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

FORM 10-QSB

(Mark One)

☒ Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the quarter ended July 31, 2003

☐ Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the transition period from to

Commission file number **0-28698**

SETO HOLDINGS, INC,

(Exact name of small business issuer as specified in its charter)

Nevada	**77-0082545**
(State or other jurisdiction of incorporation or organization)	(I.R.S.) Employer Identification Number

554 North State Road, Briarcliff Manor, New York, 10510

(Address of principal executive offices)

Registrant's telephone number, including area code **(914) 923-5000**

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

Indicate by check mark whether registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes ☒ No ☐

Class	Outstanding at July 31, 2003
Common stock $.001 par Value	13,751,300

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SETO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENT OF INCOME
SIX AND THREE MONTHS ENDED JULY 31, 2003 AND 2002
(UNAUDITED)

	Six Months Ended July 31		Three Months Ended July 31	
	2003	2002 Restated	2003	2002 Restated
Net revenues	**$ 1,960,608**	**$ 3,382,083**	**$ 939,423**	**$ 1,928,518**
Cost of sales	742,791	1,470,024	329,095	875,728
Gross margin	**1,217,817**	**1,912,059**	**610,328**	**1,052,790**
Operating expenses:				
Selling, general and administrative expenses	1,071,997	975,476	569,142	479,850
Amortization of acquisition-related intangibles	30,000	0	15,000	0
Operating expenses	1,101,997	975,476	584,142	479,850
Operating income	**115,820**	**936,583**	**26,186**	**572,940**
Interest and other, net	39,630	(67,196)	3,000	(3,053)
Income before income taxes (benefit)	**155,450**	**869,387**	**29,186**	**569,887**
Income taxes (benefit)	27,511	(61,324)	4,950	5,757
Income from continuing operations	**127,939**	**930,711**	**24,236**	**564,130**
Discontinued operations:				
Income (loss) from operations of subsidiaries	(1,608)	(71,564)	(269)	(76,800)
Loss on disposal of subsidiaries	0	(28,846)	0	(22,240)
	(1,608)	(100,410)	(269)	(99,040)
Net income	**$ 126,331**	**$ 830,301**	**$ 23,967**	**$ 465,090**
Earning per share information:				
Income from continuing operations				
Basic	**$ 0.01**	**$ 0.06**	**$ 0.00**	**$ 0.04**
Diluted	**$ 0.01**	**$ 0.06**	**$ 0.00**	**$ 0.04**
Discontinued operations:				
Basic	**($0.00)**	**($0.01)**	**($0.00)**	**($0.01)**
Diluted	**($0.00)**	**($0.01)**	**($0.00)**	**($0.01)**
Weighted average common shares outstanding	**14,308,246**	**14,783,400**	**14,259,998**	**14,783,400**
Weighted average common shares outstanding, assuming dilution	**14,308,246**	**14,783,400**	**14,259,998**	**14,783,400**

SETO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED BALANCE SHEET — JULY 31, 2003
(UNAUDITED)

ASSETS	
CURRENT ASSETS	
Cash and cash equivalents	$ 164,254
Accounts receivable	565,330
Note receivable	364,193
Inventory	887,416
Prepaid expenses and other current assets	42,172
Deferred tax asset, current portion	229,261
Net assets of discontinued operations, less liabilities	36,100
TOTAL CURRENT ASSETS	**2,288,726**
PROPERTY, PLANT AND EQUIPMENT, NET OF DEPRECIATION	**636,302**
OTHER ASSETS	
Deferred product development costs	256,671
Goodwill	85,453
Other intangible asset	260,000
Security deposits and other assets	11,039
Deferred tax asset, net of current portion	170,309
TOTAL OTHER ASSETS	**783,472**
TOTAL ASSETS	**$ 3,708,500**
LIABILITIES AND STOCKHOLDERS' EQUITY	
CURRENT LIABILITIES	
Note payable, line of credit	$ 167,600
Accounts payable	137,445
Accrued expenses	201,579
TOTAL CURRENT LIABILITIES	**506,624**
OTHER LIABILITIES	
Deferred lease liability	31,500
TOTAL OTHER LIABILITIES	**31,500**
STOCKHOLDERS' EQUITY	
Common stock par value $.001; 100,000,000 shares authorized; 13,934,100 shares issued	13,934
Additional paid in capital	4,522,434
Accumulated other comprehensive income	(150,522)
Retained earnings (deficit)	(1,171,581)
	3,214,265
Less common shares held in treasury, 182,800 shares at cost	(43,889)
TOTAL STOCKHOLDERS' EQUITY	**3,170,376**
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$ 3,708,500**

SETO HOLDINGS, INC. AND SUBSIDIARIES
CONSOLIDATED CONDENSED STATEMENT OF CASH FLOWS
SIX MONTHS ENDED JULY 31, 2003 AND 2002
(UNAUDITED)

	2003	2002 Restated
OPERATING ACTIVITIES		
Income from continuing operations	$ 127,939	$ 930,711
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	53,219	71,921
Amortization and impairment of intangibles and other acquisition-related costs	30,000	
Gain on sale of equipment	(31,749)	
Provision for deferred income taxes	20,356	(70,000)
Changes in assets and liabilities:		
Accounts receivable	320,645	(182,622)
Inventories	12,996	(142,428)
Prepaid expenses and other current assets	(11,748)	65,011
Deferred product development costs	(77,793)	
Other assets	(5,039)	(37,922)
Accounts payable, and accrued expenses	(132,136)	(211,986)
Deferred lease liability	3,000	3,000
NET CASH PROVIDED BY CONTINUING OPERATIONS	309,690	425,685
NET CASH PROVIDED BY (USED IN) DISCONTINUED OPERATIONS	4,535	(91,708)
NET CASH PROVIDED BY OPERATING ACTIVITIES	**314,225**	**333,977**
INVESTING ACTIVITIES		
Proceeds from sale of equipment	45,960	
Purchase of property and equipment	(83,973)	(93,253)
NET CASH USED IN INVESTING ACTIVITIES	**(38,013)**	**(93,253)**
FINANCING ACTIVITIES		
Decrease in short-term debt, net	(377,425)	(66,708)
Repayments of and retirement of long-term debt	(61,924)	(69,621)
Repurchase and retirement of common stock	(181,023)	(50,241)
NET CASH USED IN FINANCING ACTIVITIES	**(620,372)**	**(186,570)**
NET INCREASE (DECREASE) IN CASH	**(344,160)**	**54,154**
CASH, BEGINNING OF YEAR	**508,414**	**182,417**
CASH, END OF YEAR	**$ 164,254**	**$ 236,571**
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
CASH PAID DURING THE YEAR FOR:		
Interest	$ 4,793	$ 69,607
Income taxes	$ 15,769	$ 601

The Company acquired trade show equipment in the amount of $32,500 in a non-cash transaction with G Com.Net

SETO HOLDINGS, INC.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(UNAUDITED)

1. **PREPARATION OF INTERIM FINANCIAL STATEMENTS**

The consolidated financial statements have been prepared by SETO Holdings, Inc. (the “Company”) in conformity with accounting principles generally accepted in the United States and are consistent in all material respects with those applied in the Company’s Annual Report on Form 10-KSB for the year ended January 31, 2003. In the opinion of management, the Company’s interim financial statements include all adjustments (consisting of normal recurring accruals and adjustments necessary for adoption of new accounting standards) necessary to present fairly the results of the interim periods shown. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such Securities and Exchange Commission rules. Management believes that the disclosures made are adequate to make the information presented not misleading. The results for the interim periods are not necessarily indicative of results for the full year. The unaudited financial statements contained herein should be read in conjunction with the consolidated financial statements and notes thereto included in the Company’s January 31, 2003 Annual Report on Form 10-KSB. Certain amounts presented for the six months ended July 31, 2002 have been reclassified to conform to the current presentation.

