shares	Amount		
Balance, December 28, 2002	5,312,468	$ 53,000	$ 8,479,000	
Net income	--	--	--	$ 432,000
Other comprehensive income net of tax of $363,000 - unrealized gain on investment securities	--	--	--	544,000
Comprehensive Income	--	--	--	$ 976,000
Compensation expense related to stock options	--	--	12,000	--
Balance, December 27, 2003	5,312,468	$ 53,000	$ 8,491,000	
Net income	--	--	--	$ 402,000
Other comprehensive income net of tax of $21,000 - unrealized gain on investment securities	--	--	--	33,000
Comprehensive Income	--	--	--	$ 435,000
Compensation expense related to stock options and warrants	--	--	142,000	
Balance, December 25, 2004	5,312,468	$ 53,000	$ 8,633,000	

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

SPECTRUM LABORATORIES, INC.

CONSOLIDATED STATEMENTS OF CASH FLOWS

FISCAL YEARS ENDED

	2004	2003
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income	$ 402,000	$ 432,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	796,000	783,000
Noncash compensation and warrant related expense	142,000	12,000
Deferred income taxes	80,000	(117,000
Change in working capital components:		
Decrease in accounts receivable	10,000	143,000
(Increase) in inventories	(154,000)	(896,000
Decrease in prepaid expenses	132,000	15,000
Decrease in income tax refund receivable	--	62,000
(Increase) in Other Assets	(8,000)	--
(Decrease) Increase in accounts payable	(108,000)	58,000
Increase (Decrease) in accrued expenses	118,000	(282,000
NET CASH PROVIDED BY OPERATING ACTIVITIES	1,410,000	210,000
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition of equipment and leasehold improvements	(383,000)	(539,000
NET CASH (USED IN) INVESTING ACTIVITIES	(383,000)	(539,000
CASH FLOWS FROM FINANCING ACTIVITIES:		
Principal payments of long-term debt	(960,000)	(943,000
Loan Proceeds	4,215,000	--
NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES	3,255,000	(943,000
NET (DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS	4,282,000	(1,272,000
Cash and cash equivalents		
Beginning of year	3,837,000	5,109,000
End of year	$ 8,119,000	$ 3,837,000

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

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SPECTRUM LABORATORIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

NATURE OF OPERATIONS AND BASIS OF PRESENTATION - The consolidated financial statements include the accounts of Spectrum Laboratories, Inc. (Spectrum) and its subsidiaries (collectively, the Company), SLI Acquisition Corp. (SLIAC), Spectrum Europe B.V. (Spectrum B.V.) and Spectrum Chromatography (Chromatography). The Company develops and sells proprietary tubular membranes and membrane devices for existing and emerging life science applications used primarily by research laboratories. The Company is also engaged in the manufacture and sale of medical laboratory equipment and supplies and disposable products. Certain of the Company's products are regulated by the United States Food and Drug Administration and the California Food and Drug Bureau. All products are for sale primarily to the pharmaceutical, biotechnology and medical industries.

FISCAL YEAR - The Company's fiscal year ends on the last Saturday of the calendar year. The years ended December 25, 2004 (fiscal year 2004) and December 27, 2003 (fiscal year 2003) both consist of 52 weeks.

PRINCIPLES OF CONSOLIDATION - The accompanying consolidated financial statements include the accounts of Spectrum and its wholly owned subsidiaries and majority-owned subsidiary, SLIAC. All intercompany balances and transactions have been eliminated in consolidation.

USE OF ESTIMATES - The preparation of financial statements require management to make estimates and assumptions that affect the reported amounts of assets, liabilities, the value of stock based compensation and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from those estimates.

The Company's operations are affected by numerous factors including market acceptance, changes in technologies and new laws and government regulations and policies. The Company cannot predict what impact, if any, the occurrence of these or other events might have on the Company's operations. Significant estimates and assumptions made by management are used for, but not limited to, the allowance for doubtful accounts, the reserve for slow moving or obsolete inventories, the fair value of long-lived and intangible assets, and the realizability of deferred tax assets.

CASH AND CASH EQUIVALENTS - The Company classifies all highly liquid investments with original maturities of 90 days or less at the time of purchase as cash and cash equivalents. The Company, periodically throughout the year, has amounts on deposit that exceed insured limits.

TRADE RECEIVABLES - The Company sells its products nationally and internationally, primarily through distributors, to medical equipment and medical supply companies. The Company performs ongoing credit evaluations of its customers and generally does not require collateral. Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts on a monthly basis. Management determines the allowance for doubtful accounts by identifying troubled accounts and by using historical experience applied to an aging of accounts. Trade receivables are written off when deemed uncollectible. Recoveries of trade receivables previously written off are recorded when received. No interest is charged on past due accounts.

INVENTORIES - Inventories are stated at the lower of cost (using the first-in first-out method) or market value.

INVESTMENT IN MARKETABLE SECURITIES CLASSIFIED AS AVAILABLE-FOR-SALE SECURITIES - Management determines the appropriate classification of the securities at the time they are acquired and evaluates the appropriateness of such classifications at each balance sheet date. Management has determined that all securities should be classified as available-for-sale. Available-for-sale securities are stated at fair value and unrealized holding gains and losses, net of the related deferred tax effect, are reported as a separate component of stockholders' equity. Realized gains and losses, including losses from declines in value of specific securities determined by management to be other than temporary, are included in income. Realized gains and losses are determined on the basis of the specific identification of the securities sold. As of December 25, 2004, available-for-sale securities consisted of equity ownership of one entity. Such ownership had a historical cost of $0 and a pre tax unrealized gain was $54,000 and $907,000 in 2004 and 2003, respectively.

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

LONG-LIVED ASSETS AND PATENTS - Equipment and leasehold improvements are recorded at cost, net of accumulated depreciation and amortization. Depreciation of equipment is provided using the straight-line method over the estimated useful lives (generally five years) of the respective assets. Leasehold improvements are amortized on a straight-line basis over the lesser of the lease term or the estimated useful life of the asset. Amortization of leasehold improvements is included with depreciation expense. No depreciation is being provided for the Company owned artwork, which is carried at its historical cost.

The Company periodically reviews its long-lived assets including patents to determine potential impairment by comparing the carrying value of the long-lived assets with the estimated future net undiscounted cash flows expected to result from the use of the assets, including cash flows from disposition. Long-lived assets evaluated for impairment are grouped with other assets to the lowest level for which identifiable cash flows are largely independent of the cash flows of other groups of assets and liabilities. Should the sum of the expected future net cash flows be less than the carrying value, the Company would recognize an impairment loss at that date. An impairment loss would be measured by comparing the amount by which the carrying value exceeds the fair value (estimated discounted future cash flows) of the long-lived assets. For the year ended December 25, 2004, management has determined that no impairment of long-lived assets including patents exists.

Changes in circumstances, such as the passage of new laws or changes in regulations, technological advances or changes to the Company's business strategy, could result in the actual useful lives of long-lived assets differing from initial estimates. Factors such as changes in the planned use of equipment, customer attrition, contractual amendments or mandated regulatory requirements could result in shortened useful lives. In those cases where the Company determines that the useful life of a long-lived asset should be revised, the

Company will amortize or depreciate the net book value in excess of the estimated residual value over its revised remaining useful life.

The Company has acquired patents totaling $750,000 which are being amortized over their respective useful lives of approximately twelve years. Patent amortization for the fiscal years ended 2004 and 2003 was approximately $60,000 for each year. Estimated amortization expense for the next five years is approximately $60,000 annually, all of which relates to these patents.

GOODWILL - In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No 142, GOODWILL AND OTHER INTANGIBLE ASSETS (SFAS No. 142). SFAS No. 142 addresses financial accounting and reporting for acquired goodwill and other intangibles assets and was effective for the Company beginning December 30, 2001. Upon adoption of SFAS 142, management has determined there is one reporting unit and evaluated the carrying value of goodwill for potential impairment losses and determined no impairment existed. Management updates its annual goodwill impairment evaluation as of September of each fiscal year and has concluded that no impairment exists as of September 25, 2004. For goodwill, the impairment evaluation includes a comparison of the carrying value of the reporting unit (including goodwill) to that reporting unit's fair value. If the reporting unit's estimated fair value exceeds the reporting unit's carrying value, no impairment of goodwill exists. If the fair value of the reporting unit does not exceed the unit's carrying value, then an additional analysis is performed to allocate the fair value of the reporting unit to all of the assets and liabilities of that unit as if that unit had been acquired in a business combination and the fair value of the unit was the purchase price. If the excess of the fair value of the reporting unit over the fair value of the identifiable assets and liabilities is less than the carrying value of the unit's goodwill, an impairment charge is recorded for the difference.

INCOME TAXES - Deferred income taxes are provided on a liability method whereby deferred income tax assets are recognized for deductible temporary differences and tax credit carryforwards and deferred income tax liabilities are recognized for taxable temporary differences. Temporary differences are the differences between the reported amounts of assets and liabilities and their tax bases. Deferred income tax assets are reduced by a valuation allowance when, in the opinion of

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NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

management, it is more likely than not that some portion or all of the deferred tax assets will not be realized. Deferred income tax assets and liabilities are adjusted for the effects of changes in tax laws and rates on the date of enactment.

EARNINGS PER SHARE - Basic earnings per share is computed by dividing the net income attributable to the common stockholders by the weighted average number of common shares outstanding during the period. There is no adjustment in the net income attributable to common stockholders. Diluted earnings per share reflect the potential dilution that could occur from common shares issuable through stock options (250,704 and 69,366 equivalent shares in the fiscal years 2004 and 2003, respectively).