The consolidated financial statements include the accounts of the Company and its subsidiaries, which are wholly owned. All significant intercompany transactions are eliminated in the consolidation process.

2. **RECENT ACCOUNTING PRONOUCEMENTS**

In May 2003, the Financial Accounting Standard Board issued Statement of Financial Accounting Standards (“SFAS”) No. 150, “Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity.” This statement establishes standards for how to classify and measure certain financial insturments with characteristics of both liabilities and equity. It requires certain financial instruments that are within the scope to be classified as a liability (or net asset in some circumstances), which previously were classified a equity. This statement is effective for financial statements entered into or modified after May 31, 2003, and otherwise is effective at the beginning of the first interim period beginning after June 15, 2003. The adoption of this statement is not expected to have a material impact on the Company's financial statements.

3. **NATURE OF OPERATIONS, RISKS AND UNCERTAINTIES**

The Company currently has a minuscule share of the dicing blade and ceramics market. There can be no assurance that the Company will be able to increase its market share or that the market demand will increase. Furthermore, the Company faces the possibility of adverse market conditions from technological changes, shifting product emphasis among competitors and the entry of new competitors in the market.

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents and accounts receivable. The Company places its cash and cash equivalents with high quality financial institutions.

Currency Risk. The Company transacts business in currencies other than the U.S. dollar, primarily the Malaysian Ringgit. The Malaysian Ringgit is pegged to the U.S. dollar therefore the Company has not established any transaction or balance sheet risk management programs. For foreign subsidiaries whose functional currency is the local foreign currency, balance sheet accounts are translated at exchange rates in effect at the end of the year and income statement accounts are translated at average exchange rates for the year. Acquisition related translation gains or losses are included as a separate component of shareholders’ equity. Exchange differences arising from foreign currency translation are included in the profit and loss account.

4. **INVENTORY**

Inventory at July 31, 2003 consists of:

Finished goods	$478,291
Work in Process	52,728
Raw Materials	339,939
Supplies	16,458
	$887,416

5. **GOODWILL**

The Company adopted SFAS No. 142 effective January 31, 2002 and accordingly, has ceased amortizing amounts related to goodwill starting January 31, 2002. The balance of goodwill is related to the Company's East Coast Sales Company segment. In accordance with SFAS No. 142, the Company has evaluated the fair value of its East Coast Sales segment and determined that none of the goodwill recorded was impaired. The fair value was determined using a reasonable estimate of future cash flows of the segment and a risk adjusted discount rate to compute a net present value of future cash flows.

6. **IDENTIFIED INTANGIBLE ASSETS**

On December 1, 2002, the Company acquired the customer lists from a Malaysian Company for $300,000, to be amortized over a period of 5 years. The Company's identified intangible assets are subject to amortization. Amortization of identified intangible assets amounted to $30,000 and $0 for the six months ended July 31, 2003 and 2002, respectively.

7. **NOTES PAYABLE AND LONG-TERM DEBT**

The Company has an available line-of-credit with a financial institution in the amount $1,700,000. The line-of-credit carries an annual rate of 2.9% plus the 30-day commercial paper rate with an expiration date of October 31, 2003. As of July 31, 2003, the Company had utilized $167,600 of the line-of-credit. The personal guarantee of the Company's president and the assets of the Company secure the line-of-credit.

8. **INTEREST AND OTHER, NET**

Interest and Other, net included:

	Six Months Ended		Three Months Ended	
	July 31, 2003	July 31, 2002 Restated	July 31, 2003	July 31, 2002 Restated
Interest income	$ 19,878	$ 14,425	$ 9,955	$ 8,620
Gain on sale of assets	31,749			
Interest expense	(11,391)	(80,862)	(6,598)	(11,255)
Foreign currency exchange income (loss)	(606)	(759)	(357)	(418)
Total	$ 39,630	($67,196)	$ 3,000	($3,053)

9. **COMMITMENTS AND CONTINGENCIES**

The Company is obligated under a lease agreement with an entity owned by an officer of the Company, which expires on April 30, 2013. Annual rent expense is as follows; $60,000 for each of the first five years, $66,000 for the second five years and $72,000 for each of the final five years. The Company is also obligated for insurance and the increase in real estate taxes over the base year as stipulated in the lease. This lease requires the following future minimum rental payments:

July 31, 2004	$ 66,000
July 31, 2005	66,000
July 31, 2006	66,000
July 31, 2007	67,500
July 31, 2008	72,000
Thereafter	342,000
	$679,500

Rent expense charged to operations was $35,500 and $33,000 in Q2 2004 and Q2 2003, respectively.

10. **EARNINGS PER SHARE**

The following reconciles the number of common shares outstanding at July 31 of 2003 and 2002 to the weighted average number of common shares outstanding for the purposes of calculating basic and dilutive earnings per share:

	Six Months Ended July 31		Three Months Ended July 31	
	2003	**2002 Restated**	**2003**	**2002 Restated**
Weighted average common shares outstanding	14,308,246	14,783,400	14,259,998	14,783,400
Effect of using diluted securities:				
Weighted average common equivalent shares from stock options				
Diluted number of common shares outstanding	14,308,246	14,783,400	14,259,998	14,783,400

At July 31, 2003 there were approximately 6,000,000 million shares of common stock potentially issuable with respect to stock options, which could dilute basic earnings per share in the future.

11. **STOCK REPURCHASE PROGRAM**

During the first six months of fiscal 2004, the Company repurchased 733,400 shares of common stock under the Company's authorized repurchase program at a cost of $181,023 and cancelled 624,300 shares. On June 27, 2003 the Company with unanimous consent of its board of directors, increased its stock repurchase program from one million shares to two and a half million shares. As of July 31, 2003 a total of 1,517,300 shares remained available for repurchase under the program.

12. **DISPOSITION OF SUBSIDIARY**

On February 1, 2001, the Company adopted a formal plan to sell Fuji Fabrication, SDN, BHD. On October 1, 2001, the assets of Fuji Fabrication, which consisted primarily of inventory and equipment, were sold for $290,547 with the Company assuming a note for the full amount of the selling price. On October 1, 2002 the Company recast the note for $396,693, which included the sales of additional inventory and previously accrued interest. Interest on the note is stated at 10% (annually) and is payable in 12 monthly installments. On July 1, 2003 the company received $32,500 in equipment which was offset against the note receivable at July 31, 2003. The note is payable in full on September 30, 2003.

Fuji Fabrication had no sales for the six months ended July 31, 2003 and 2002. General and administrative expenses for the six months ended July 31, 2003 and 2002 totaled $1,608 and $4,555, respectively. The company expects to cease all operations by October 31, 2003.