REVENUE RECOGNITION - The Company records revenue at the time the related products are shipped.

PRODUCT RETURNS AND WARRANTIES - The Company records a provision for estimated product returns and warranties at the time the revenue is recognized.

RESEARCH AND DEVELOPMENT - The Company expenses research and development costs as incurred.

ADVERTISING COSTS - Costs associated with advertising and promoting products are expensed as incurred. Advertising and promotion expense was approximately $171,000 and $449,000 during fiscal years 2004 and 2003, inclusive of trade shows in both years.

REMEASUREMENT OF FOREIGN CURRENCIES - Monetary assets and liabilities of Spectrum B.V. are remeasured into U.S. dollars at year-end exchange rates and nonmonetary assets and stockholders' equity are remeasured using historical rates of exchange. Income and expenses are remeasured at average rates during the respective years. The functional currency of this subsidiary is the U.S. dollar; therefore, remeasurement gains or losses are included in income. Remeasurement gains included in income as contra SG&A expenditure for fiscal years 2004 and 2003 were approximately $34,000 and $51,000, respectively. As of December 25, 2004 there was $159,000 in cash and $249,000 in accounts receivable that were denominated in Euros.

FAIR VALUE OF FINANCIAL INSTRUMENTS - Management believes that the carrying amount of cash and cash equivalents approximates fair value because of the short maturity of these financial instruments. Long-term debt bears interest at a rate indexed to the prime rate and, therefore, management believes the carrying amount of the outstanding borrowings at December 25, 2004 approximates fair market value.

ACCOUNTING FOR STOCK-BASED COMPENSATION - The Company accounts for stock-based employee compensation under the requirements Financial Accounting Standards Board's Statement of Financial Accounting Standards No. 123, ACCOUNTING FOR STOCK-BASED COMPENSATION "SFAS No. 123 which allows utilizing Accounting Principles Board (APB) Opinion No. 25, which does not require compensation to be recorded if the consideration to be received is at least equal to fair value at the measurement date. Nonemployee stock-based transactions are accounted for under SFAS No. 123, the requirements of the, which requires compensation to be recorded based on the fair value of the securities issued or the services received, whichever is more reliably measurable.

SFAS No. 123 requires the disclosure of pro forma net income and earnings per share had the Company adopted the fair value method. Under SFAS No. 123, the fair value of stock-based awards to employees is calculated through the use of option-pricing models, even though such models were developed to estimate the fair value of freely tradable, fully transferable options with vesting restrictions which significantly differ from the Company's stock option awards. These models also require subjective assumptions, including future stock price volatility and expected time to exercise, which greatly affect the calculated value. The Company's calculations for the options granted in 2004 were made using the Black-Scholes option-pricing model with the following weighted average assumptions in 2004: expected life of ten years; stock volatility of 87%; risk-free interest rate 2.8%; and no dividends during the expected term.

SPECTRUM LABORATORIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

The calculations are based on a single-option valuation approach and forfeitures are recognized as they occur. The following table illustrates the effect on net income and earnings per share had compensation cost for employee stock-based compensation been determined based on the grant date fair values of awards:

	2004	2003
Net income:		
As reported	$ 402,000	$ 432
Add total stock-based employee compensation expense determined under APB opinion 25, net of related tax effects	12,000	12
(Deduct) total stock-based employee compensation expense determined under fair value based for all awards, net of related tax effects	(58,000)	(64
Pro forma	$ 356,000	$ 380
Basic earnings per share:		
Assreportedd	$ 0.08	$
Prooformaa	$ 0.07	$
Diluted earnings per share:		
Assreportedd	$ 0.07	$
Prooformaa	$ 0.06	$
Weighted average shares outstanding:		
Basic	5,312,468	5,312
Diluted	5,563,172	5,381

SEGMENT INFORMATION - In accordance with FASB Statement No. 131, DISCLOSURES ABOUT SEGMENTS OF AN ENTERPRISE AND RELATED INFORMATION, the Company has determined the products are all classified into three product groups as further discussed in Note 13. The Company has further analyzed the type and class of its customers, and the product distribution methods, and has determined that the Company has one reportable segment.

RECENT ACCOUNTING PRONOUNCEMENTS -

In January 2003, the FASB issued FASB Interpretation No. ("FIN") 46, "Consolidation of Variable Interest Entities" ("FIN 46"). In December 2003, FIN 46 was replaced by FASB interpretation No. 46(R) "Consolidation of Variable Interest Entities." FIN 46(R) clarifies the application of Accounting Research Bulletin No. 51, "Consolidated Financial Statements," to certain entities in which equity investors do not have the characteristics of a controlling financial interest or do not have sufficient equity at risk for the entity to finance its activities without additional subordinated financial support from other parties. FIN 46(R) requires an enterprise to consolidate a variable interest entity if that enterprise will absorb a majority of the entity's expected losses, is entitled to receive a majority of the entity's expected residual returns, or both. FIN 46(R) is effective for entities being evaluated under FIN 46(R) for consolidation no later than the end of the first reporting period that ends after March 15, 2004. The Company does not currently have any variable interest entities that will be impacted by adoption of FIN 46(R).