13. **PRINCIPAL PRODUCTS AND SEGMENTATION OF SALES**

The Company has adopted FASB Statement No. 131, "Disclosures about Segments of a Business Enterprise and Related Information." The Company is managed in three principal operating segments, which are (1) custom cut and fabricated ceramic parts for the aircraft, aerospace, defense, detection/protection industries, (2) the manufacturing of disposable precision diamond cutting tools for the semiconductor and electronics industries, and (3) contract manufacturing of personal safety devices. These operating segments were determined based on the nature of the products and services offered. Operating segments are defined as components of an enterprise about which separate financial information is available and is evaluated regularly by the chief operating decision-maker (CEO) to decide how to allocate resources and to assess performance.

Operating segments do not record inter-segment revenue, and, accordingly, there is none to be recorded. The accounting policies for segment reporting are the same as for the Company as a whole. Financial information relating to the principal industry segments and classes of products are as follows:

	Six Months Ended July 31		Three Months Ended July 31	
	2003	2002 Restated	2003	2002 Restated
Sales to customers:				
Industry A — Ceramics	$1,506,165	$2,575,127	$767,635	$1,569,788
Industry B — Diamond tools	262,573	433,365	50,816	170,481
Industry C — Contract manufacturing	191,870	373,591	120,972	188,249
	$1,960,608	$3,382,083	$939,423	$1,928,518

	Six Months Ended July 31		Three Months Ended July 31	
	2003	2002 Restated	2003	2002 Restated
Operating income or (loss):				
Industry A — Ceramics	$ 284,881	$ 977,661	$ 160,034	$607,689
Industry B — Diamond tools	(163,457)	(107,973)	(135,464)	(62,423)
Industry C — Contract manufacturing	(5,604)	66,895	1,616	27,674
	$ 115,820	$ 936,583	$ 26,186	$572,940

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	Six Months Ended July 31		Three Months Ended July 31	
	2003	2002 Restated	2003	2002 Restated
Sales to customers:				
United States	$1,205,432	$2,340,895	$523,567	$1,331,184
Far East	67,970	62,036	31,500	3,645
Canada	687,206	979,152	384,356	593,689
	$1,960,608	$3,382,083	$939,423	$1,928,518

Net property, plant and equipment by country were as follows:

	2003	2002 Restated
United States	$234,929	$208,497
Far East	401,373	430,627
	$636,302	$639,124

Three customers each accounted for more than 10% of total sales and together accounted for approximately 64% and 67% of total sales for the six and three months ended July 31, 2003.

14. **RESTATEMENT OF PRIOR YEAR RESULTS**

In fiscal 2003, due to China's acceptance into the World Trade Organization (WTO), the Company disposed of its Hong Kong Batteries Industries Ltd. operating segment. With China being accepted into the WTO, Hong Kong Batteries Industries' customers were now able to purchase comparable products manufactured in mainland China for considerably lower prices than Hong Kong Batteries was charging. Accordingly, the accompanying consolidated financial statements for Q2 2003 have been restated from those originally reported to reflect the discontinuance of Hong Kong Batteries Industries Ltd. As a result, income from continuing operations for Q2 2003 increased $57,880 and the loss from discontinued operations increased by $57,880. In addition, the diluted number of common shares outstanding of 13,158,400 shares used in the calculation of earnings per diluted shares of common stock was incorrect. The correct amount should have been 14,783,400. Earnings per share were not materially affected in both cases.

The following illustrates the effect of the above mentioned restatements:

	Six Months Ended July 31, 2002		Three Months Ended July 31, 2002	
	As Originally Reported	As Restated	As Originally Reported	As Restated
Net revenues	$ 3,828,761	$ 3,382,083	$ 1,992,922	$ 1,928,518
Cost of sales	1,838,558	1,470,024	930,742	875,728
Gross margin	1,990,203	1,912,059	1,062,180	1,052,790
Operating expenses	1,111,911	975,476	555,787	479,850
Operating income	878,292	936,583	506,393	572,940
Interest and other, net	(66,785)	(67,196)	(2,841)	(3,053)
Income before income taxes (benefit)	811,507	869,387	503,552	569,887
Income taxes (benefit)	(61,324)	(61,324)	5,757	5,757
Income from continuing operations	872,831	930,711	497,795	564,130
Discontinued operations:				
Income (loss) from operations of subsidiaries	(4,555)	(71,564)	(1,336)	(76,800)
Gain (loss) on disposal of subsidiaries	(37,975)	(28,846)	(31,369)	(22,240)
	(42,530)	(100,410)	(32,705)	(99,040)
Net income (loss)	$ 830,301	$ 830,301	$ 465,090	$ 465,090
Earning per share information:				
Income from continuing operations				
Basic	$ 0.06	$ 0.06	$ 0.03	$ 0.04
Diluted	$ 0.06	$ 0.06	$ 0.03	$ 0.04
Discontinued operations:				
Basic	($0.00)	$ 0.00	($0.00)	$ 0.00
Diluted	($0.00)	$ 0.00	($0.00)	$ 0.00
Weighted average common shares outstanding	14,783,400	14,783,400	14,783,400	14,271,000
Weighted average common shares outstanding, assuming dilution	14,783,400	14,783,400	14,783,400	14,271,000

Statement of cash flows:

	July 31,2002	
	As Originally Reported	**As Restated**
OPERATING ACTIVITIES		
Income from continuing operations	$ 872,831	$ 930,711
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	88,000	71,921
Provision for deferred income taxes	(70,000)	(70,000)
Changes in assets and liabilities:		
Accounts receivable	(279,819)	(182,622)
Inventories	(142,428)	(142,428)
Prepaid expenses and other current assets	66,293	65,011
Other assets	(39,737)	(37,922)
Accounts payable, and accrued expenses	(400,904)	(211,986)
Deferred lease liability	3,000	3,000
NET CASH PROVIDED BY CONTINUING OPERATIONS	97,236	425,685
NET CASH PROVIDED BY DISCONTINUED OPERATIONS	(37,975)	(91,708)
NET CASH PROVIDED BY OPERATING ACTIVITIES	**59,261**	**333,977**
INVESTING ACTIVITIES		
Purchase of property and equipment	(93,253)	(93,253)
NET CASH USED IN INVESTING ACTIVITIES	**(93,253)**	**(93,253)**
FINANCING ACTIVITIES		
Increase (decrease) in short-term debt, net	(66,708)	(66,708)
Repayments of and retirement of long-term debt	(69,621)	(69,621)
Repurchase and retirement of common stock	(50,241)	(50,241)
NET CASH USED IN FINANCING ACTIVITIES	**(186,570)**	**(186,570)**
NET INCREASE (DECREASE) IN CASH	**(220,562)**	**54,154**
CASH, BEGINNING OF YEAR	**543,072**	**182,417**
CASH, END OF YEAR	**$ 322,510**	**$ 236,571**

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

The "Strategy," "Critical Accounting Estimates" and "Outlook" sections all contain a number of forward-looking statements, all of which are based on our current expectations. Our actual results may differ materially. These statements do not reflect the potential impact of any mergers, acquisitions, divestitures or other business combinations that had not closed as of September 10, 2003.

Recent Developments

We are currently restating our previously issued financial statements for the two years ended January 31, 2002, including the corresponding fiscal 2002 and 2003 quarterly periods. The impact of the restatement on such prior periods was reflected as an adjustment to opening retained earnings as of February 1, 2001. The restatement will be reported in Amendment No. 1 to the Company's Annual Report on form 10-KSB/A for the years ended January 31 2001 and Amendment No. 1 to the Company's Quarterly Reports on Form 10-QSB/A for the quarterly periods ended April 30, 2002 and 2001, July 31, 2002 and 2001, and October 31, 2002 and 2001.

Throughout the following Management's Discussion and Analysis of Financial Condition and Results of Operations, all amounts referencing prior periods and prior period comparisons reflect the balances and amounts on a restated basis.

Strategy

Our goal is to be a "niche" company, with the ability to provide products and services to a variety of larger corporations who need contract manufacturing and/or made-to-order products. Our primary areas of focus are the fabrication of ceramic parts for the airline security business and jet engine manufacturing along with cutting blades for silicon wafers.

All of our businesses operate in competitive environments characterized by the introduction of new products with lower prices. As part of our overall strategy, we use our relatively small size and ability to provide "niche" services for larger companies in order to compete vigorously in each relevant market segment. Our competition comes from established businesses as well as new entrants to the marketplace. The trend in the United States (U.S.) toward HomeLand Security will offer us new opportunities, but will result in more competition. Competition tends to increase pricing pressure on our products, which may mean that we must offer our products at lower prices than we had anticipated, resulting in lower profits. Because some of our customers already have established products, it is inherently difficult for us to compete against them. In addition, certain market segments in which we compete, such as dicing blade products, have experienced an overall economic decline, increasing the degree of competition within this market segment. When we believe it is appropriate, we will take various steps, including discontinuing older products and reducing prices, in order to increase acceptance of our products and to be competitive within each relevant market segment.

We plan to continue to cultivate new businesses and work with the security and chip making industries to expand our product lines.

East Coast Sales Company – East Coast Sales Company (ECS) operating segment specializes in the distribution and value-added fabrication of technical ceramic products for the airline security industry and jet engine manufacturers, and distributes clean room supplies and tools. Our strategy for ceramic fabrication is to increase our production efficiency by utilizing our foreign subsidiary's labor force and updating our machinery. After September 11th, East Coast Sales experienced an increase in demand for its ceramic products used in the manufacture of airport safety and detection devices. Our three major customers are developing new products which will require our ceramic products. In addition to airport security devices, our ceramic products are used in military defense equipment such as missiles, and by manufacturers of jet engines for both commercial and military use. To increase the acceptance and deployment of our ceramic products, we are focused on providing our customers with the highest quality products and services.

Semicon Tools and DTI Technology – Semicon Tools and DTI Technology operating segment's strategy is to produce quality diamond cutting tools for the semiconductor industry. We plan to improve the quality and capability of our diamond cutting products that we currently have on the market. We are currently consulting with an outside source in Taiwan to improve our manufacturing process and diamond tool technology. The diamond tool segment is very dependent on the semiconductor industry which over the last three years has experienced economic decline and is still not showing signs of growth. The diamond blades manufactured by DTI Technology are a vital part of East Coast Sale's ceramic fabrication process.

SETO Technology **–** SETO Technology's strategy is to provide contract-manufacturing services for personal electronic safety devices and to produce medical, automotive and mining safety devices. This segment is currently developing and selling medical training products, auto safety devices and safety helmets. Currently this segment's main product is a CPR training device used by the medical industry. We have five different models under contract on an exclusive and nondisclosure basis. SETO Technology has also contracted with a third party to develop and manufacture a safety helmet that we expect to bring to market in fiscal 2004. As of July 31, 2003 we have advanced a total of $256,671 to the developer who is producing the tooling and molds to be used in the manufacturing process of the helmet and other safety devices. We expect to start depreciating and expensing these costs when we begin producing the helmets in the fourth quarter of this fiscal year.

Critical Accounting Estimates

The methods, estimates and judgments we use in applying our accounting policies have a significant impact on the results reported in our financial statements. Some of these accounting policies require us to make difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. Our most critical accounting estimates include the assessment of recoverability of goodwill, which impacts write-offs of goodwill; valuation of inventory, which impacts gross margin; assessment of recoverability of long-lived assets, which primarily impacts gross margin when we impair assets or accelerate their depreciation; and recognition and measurement of current and deferred income tax assets and liabilities, which impacts our tax provision. Below we discuss these policies further, as well as the estimates and judgments involved. We also have other policies that we consider to be key accounting policies, such as our policy for revenue recognition; however, this policy does not meet the definition of critical accounting estimates because they generally require us to make estimates or judgments that are difficult or subjective.

Goodwill – According to our accounting policy we perform an annual impairment review in the fourth quarter of each year, or more frequently if indicators of potential impairment exist. Our most recent review was in the fourth quarter of fiscal 2003 (January 31, 2003). Our impairment review process is based on a discounted future cash flow approach that uses our estimates of revenue for the reporting unit, driven by assumed market growth rates and assumed segment share, and estimated costs as well as appropriate discount rates. These estimates are consistent with the plans and estimates that we use to manage the underlying business. In the future, we may incur charges for impairment of goodwill if the ceramic fabrication business experiences an economic downturn, new technology becomes available, we lose market acceptance, we fail to deliver new products, or if we fail to achieve our assumed revenue growth rates or assumed gross margin.

Inventory – Our policy for valuation of inventory, including the determination of obsolete or excess inventory requires us to estimate the future demand for our products within specific time horizons, generally one year or less. If our demand forecast for specific products is greater than actual demand and we fail to reduce manufacturing output accordingly, we could be required to record additional inventory reserves, which would have a negative impact on our gross margin.

Long-Lived Assets – We assess the impairment of long-lived assets when events or changes in circumstances indicate that the carrying value of the assets or the asset grouping is not recoverable. Factors that we consider in deciding when to perform impairment review include significant under-performance of a business or product line in relation to expectations, significant negative industry or economic trends, and significant changes in our use of the assets. Recoverability of assets that will continue to be used in our operations is measured by comparing the carrying amount of the assets grouping to the related total future net cash flows. If an assets grouping carrying value is not recoverable through those cash flows, the asset grouping is considered to be impaired. The impairment is measured by the difference between the assets' carrying amount and their fair value, based on the best information available, including market prices or discounted cash flow analysis.

Income Taxes – In determining income for financial statement purposes, we must make certain estimates and judgments. These estimates and judgments occur in the calculation of certain tax liabilities and in the determination of the recoverability of certain tax assets, which arise from temporary differences between the tax and financial statement recognition of revenue and expense. As of July 31, 2003, taxes were not provided on approximately $99,674 of undistributed earnings of foreign subsidiaries, as we invest or expect to invest the undistributed earnings indefinitely. If in the future these earnings are repatriated to the United States, or if we determine such earnings will be remitted in the foreseeable future, additional tax provisions would be required.

We must assess the likelihood that we will be able to recover our deferred tax assets. If recovery is not likely, we must increase our provision for taxes by recording a reserve, in the form of a valuation allowance, for the deferred tax assets that we estimate will not ultimately be recoverable. As of July 31, 2003, we believe that our recorded deferred tax assets will ultimately be recovered. However, should there be a change in our ability to recover our deferred tax assets; our tax provision would increase in the period in which we determine that the recovery is not probable.