On April 30, 2003, the Financial Accounting Standards Board issued SFAS No. 149, "Amendment of Statement 133 on Derivative Instruments and Hedging Activities." SFAS No. 149 amends and clarifies accounting for derivative instruments, including certain derivative instruments embedded in other contracts, and for hedging activities under SFAS No. 133. The new guidance amends SFAS No. 133 for decisions made as part of the Derivatives Implementation Group ("DIG") process that effectively required amendments to SFAS No. 133,

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NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

and decisions made in connection with other FASB projects dealing with financial instruments and in connection with implementation issues raised in relation to the application of the definition of a derivative and characteristics of a derivative that contains financing components. In addition, it clarifies when a derivative contains a financing component that warrants special reporting in the statement of cash flows. SFAS No. 149 is effective for contracts entered into or modified after June 30, 2003 and for hedging relationships designated after June 30, 2003. Adoption of this standard did not have an impact on the Company's consolidated financial statements.

In May 2003, the FASB issued SFAS No. 150 ACCOUNTING FOR FINANCIAL INSTRUMENTS WITH THE CHARACTERISTICS OF BOTH LIABILITIES AND EQUITIES. SFAS No. 150 establishes standards regarding the manner in which an issuer classifies and measures certain types of financial instruments having characteristics of both liabilities and equity. Pursuant to SFAS No. 150, such freestanding financial instruments (i.e., those entered into separately from an entity's other financial instruments or equity transactions or that are legally detachable and separately exercisable) must be classified as liabilities or, in some cases, assets. In addition, SFAS No. 150 requires that financial instruments containing obligations to repurchase the issuing entity's equity shares and, under certain circumstances, obligations that are settled by delivery of the issuer's shares be classified as liabilities. Certain aspects of SFAS No. 150 have been deferred; however, the Statement is effective for financial instruments entered into or modified after May 31, 2003 and for other instruments at the beginning of the first interim period beginning after June 15, 2003. The Company does not currently have any financial instruments that have been impacted by SFAS No. 150.

In December 2003, the SEC issued Staff Accounting Bulletin ("SAB") No. 104, "Revenue Recognition." SAB 104, which was effective upon issuance, updates portions of the interpretive guidance included in Topic 13 of the codification of Staff Accounting Bulletins and revises or rescinds portions of the interpretative guidance included in SAB 101 in order to make this interpretive guidance consistent with current authoritative accounting and auditing guidance and SEC rules and regulations. The principal revisions relate to the incorporation of certain sections of the staff's Frequently Asked Question ("FAQ") document on revenue recognition into Topic 13. SAB 101, "Revenue Recognition in Financial Statements," which was issued in December 1999, provides guidance to SEC registrants on the recognition, presentation and disclosure of revenues in the financial statements. Since the Company has already adopted all such standards upon issuance, the application of this revised guidance did not impact its consolidated financial position, results of operations, or disclosure requirements.

In July 2004, the Emerging Issues Task Forces ("EITF") published its consensus on Issue No. 03-1, "The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments." EITF Issue No. 03-1 addresses the meaning of other-than-temporary impairment and its application to debt and equity securities within the scope of Statement of Financial Accounting Standards ("SFAS") No. 115, certain debt and equity securities within the scope of SFAS No. 124, and equity securities that are not subject to the scope of SFAS No. 115 and not accounted for under the equity method of accounting. In September 2004, the Financial Accounting Standard Board ("FASB") issued FASB Staff Position ("FSP") Emerging Issues Task Force (EITF) Issue 03-1-b, Effective Date of Paragraphs 10-20 of EITF Issue No. 03-1, which delays the effective date for the recognition and measurement guidance in EITF Issue No. 03-1. In addition, the FASB has issued a proposed FSP to consider whether further application guidance is necessary for securities analyzed for impairment under EITF Issue No. 03-1-a. Adoption of this standard did not have an impact on the Company's consolidated financial statements.

In November 2004, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 151, "Inventory Costs" an amendment of Accounting Research Bulletin ("ARB") No. 43, to clarify the accounting for abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage). This Statement requires that those items be recognized as current-period charges regardless of whether they meet the criterion of "so abnormal". In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. Companies are required to adopt the provisions of this Statement for fiscal years beginning after June 15, 2005. The Company does not believe there will be a material effect on its consolidated financial position or results of operations from the adoption of this standard.

SPECTRUM LABORATORIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES (Continued)

In December 2004, the FASB issued SFAS No.153, "Exchanges of Nonmonetary Assets, an amendment of APB Opinion No. 29, Accounting for Nonmonetary Transactions." The amendments made by Statement 153 are based on the principle that exchanges of nonmonetary assets should be measured based on the fair value of the assets exchanged. Further, the amendments eliminate the narrow exception for nonmonetary exchanges of similar productive assets and replace it with a broader exception for exchanges of nonmonetary assets that do not have commercial substance. Previously, Opinion 29 required that the accounting for an exchange of a productive asset for a similar productive asset or an equivalent interest in the same or similar productive asset should be based on the recorded amount of the asset relinquished. Opinion 29 provided an exception to its basic measurement principle (fair value) for exchanges of similar productive assets. The Board believes that exception required that some nonmonetary exchanges, although commercially substantive, be recorded on a carryover basis. By focusing the exception on exchanges that lack commercial substance, the Board believes this Statement produces financial reporting that more faithfully represents the economics of the transactions. The Statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. Earlier application is permitted for nonmonetary asset exchanges occurring in fiscal periods beginning after the date of issuance. The provisions of this Statement shall be applied prospectively. The Company has evaluated the impact of the adoption of SFAS 153, and does not believe the impact will be significant to the Company's overall results of operations or financial position.

In December 2004, the FASB issued SFAS No.123 (revised 2004), "Share-Based Payment". Statement 123(R) will provide investors and other users of financial statements with more complete and neutral financial information by requiring that the compensation cost relating to share-based payment transactions be recognized in financial statements. That cost will be measured based on the fair value of the equity or liability instruments issued. Statement 123(R) covers a wide range of share-based compensation arrangements including share options, restricted share plans, performance-based awards, share appreciation rights, and employee share purchase plans. Statement 123(R) replaces FASB Statement No. 123, Accounting for Stock-Based Compensation, and supersedes APB Opinion No. 25, Accounting for Stock Issued to Employees. Statement 123, as originally issued in 1995, established as preferable a fair-value-based method of accounting for share-based payment transactions with employees. However, that Statement permitted entities the option of continuing to apply the guidance in Opinion 25, as long as the footnotes to financial statements disclosed what net income would have been had the preferable fair-value-based method been used. Public entities (other than those filing as small business issuers) will be required to apply Statement 123(R) as of the first interim or annual reporting period that begins after June 15, 2005. The Company has evaluated the impact of the adoption of SFAS 123(R), and the effect of which is discussed in Footnote 1.

In December 2004 the Financial Accounting Standards Board issued two FASB Staff Positions--FSP FAS 109-1, Application of FASB Statement 109

"Accounting for Income Taxes" to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004, and FSP FAS 109-2 Accounting and Disclosure Guidance for the Foreign EarningsRepatriation Provision within the American Jobs Creation Act of 2004. Neither of these affected the Company as it does not participate in the related activities.

NOTE 2. INVENTORIES

Inventories consist of the following at December 25, 2004:

Raw materials	$ 2,383,000
Work in process	166,000
Finished goods	889,000
	3,438,000
Less reserve for slow moving and obsolete items	(622,000)
	$ 2,816,000

SPECTRUM LABORATORIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 3. EQUIPMENT AND LEASEHOLD IMPROVEMENTS

Equipment and leasehold improvements consist of the following at December 25, 2004:

Machinery, equipment and tooling	$ 5,339,000
Office furniture and equipment	1,126,000
Leasehold improvements	1,090,000
	7,555,000
Less accumulated depreciation and amortization	(6,156,000)
	$ 1,399,000

Depreciation and amortization expense of equipment and leasehold improvements for fiscal years 2004 and 2003 was $736,000 and $722,000, respectively.

NOTE 4. INCOME TAXES

The Company's provision for income taxes consists of the following:

	2004	2003
Current:		
Federal	$ (14,000)	$ (28,000)
State	30,000	8,000
Foreign	47,000	37,000

	63,000	17,000
Deferred:		
Federal	10,000	(117,000)
State	70,000	--
	80,000	(117,000)
	$ 143,000	$ (100,000)

Pre tax income subject to foreign and U.S. income taxes for fiscal 2004 and 2003 were as follows:

	2004	2003
U.S. pre tax income	$ 409,000	$ 222,000
Foreign pre tax income	136,000	110,000
	$ 545,000	$ 332,000

The reported provision for income taxes differs from the amount computed by applying the statutory federal income tax rate of 35% to the consolidated income before provision for income taxes as follows:

	2004	2003
Statutory federal income tax provision	$ 185,000	$ 116,000
State income taxes, net of federal benefit	20,000	16,000
Change in valuation allowance	--	--
Nondeductible expenses	9,000	24,000
Tax credits generated in current year	(86,000)	(234,000)
Other	15,000	(22,000)
Income tax (benefit) provision	$ 143,000	$ (100,000)

NOTE 4. INCOME TAXES (Continued)

The components of the Company's net deferred income tax assets as of December 25, 2004 are as follows:

	2004
Deferred Tax Assets:	

Operating loss carryforwards	$ 1,950,000
Intangibles, primarily in-process research and development	345,000
Stock based compensation not currently deductible	192,000
Reserves not currently deductible	471,000
Equipment and leasehold improvements	278,000
Tax credits	186,000
Other	67,000
	3,489,000
Deferred Tax Liabilities:	
Marketable Securities	(384,000)
	3,105,000
Valuation allowance	(1,500,000)
Net deferred tax assets	$ 1,605,000

The net deferred tax assets have been classified on the accompanying consolidated balance sheet as follows:

Current assets	$ 525,000
Noncurrent assets	1,080,000
Net deferred tax assets	$ 1,605,000

In assessing the realizability of deferred tax assets, management has estimated that it is more likely than not that approximately $1,500,000 will not be realized. This valuation allowance represents a portion of net operating loss carryforwards attained through a prior business acquisition. As further discussed below, tax law limits the use of an acquired entity's net operating loss carryforwards to subsequent taxable income of the consolidated entity. During fiscal years 2004 and 2003, the Company utilized approximately $298,000 and $116,000, respectively, of net operating losses, to offset currently payable tax liability. Realization of the remaining deferred tax assets is dependent upon generating sufficient future taxable income. Although realization is not assured, management believes the net deferred taxes will be realized and continue to evaluate the realizability of the deferred tax assets by assessing the need for and amount of a valuation allowance.

At December 25, 2004, the Company had approximately $5,176,000 in net operating loss carryforwards for federal income tax purposes available to offset future taxable income. Certain of these loss carryforwards are limited to approximately $298,000 annually. Any unused net operating loss is carried forward. As a result of the limitation discussed above, it is probable that $1,500,000 of the Company's net operating loss will expire without utilization. Loss carryforwards for tax purposes expire in amounts and by fiscal year as follows: 2005 $2,836,000; 2006 $1,820,000; 2007 $274,000; 2010 $13,000; 2012 $114,000, 2018 $85,000 and 2202 $34,000.

NOTE 5. LONG-TERM DEBT

In December of 2004 the Company increased its borrowings by $4,215,000. Spectrum's prior two equipment acquisition loans were consolidated into one loan plus a revolving credit note. The proceeds of the acquisition loan are restricted to certain purposes, as defined in the credit agreement.The acquisition loan has an outstanding balance at December 25, 2004 of $6,000,000, bears interest at prime plus .25% (5.50% at December 25, 2004) and requires 24 monthly principal installments of $85,000 beginning February 1, 2005 thru January 1, 2007, then 12 monthly principal installments of $100,000 thru January 1, 2008, then

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NOTE 5. LONG-TERM DEBT (Continued)

12 monthly principal installments of $110,000 thru January 1, 2009 and finally 12 monthly principal installments of $120,000 thru January 1, 2010,

The revolving credit note provides the Company with additional liquidity and the ability to issue letters of credit aggregating up to $300,000 through April 1, 2005. The Company did have a $75,000 outstanding standby letter of credit outstanding as of December 25, 2004 although no proceeds had been drawn against the standby letter of credit during 2004. Interest on any proceeds drawn on the revolving credit note bear interest at prime plus .25% and interest is payable on the first of every month. The Company is required to have a period of not less than 30 consecutive days during the 12 month period ending April 1, 2005 during which time there are to be no outstanding revolving credit loans.

The agreement is secured by substantially all of the assets of the Company and is personally guaranteed by the majority stockholder. The agreement also requires the maintenance of certain financial and non-financial loan covenants and restricts payment of dividends. The Company was not in compliance with one of these loan covenants at December 27, 2003 relating to cash flow to debt coverage. The Company received a covenant waiver from its bank on March 25, 2004. Future maturities of long-term debt owed on December 25, 2004 by fiscal year are approximately as follows: 2005 $935,000; 2006 $1,020,000; 2007 $1,185,000; 2008 $1,310,000; 2009 $1,430,000; and 2010 $120,000.

NOTE 6. STOCK OPTION PLAN

The Company has an option plan referred to as the 2000 Option Plan (the "2000 Option Plan"or "Plan") with 600,000 shares of common stock reserved for option grants to key employees, directors and consultants. Exercise prices for the stock options will not be less than 100% of the fair market value of the stock on the date of grant. Options under the Plan expire not more than ten years from date of grant. Options issued under the Plan become exercisable over a five-year period (20% per year).

In addition to the 2000 Option Plan, during 1998 the Company granted nonqualified stock options to purchase 5% of the outstanding stock to an officer of the Company at $1.20 per share. The terms of this grant result in variable plan accounting. Accordingly, future compensation expense will be measured and recorded based on stock price fluctuations. At the date of grant, 60% of these options vested immediately and the remaining 40% vest over two to four years. As of

2003, all of these options, which aggregate to 265,624, are fully vested. Total compensation expense recorded was approximately $12,000 in both fiscal years.