In addition, the calculation of our tax liabilities involves dealing with uncertainties in the application of complex tax regulations. We recognize potential liabilities for anticipated tax audit issues in the U.S. and other tax jurisdictions based on our estimate of whether, and the extent to which, additional taxes will be due. If payment of these amounts ultimately proves to be unnecessary, the reversal of the liabilities would result in tax benefits being recognized in the period when we determine the liabilities are no longer necessary. If our estimate of tax liabilities proves to be less than the ultimate assessment, a further charge to expense would result.

Results of Operations – Second Quarter of Fiscal 2004 Compared to Second Quarter Fiscal 2003

The following table sets forth certain consolidated statements of income data as a percentage of net revenue for the quarter ended July 31, 2003 and 2002:

	Three Months Ended	
	July 31, 2003	**July 31, 2002 Restated**
Net revenues	**100.00%**	**100.00%**
Cost of sales	**35.04%**	**45.41%**
Gross margin	**64.96%**	**54.59%**
Selling, general and administrative expenses	**60.59%**	**24.89%**
Amortization of goodwill	**0.00%**	**0.00%**
Amortization and impairment of acquisition-related intangibles	**1.60%**	**0.00%**
Operating income	**5.91%**	**25.66%**

Our net revenue for Q2 2004 of $939,423 was down approximately 52% compared to Q2 2003, primarily due to the decrease in demand for our ceramic products used by the airline security manufacturing industry. Net revenue for our diamond tool segment was down 71% compared with Q2 2003 which is primarily due to the weak global semiconductor market. Our contract manufacturing revenues were down 36% compared with Q2 2003, primarily due to a technical change that a major customer is making to their personal safety device that SETO Technology manufactures for them. We expect to begin producing this new product in the latter part of Q3 this fiscal year.

Our gross margin percentage in Q2 2004 of 65% was up compared to 55% in Q2 2003. The gross margin for our diamond tool segment was higher compared to Q3 2003 primarily due to lower raw material costs; and our gross margins for our contract manufacturing segment was down, which was primarily due to the lack of sales volume. See "Outlook" for a discussion of gross margin expectations.

Ceramics — East Coast Sales Company

The revenue and operating income for the East Coast Sales Company operating segment for the second quarter of 2004 and 2003 were as follows:

	Q2 2004	Q2 2003 Restated
Revenue	$767,635	$1,569,788
Operating income (loss)	$160,034	$ 607,689

The East Coast Sales Company operating segment is our ceramics division, which experienced a decrease in sales due to the decreased demand from the airline security manufacturing industry. Net revenues for this segment decreased $802,153 or 51% in Q2 2004 compared to Q2 2003. The decrease in revenue was due to lower sales of custom cut ceramics that are used in airport security devices.

Net operating income for the East Coast Sales Company operating segment decreased by $447,655 or 74% compared to Q2 2003 primarily due to the decrease in demand from the industries mentioned above.

Diamond Tools – Semicon Tools/DTI Technology

The revenue and operating income for the diamond tool operating segment for the second quarter of 2004 and 2003 were as follows:

	Q2 2004	Q2 2003 Restated
Revenue	$ 50,816	$ 170,481
Operating income (loss)	($135,464)	($62,423)

Net revenue in Q2 2004 was down $119,665 or 71%, compared to Q2 2003. The net operating loss for Q2 2004 increased $73,041 or 117%, compared to Q2 2003. The increase in the net operating loss from fiscal Q2 2003 to Q2 2004 was primarily due to lower sales volume and we wrote off $75,000 in slow moving or obsolete inventory during the quarter.

Contract Manufacturing – SETO Technology

The revenue and operating income for the contract manufacturing operating segment for the second quarter of 2004 and 2003 were as follows:

	Q2 2004	Q2 2003 Restated
Revenue	$120,972	$188,249
Operating income (loss)	$ 1,616	$ 27,674

Net revenue for Q2 2004 was down $67,277 or 36%, compared to Q2 2003, primarily due to a major customer who is currently redesigning a product that SETO Technology produces. The lack of sales volume also contributed to the lower operating income of $1,616 we experienced in Q2 2004. Sales will continue to lag behind fiscal 2003 until the latter part of third quarter when we expect to begin production of our customer’s newly designed product.

Operating Expenses

Operating expenses for the second quarter of 2004 and 2003 were as follows:

	Q2 2004	Q2 2003 Restated
Selling, general and administrative expenses	$569,142	$479,850
Amortization and impairment of acquisition-related intangibles	$ 15,000	$ 0

Selling, general and administrative expenses increased $89,292, or 19% compared to Q2 2003. This increase was primarily due to higher administrative expenses such as insurance, travel and utilities expenses.

Amortization and impairment of acquisition-related intangibles increased $15,000 in Q2 2004 compared to Q2 2003, which was due to the amortization of the customer lists we purchased in fiscal 2002. If market conditions change and it is deemed that the customer lists do not have any future benefit and become impaired, we may write off the entire amount, which would have a negative effect on our operating income.

Interest and Other, Net

Interest and other, net and taxes for the second quarter of 2004 and 2003 were as follows:

	Q2 2004	Q2 2003 Restated
Interest income	$ 9,955	$ 8,620
Gain (loss) on sale of assets Interest expense	($6,598)	($11,255)
Foreign currency exchange loss	($357)	($418)
Provision for income taxes (benefit)	$ 4,950	$ 5,757

In Q2 2004, interest income increased primarily due to the payments we received on our note receivable from G-Com Net which was recast last fiscal year with a higher face value. (See "Discontinued Operations" below)

Interest expense decreased $4,657, or 42%, to $6,598 in Q2 2004 compared to $11,255 in Q2 2003. This decrease was primarily due to us paying down our line-of-credit during the second quarter of fiscal 2004. See "Financial Condition" section for a more detailed discussion of our financing activities.

Foreign currency exchange loss was relatively flat compared to Q2 2003. We experience currency translation gains or losses when we purchase items from foreign countries (other than Malaysia) whose currencies are not pegged to the U.S. Dollar. Historically, these gains and losses have been insignificant and therefore we do not expect any significant losses in the future.

Our effective income tax benefit was 52% in Q2 2004 compared to an effective income benefit of 43% for Q2 2003. The decrease in the effective tax benefit in Q2 2004 is primarily due to the decrease in net income from our U.S. operating segment East Coast Sales Company. Our effective tax benefit is a result of our net operating loss carryforward which we expect to realize the full benefit of our net operating loss carryover by fiscal 2005.

Results of Operations – First Half of Fiscal 2004 Compared to First Half Fiscal 2003

The following table sets forth certain consolidated statements of income data as a percentage of net revenue for the six months ended July 31, 2003 and 2002:

	Six Months Ended	
	July 31, 2003	July 31, 2002 Restated
Net revenues	**100.00%**	**100.00%**
Cost of sales	**37.89%**	**43.47%**
Gross margin	**62.11%**	**56.53%**
Selling, general and administrative expenses	**54.68%**	**28.85%**
Amortization of goodwill	**0.00%**	**0.00%**
Amortization and impairment of acquisition-related intangibles	**1.53%**	**0.00%**
Operating income	**5.90%**	**27.68%**

Our net revenue for the first half of fiscal 2004 of $1,960,608 was down approximately 42% compared to the first half of fiscal 2003, primarily due to the decrease in demand for our ceramic products used by the airline security manufacturing industry. Net revenue for our diamond tool segment was down 40% compared with the first six months of fiscal 2003 which is primarily due to the weak global semiconductor market. Our contract manufacturing revenues were down 49% compared with the first half of fiscal 2003, primarily due to a technical change that a major customer is making to their personal safety device that SETO Technology manufactures for them. We expect to begin producing this new product in the latter part of Q3 of this fiscal year.

Our gross margin percentage for the first half of fiscal 2004 of 62% was up compared to 57% in first half of fiscal 2003. The gross margin for our diamond tool segment was higher compared to the first half of fiscal 2003 primarily due to lower raw material costs; and our gross margins for our contract manufacturing segment was down, which was primarily due to the lack of sales volume. See “Outlook” for a discussion of gross margin expectations.

Ceramics — East Coast Sales Company

The revenue and operating income for the East Coast Sales Company operating segment for the first half of 2004 and 2003 were as follows:

	YTD 2004	YTD 2003 Restated
Revenue	$1,506,165	$2,575,127
Operating income (loss)	$ 284,881	$ 977,661

The East Coast Sales Company operating segment is our ceramics division, which experienced a decrease in sales due to the decreased demand from the airline security manufacturing industry. Net revenues for this segment decreased $1,068,962 or 42% in the first half of fiscal 2004 compared to the first half of fiscal 2003. The decrease in revenue was due to lower sales of custom cut ceramics that are used in airport security devices.

Net operating income for the East Coast Sales Company operating segment decreased by $692,780 or 71% compared to the first half of fiscal 2003 primarily due to the decrease in demand from the industries mentioned above.

Diamond Tools – Semicon Tools/DTI Technology

The revenue and operating income for the diamond tool operating segment for the first half of 2004 and 2003 were as follows:

	YTD 2004	YTD 2003 Restated
Revenue	$ 262,573	$ 433,365
Operating income (loss)	($163,457)	($107,973)

Net revenue for the first half of fiscal 2004 was down $170,792 or 40%, compared to the first half of fiscal 2003. The net operating loss for the first six months of fiscal 2004 increased $55,484 or 51%, compared to the first six months of fiscal 2003. The increase in the net operating loss from the first six months of fiscal 2003 to the first six months of fiscal 2004 was primarily due to much lower sales volume and we wrote off $75,000 in slow moving or obsolete inventory in second quarter.

Contract Manufacturing – SETO Technology

The revenue and operating income for the contract manufacturing operating segment first half of 2004 and 2003 were as follows:

	YTD 2004	YTD 2003 Restated
Revenue	$191,870	$373,591
Operating income (loss)	($5,604)	$ 66,895

Net revenue for the first six months of fiscal 2004 was down $181,721 or 49%, compared to the first six months of fiscal 2003, primarily due to a major customer who is currently redesigning a product that SETO Technology produces. The lack of sales volume also contributed to an operating loss of $5,604 we experienced in the first six months of fiscal 2004. Sales will continue to lag behind fiscal 2003 until the latter part of third quarter when we expect to begin production of our customer's newly designed product.

Operating Expenses

Operating expenses for the first six months of fiscal 2004 and 2003 were as follows:

	YTD 2004	YTD 2003 Restated
Selling, general and administrative expenses	$1,071,997	$975,476
Amortization and impairment of acquisition-related intangibles	$ 30,000	$ 0

Selling, general and administrative expenses increased $96,521, or 10% compared to the first six months of fiscal 2003. This increase was primarily due to higher administrative expenses such as insurance, travel and utilities expenses.

Amortization and impairment of acquisition-related intangibles increased $30,000 in the first six months of fiscal 2004 compared to the first six months of fiscal 2003, which was due to the amortization of the customer lists we purchased in fiscal 2002. If market conditions change and it is deemed that the customer lists do not have any future benefit and become impaired, we may write off the entire amount, which would have a negative effect on our operating income.

Interest and Other, Net

Interest and other, net and taxes for the first six months of 2004 and 2003 were as follows:

	YTD 2004	YTD 2003 Restated
Interest income	$ 19,878	$ 14,425
Gain (loss) on sale of assets	$ 31,749	
Interest expense	($11,391)	($80,862)
Foreign currency exchange loss	($606)	($759)
Provision for income taxes (benefit)	$ 27,511	($61,234)

In the first six months of fiscal 2004, interest income increased primarily due to the payments we received on our note receivable from G-Com Net which was recast last fiscal year with a higher face value. (See "Discontinued Operations" below)

In the first quarter of fiscal 2004 we sold some equipment in Malaysia for a gain of $31,749. The equipment consisted of an automobile and a dicing saw that our diamond tool segment DTI Technology sold.

Interest expense decreased $69471, or 86%, to $11,391 during the first six months of fiscal 2004 compared to $80,862 in the first six months of fiscal 2003. This decrease was primarily due to us paying down our line-of-credit during the second quarter of fiscal 2004 and the repayment of two equipment loans. See "Financial Condition" section for a more detailed discussion of our financing activities.

Foreign currency exchange loss was relatively flat compared to the first six months of fiscal 2003. We experience currency translation gains or losses when we purchase items from foreign countries (other than Malaysia) whose currencies are not pegged to the U.S. Dollar. Historically, these gains and losses have been insignificant and therefore we do not expect any significant losses in the future.

Our effective income tax benefit was 16% in Q2 2004 compared to an effective income benefit of 43% for the first six months ended fiscal 2003. The decrease in the effective tax benefit in the first six months of fiscal 2004 is primarily due to the decrease in net income from our U.S. operating segment East Coast Sales Company. Our effective tax benefit is a result of our net operating loss carryforward which we expect to realize the full benefit of our net operating loss carryover by fiscal 2005.

Discontinued Operations

As discussed below, in fiscal 2003, we have exited the business of manufacturing consumer electronic products and rechargeable and other batteries for consumer products. On February 1, 2001, we adopted a formal plan to sell Fuji Fabrication, Sdn. Bhd. On October 1, 2001; we sold the assets, which consisted primarily of inventory and equipment of Fuji Fabrication to G Com Net for $290,547. We assumed a 10% note for the full amount of the selling price which was due on September 30, 2002. On October 1, 2002 at the request of G Com Net, we increased the principal amount of the note to $396,693 due to sales of additional inventory and previously accrued interest and extended its maturity so the note is payable in full on September 30, 2003. Currently we believe G Com Net will repay the note on its due date. As of June 6, 2003, G Com Net is current with all interest payments required by the new note. If conditions change and there is a definite indication that the note is impaired we would then have to write off the note in full. This would have a negative effect on our net income (loss) from discontinued operations.

On October 31, 2002, we adopted a formal plan to discontinue the operations of Hong Kong Batteries Industries, Ltd. (Hong Kong Batteries). Hong Kong Batteries was a trading company that bought industrial batteries from manufacturers in mainland China and resold them to companies in Hong Kong, Asia and Europe. When China was approved for World Trade Organization Status (WTO) at the end of 2001, without our knowledge most of Hong Kong Batteries' suppliers hired English speaking sales and marketing managers and began to directly approach all the end user customers of Hong Kong Batteries. During the first and second quarters of fiscal 2003, Hong Kong Batteries was still receiving orders from its customers. Then during the third quarter it did not receive any orders and was informed by its customers that the Chinese suppliers offered substantial discounts if they bought their products directly from the Chinese manufacturers. After many discussions and meetings with the management of Hong Kong Batteries, we could not overcome the problem and decided to cease operations as soon as possible due to the lack of revenue and the high overhead cost we would have incurred if we continued operating. The discontinuance of Hong Kong Batteries Industries, Ltd resulted in us writing off $688,183 in goodwill and incurring an additional $225,759 in disposal costs, which consisted mainly of the write off of cash advances to Hong Kong Batteries and travel expenses.