A summary of the status of the Plan and the nonqualified options and changes during fiscal years ended 2004 and 2003 are as follows:

	Number of shares	Weighted Average Exercise Exercise
OUTSTANDING, December 28, 2002	797,724	$ 1.71
Granted	-	-
Forfeited	(99,000)	$ 2.25
OUTSTANDING, December 27, 2003	698,724	$ 1.63
Granted	150,000	$ 2.10
Forfeited	(9,050)	$ 2.17
OUTSTANDING, December 25, 2004	839,674	$ 1.72

At December 25, 2004, 25,950 shares were available for future grants under the Plan. The number of options exercisable were 523,144 and 451,484 as of December 25, 2004 and December 27, 2003, respectively.

SPECTRUM LABORATORIES, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

NOTE 6. STOCK OPTION PLAN (Continued)

A further summary of options outstanding at December 25, 2004 is as follows:

Options Outstanding				Options Exerc	
Exercise Prices	Number of options	Weighted average exercise price	Weighted average remaining contractual life in years	Number of options	
$ 1.20	265,624	$ 1.20	5.67	265,624	$

1.53	225,000	1.53	7.56	90,000
1.88	400	1.88	2.84	400
2.10	150,000	2.10	9.94	-
2.13	159,400	2.13	5.37	127,520
2.18	10,000	2.18	1.48	10,000
2.20	3,600	2.20	2.02	3,600
3.20	20,150	3.20	0.96	20,500
4.37	5,000	4.37	1.11	5,000
7.50	500	7.50	1.79	500
	839,674			523,144

NOTE 7. WARRANTS

During the first quarter of 2004 the Company issued warrants to a third party (the Warrant Holder) to purchase 125,000 shares of common stock at $1.70 per share through February 4, 2010 with a fair value of $130,000. The Warrant Holder is entitled to purchase an additional 125,000 shares of common stock at $1.70 upon having assisted Spectrum in raising at least $2.5 million in gross proceeds from one or more private or public equity financings originated or facilitated by the Warrant Holder through February 3, 2010. Spectrum's estimate of the fair value of the first 125,000 warrants granted were made using the Black-Scholes warrant-pricing model with the following weighted average assumptions: expected life of three years; stock volatility of 66%; risk-free interest rate 2.5%; and no dividends during the expected term.

Based on the Black-Scholes warrant-pricing model Spectrum and the Board of Directors decision not to actively pursue either private or public equity financing at this time Spectrum has recorded $130,000 in warrant related expense in the third quarter associated with the 125,000 warrants issued during the first quarter. If Spectrum is successful in the future, in raising the required $2.5 million, with the Warrant Holder's assistance, the additional 125,000 warrants will vest immediately upon issuance and the Company will measure the warrants using the Black-Scholes warrant pricing model and the fair value of the warrants will be charged against the proceeds at that time.

NOTE 8. RELATED-PARTY TRANSACTIONS

ROYALTY AGREEMENT - The Company is committed under a royalty agreement to pay the majority stockholder royalties of 7% of the net sales of certain products, as defined, through the life of the defined products. During 2004 and 2003, the Company incurred royalty expenses of $304,000 and $312,000, respectively, under this agreement.

The Company's Chairman of the Board of Directors and Chief Executive Officer is also on the Board of Directors of Arbios Systems, Inc. in which Spectrum holds marketable securities.

NOTE 9. COMMITMENTS, RENT EXPENSE AND OTHER AGREEMENTS

LEASE COMMITMENTS AND RENT EXPENSE - The Company is obligated under the terms of various operating lease agreements for manufacturing, warehouse and office facilities thru December 2006. Certain of these leases provide for rent escalation adjustments. Rent expense was $525,000 and $491,000 in fiscal years 2004 and 2003, respectively. Minimum future rental payments under these operating lease agreements for the years ending on the last Saturday of the calendar year December 31 are as follows: 2005 $566,000; 2006 $106,000; (total $672,000). The Company anticipates it will be extending its lease on its principal facility located California upon its current termination date of July 2005.

NOTE 10. GEOGRAPHIC INFORMATION

Net sales by country for fiscal years ended 2004 and 2003 are as follows:

	2004	2003
United States	$ 9,924,000	$ 9,527,000
Japan	696,000	634,000
Other countries, each of which represent less than 5% of total net sales	2,630,000	2,383,000
	$ 13,250,000	$ 12,544,000

There were no significant assets held outside the United States at December 25, 2004 or December 27, 2003. Sales to Japan are denominated in U.S. dollars and there are no material differences in gross margin in sales to different countries.