In conjunction with the discontinuance of the operations of Fuji Fabrication and Hong Kong Batteries, we have accrued $34,000 for additional estimated disposition costs. As of July 31, 2003 we have incurred $34,269 in expenses relating to the disposition of Fuji Fabrication and Hong Kong Batteries.

The components of income (loss) from discontinued operations of subsidiaries are as follows:

Fuji Fabrication

	Six Months Ended July 31		**Three Months Ended July 31**	
	2003	**2002 (Restated)**	**2003**	**2002 (Restated)**
Net sales		$ 0		$ 0
Cost of sales		0		0
Gross income (loss)	0	0	0	0
Selling, general and administrative expenses	1,608	4,555	1,336	3,219
Other income (expense)	0	0	0	0
Net income (loss)	($1,608)	($4,555)	($1,336)	($3,219)

Hong Kong Batteries

	Six Months Ended July 31		Three Months Ended July 31	
	2003	2002 (Restated)	2003	2002 (Restated)
Net sales	$0	$ 446,678	$0	$ 64,404
Cost of sales	0	368,534	0	55,014
Gross income (loss)	0	78,144	0	9,390
Selling, general and administrative expenses	0	117,693	0	57,195
Other income (expense)	0	(27,460)	0	(27,659)
Net income (loss)	$0	($67,009)	$0	($75,464)

Financial Condition

Our financial condition remains strong. At July 31, 2003, cash totaled $164,254, down from $508,414 at January 31, 2003. We used cash to pay off existing equipment loans totaling $61,924, and $181,023 was used for our stock repurchase program. At July 31, 2003, total short-term and long-term debt was $473,328, a decrease of $633,281 compared to January 31, 2003. At July 31, 2003, total debt was $473,328 which represented 15% of stockholders' equity.

For the first six month of fiscal 2004, cash provided by operating activities was $351,792, compared to $333,977 for the first six months of fiscal 2003. Cash was provided by net income adjusted for non-cash related items. Working capital uses of cash included an increase in prepaid expenses, deferred product development costs and other assets and a decrease in accounts payable and accrued expenses. For the first six months of fiscal 2004, net cash provided by discontinued operations was $4,535, compared to cash used in discontinued operations of $91,708 in first six months of fiscal 2003. This increase was primarily due to the net loss that our discontinued subsidiary Hong Kong Batteries Industries, Ltd posted during the second quarter of fiscal 2003. For the first six months of fiscal 2004, our three largest customers accounted for approximately 64% of net revenue, with one of these customers accounting for approximately 35% of net revenue. At July 31, 2003, these three largest customers accounted for approximately 64% of net accounts receivable.

We used $38,013 in net cash for investing activities during the first six months of fiscal 2004, compared to $93,253 during the first six months of fiscal 2003. The decrease in cash used for investing activities as compared to fiscal 2003 was due to the sale of equipment during Q1 2004. Capital expenditures during the first six months of fiscal 2004 decreased $9,280 compared to fiscal 2003 primarily due to us postponing capital purchases until the third and fourth quarters of fiscal 2004. We anticipate capital expenditures of $200,000 for fiscal 2004.

We used $620,372 in net cash for financing activities during the first six months of fiscal 2004, which increased from $433,802 for the same period in fiscal 2003. The major financing uses of cash for the first six months of fiscal 2004 and 2003 were the repayment of debt and repurchase of our common stock. In fiscal 2004, we purchased 733,400 shares of our common stock for $181,023. Financing sources of cash of $272,575 during the first six months of fiscal 2004 were primarily from amounts we drew down on our revolving line-of-credit. In addition we paid back at total of $650,000 on the line of credit during the first six months of fiscal 2004. We have another potential source of liquidity from authorized borrowings in the form of a line-of-credit with a U.S. financial institution for $1.7 million. At July 31, 2003, we had $1,532,400 available for use from this line of credit.

We believe that we have the financial resources needed to meet our anticipated business requirements for the next 12 months, including capital expenditures for the expansion or upgrading of our manufacturing capacity and working capital requirements.

Outlook

In general, as we look ahead to the second half of fiscal 2004, the outlook continues to be uncertain, and we anticipate a year that will be largely driven by the airline security, military, jet engine and semiconductor industries as well as the global economy. Although it is difficult to predict product demand for the rest of fiscal 2004, we expect a 35% to 45% decrease in revenue from our ceramic segment, East Coast Sales Company. During the third quarter of fiscal 2004 we may be able to better forecast ceramic sales more accurately due to the Department of HomeLand Security issuing new orders for security devices. Some new orders did materialize during the second quarter but a lower volume than we anticipated, but we are expecting sales to increase slightly in the third and fourth quarters compared to the first six months six months of fiscal 2004. The outlook for the diamond tools industry continues to be weak. We have cut costs in order to compete with other manufacturers and we have improved the quality and capability of our diamond cutting products. The diamond tool industry is very dependent on the semiconductor industry, which over last three years has experienced economic decline and is still not showing signs of growth, but our other product lines such as scribes for LED’s and cutting services has been increasing slowly, as these items are also semiconductor related. We are currently interviewing and hiring new representatives to sell in new countries that we are not currently servicing. The outlook for the contract manufacturing segment remains strong, however, a major customer is currently redesigning its product that we manufacture and this had an adverse effect on our net revenue and operating profit for the first half and the third quarter of fiscal 2004. We expect to start producing the redesigned product by the latter part of the third quarter of this year. In addition, we have a contract with a third party to develop and manufacture a safety helmet that we expect to bring to market in late fiscal 2004. In this environment, revenue growth for our new safety helmet is largely dependent on the commercial acceptance of our current designs and successfully marketing the designs to the safety and rescue industries, which we can not assure.

Our financial results are substantially dependent on sales of ceramics and related products by the East Coast Sales Company operating segment. Revenue is partly a function of the mix of products we offer, all of which are difficult to forecast. Because of the changing conditions throughout the world our revenue is subject to the impact of economic conditions in various geographic regions.

Our gross margin expectation for fiscal 2004 is approximately 55% plus or minus a few points, which is a slight increase from the fiscal 2003 gross margin of 51%. Our gross margin varies depending on unit sales volumes and product mixes. Our policy for valuation of inventory, including the determination of obsolete inventory, requires us to estimate the future demand for our products within six months or less. The estimates of future demand that we use in the valuation of inventory are also used for near-term factory planning. If our demand forecast is greater than actual demand and we fail to reduce manufacturing output accordingly, we would likely be required to record additional inventory reserves, which would have a negative impact on our gross margin. Various other factors including unit sales volumes and new technologies will also continue to affect cost of sales and the variability of gross margin percentages.

In fiscals 2003 and 2002 we improved our cutting blade facility and updated our ceramics fabrication facility. We expect that capital spending will increase to $200,000 (down from 250,000) for fiscal 2004 from $ 124,785 in fiscal 2003. The increase is primarily due to the expected tooling equipment needed to produce our new safety helmet. If market demand does not grow or our new products are not accepted, revenues and gross margins may also be adversely affected.