NOTE 11. MAJOR CUSTOMERS

Net sales for fiscal years 2003 and 2002 include sales to the following major customers (each of which accounted for 10% or more of the total sales of the Company) together with the receivables due from those customers as of December 25, 2004 and December 27, 2003:

	2004		2003	
	NET SALES	TRADE ACCOUNTS RECEIVABLE	Net Sales	Trade Accounts Receivable
Customer A	$ 1,733,000	$ 309,000	$ 1,639,000	$ 267,000
Customer B	$ 1,602,000	$ 220,000	$ 1,675,000	$ 232,000

NOTE 12. PREFERRED STOCK OF SUBSIDIARY

On October 1, 1996, SLI Acquisition Corp., (SLIAC), a subsidiary of the Company, entered into an Asset Purchase Agreement with Cellco, Inc., a Delaware corporation, and acquired the operating assets and liabilities of Cellco, Inc. in exchange for 10,000 shares of the subsidiary's preferred stock valued at $2,000,000 for redemption purposes. One of the subsidiary's preferred stockholders sold its stock with a carrying value of $245,000 to the Company in 1999. At December 25, 2004, there is $1,755,000 in preferred stock of the subsidiary outstanding. The preferred stockholders of the subsidiary had the right to put their stock to SLIAC at any time through September 30, 2001 for an aggregate price of $1,755,000. In the event the subsidiary is combined with the Company and the combined company completes an underwritten offering, the preferred stockholders have the right to exchange such stock for 7% of the newly combined company. The preferred shares of SLIAC are nonvoting and have preference over common stockholders as to dividends and liquidation.

NOTE 13. SUPPLEMENTAL DISCLOSURE OF CASH FLOW INFORMATION

	2004	2003
Cash paid for:		
Income (refunds) taxes	$ (116,000)	$ (33,000)
Interest	$ 107,000	$ 140,000

NOTE 14. PRODUCT GROUP INFORMATION

The Company's product groups are based on specific product characteristics and are grouped into bioprocessing/laboratory products, original equipment manufacturing ("OEM") and operating room disposable products. Bioprocessing/laboratory products consist primarily of (1) hollow fiber membrane devices that allow components retained by a membrane to be concentrated, including filters utilized for micro and ultra filtration separations that are sold to biotech and pharmaceutical companies. (2) membranes used to concentrate, separate and purify dissolved or suspended molecules that are sold primarily to laboratories. OEM principally consists of manufacturing hollow fiber membrane devices to certain customer's specifications. Operating room disposable products consist of sterile plastic surgical drapes and cloth bandages that are used primarily by hospitals.

Revenue by product group is as follows:

	2004	2003
Bioprocessing/laboratory products	$ 9,142,000	$ 8,918,000
Original equipment manufacturing	2,464,000	1,995,000

Operating room disposable products	1,644,000	1,631,000
	$ 13,250,000	$ 12,544,000

NOTE 15. FOURTH QUARTER ADJUSTMENTS

The Company incurred a physical inventory pre tax loss of approximately $185,000 in the fourth quarter of 2004, resulting in a total fourth quarter 2004 pre tax loss of $178,000. In addition the Company estimates its taxes during the first three quarters of the year based on prior year's tax rate. A detailed tax analysis is prepared based on the annual results and applicable taxes recorded. This analysis resulted in a annual tax expense of $143,000 for fiscal year 2004 resulting in a tax benefit of $85,000 being recorded in the fourth quarter.

NOTE 16. SUBSEQUENT EVENT

The Board of Directors of Spectrum elected on October 6, 2004 to amend its Certificate of Incorporation to effect a 1 for 25,000 reverse stock split. Stockholders, subsequent to the reverse stock split, holding fractional shares, would be paid $2.56 per share for each pre reverse stock split share. The Board of Directors then elected to effectuate a going private transaction as subsequent to the reverse stock split the Company anticipates it will only have 3 shareholders.

To effectuate the above transactions Spectrum filed a Schedule 14C Information Statement with the Securities and Exchange Commission ("SEC") on October 12, 2004 and has filed amendments with the latest amended Schedule 14C filed on September 7, 2005 In addition the Company filed a Schedule 13E-3 Transaction Statement on October 13, 2004 with the latest amended Schedule 13E-3A being filed on September 7, 2005. The Company has recognized approximately $65,000 in expense as of December 25, 2004 relating to going private.

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SPECTRUM LABORATORIES, INC.

SCHEDULE II: VALUATION AND QUALIFYING ACCOUNT INFORMATION

	Fiscal year	Balance at beginning of year	Provision charged to expense	Net recoveries (charge-offs)	Balance at end of yea
Doubtful Accounts:	2004	$ 110,000	$ 63,000	$ (37,000)	$ 136,00
	2003	$ 119,000	$ --	$ (9,000)	$ 110,00
Sales returns & allowances	2004	$ 30,000	$ 30,000	$ --	$ 60,00

	2003	$ 30,000	$ --	$ --	$ 30,00
Slow moving and obsolete inventory:	2004	$ 627,000	$ 39,000	$ (44,000)	$ 622,00
	2003	$ 669,000	$ --	$ (42,000)	$ 627,00
Deferred Tax Assets	2004	$ 1,500,000	$ --	$ --	$ 1,500,00
	2003	$ 1,500,000	$ --	$ --	$ 1,500,00

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