Depreciation for fiscal 2004 is expected to be approximately $142,500, compared to $141,488 in fiscal 2003. Most of this increase would be included in cost of sales.

We expect amortization of other intangible assets to be approximately $60,000 in fiscal 2004, as compared to $10,000 in fiscal 2003. As of July 31, 2003 amortization expense totaled $30,000.

We review our acquisition-related intangible assets for impairment whenever indicators of potential impairment exist. We also review goodwill for impairment in the fourth quarter of each year, or earlier if indicators of potential impairment exist. If we fail to deliver products for this group, if our new products fail to gain market acceptance, or if market conditions in the ceramic business decline, our revenue and cost forecasts may not be achieved and we may incur charges for impairment of goodwill.

We expect our tax rate to be minimal for fiscal 2004. This estimate is lower than the rate in fiscal 2003, primarily due the anticipated decrease in net revenues from our East Coast Sales Company operating segment and the use of our available net operating loss carryover for federal income tax purposes. The expected rate is based on current tax law and is subject to change.

Our future results of operations and the other forward-looking statements contained in this “Outlook” section and in our “Strategy” and “Critical Accounting Estimates” sections involve a number of risks and uncertainties, in particular the statements regarding our strategies, our expectations regarding new products, future economic conditions, revenues, gross margin and costs, capital spending and depreciation and amortization. In addition to the factors discussed above, among the other factors that could cause actual results to differ materially are the following: business and economic conditions and trends in the airline security business, jet engine manufacturers, microchip industry, and safety industries in various geographic regions; possible disruption in commercial activities related to terrorist activity and armed conflict, such as change in logistics and security arrangements, and reduced end-user purchases relative to expectations; the impact of events outside the United States, such as the business impact of fluctuating currency rates, unrest or political instability in a locale; changes in customer order patterns; competitive factors and acceptance of new products in specific market segments; pricing pressures; excess or obsolete inventory and variations in inventory valuation and the spread of SARS illness could adversely affect our business and our customer order patterns.

We believe that we have the products, facilities, personnel and financial resources for continued business success, but future revenues, costs, margins and profits are all influenced by a number of factors, including those discussed above, all of which are inherently difficult to forecast.

Quantitative and Qualitative Disclosures about Market Risk

We are exposed to financial market risks, including changes in currency exchange rates and interest rates. We do not try to mitigate these risks by utilizing derivative financial instruments or other risky strategies.

A substantial majority of our revenue, expense, and capital purchasing activities are transacted in U. S. dollars. However, we do enter into these transactions in other currencies, primarily the Malaysian Ringgit. The Malaysian Ringgit is pegged to the U.S. Dollar and is translated to U.S. dollars for consolidated purposes. For the first half of fiscal 2004 we reported a foreign currency exchange loss of $606, compared to a loss of $759 for the first six months of fiscal 2003, neither of which materially impacted the financial statements.

Inflation has not had a material effect on our revenues and income from continuing operations in the past four years. Inflation is not expected to have a material future effect.

ITEM 3. CONTROLS AND PROCEDURES

Quarterly Controls Evaluation and Related CEO and CFO Certifications

Within the 90 days prior to the date of this Quarterly report on Form 10-QSB, the company evaluated the effectiveness of the design and operation of its “disclosure controls and procedures” (Disclosure Controls), and its “internal controls and procedures for financial reporting” (Internal Controls). The controls evaluation was done under the supervision and with the participation of management, including our Chief Executive Officer (CEO) and Chief Financial Officer (CFO).

Immediately following the Signatures of this Quarterly Report are certifications of the CEO and the CFO, which are required in accord with Rule 13a-14 of the Securities Exchange Act of 1934 (the Exchange Act). This Controls and Procedures section includes the information concerning the controls evaluation referred to in the certifications and it should be read in conjunction with the certifications for a more complete understanding of the topics.

Disclosure Controls and Internal Controls

Disclosure controls are procedures designed to ensure that information required to be disclosed in our reports filed under the Exchange Act, such as this Quarterly Report, is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission’s rules and forms. Disclosure Controls are also designed to ensure that such information is accumulated and communicated to our management, including the CEO and CFO, as appropriate to allow timely decisions regarding required disclosure. Internal Controls are procedures which are designed to provide reasonable assurance that (1) our transactions are properly authorized; (2) our assets are safeguarded against unauthorized or improper use; and (3) our transactions are properly recorded and reported, all to permit the preparation of our financial statements in conformity with generally accepted accounting principles.

Limitations on the Effectiveness of Controls

The company’s management, including the CEO and CFO, does not expect that our Disclosure Controls or our Internal Controls will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance, that the control system’s objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within the company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error of mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures. Because of the inherent limitations in a cost-effective control system, misstatements due to error or fraud may occur and not be detected.

Scope of the Controls Evaluation

The evaluation of our Disclosure Controls and our Internal Controls included a review of the controls’ objectives and design, the company’s implementation of the controls and the effect of the controls on the information generated for use in this Quarterly Report. In the course of the controls evaluation, we sought to identify data errors, control problems or acts of fraud and confirm the appropriate corrective action, including process improvements, were being undertaken. This type of evaluation is performed on a quarterly basis so that the conclusions of management, including the CEO and CFO, concerning controls effectiveness can be reported in Quarterly Reports on form 10-QSB and Annual Report on Form 10-KSB. Our Internal Controls are also evaluated on an ongoing basis by our CEO and CFO as well as our independent auditors who evaluate them in connection with determining their auditing procedures related to their report on our annual financial statements and not to provide assurance on our Internal Controls. The overall goals of these various evaluation activities are to monitor our Disclosure Controls and our Internal Controls, and to modify them as necessary; our intent is to maintain the Disclosure Controls and The Internal Controls as dynamic systems that change as conditions warrant.

Among other matters, we sought in our evaluation to determine whether there were any “significant deficiencies” or “material weaknesses” in the company’s Internal Controls, and whether the company identified any acts of fraud involving personnel with a significant role in the company’s Internal Controls. This information was important for both the controls evaluation generally, and because item 4 in the certifications of the CEO and CFO require that the CEO and CFO disclose that information to our audit committee and independent auditors, and report on related matters in this section of the Quarterly Report. In the professional auditing literature, “significant deficiencies” are referred to as “reportable conditions” which are issues that could have a significant adverse effect on the ability to record, process, summarize and report financial data in the financial statements. Auditing literature defines “material weakness” as a particularly serious reportable condition where internal control does not reduce to a relatively low level the risk that misstatements caused by error or fraud may occur in amounts that would be material in relation to the financial statements and the risk of such misstatements would not be detected within a timely period by employees in the normal course of performing their assigned functions. We also sought to deal with other controls matters in the controls evaluation, and in each case if a problem was identified, we considered what revision, improvement and/or correction to make in accordance with our ongoing procedures.

From the date of the controls evaluation to the date of this Quarterly Report, there have been no significant changes in Internal Controls or in other factors that could significantly affect Internal Controls, including corrective actions with regard to significant deficiencies and material weaknesses.

Conclusions

Based upon the controls evaluation, our CEO and CFO have concluded that, subject to the limitations noted above, our Disclosure Controls are effective to ensure that material information relating to SETO Holdings, Inc. and its consolidated subsidiaries is made known to management, including the CEO and CFO, particularly during the period when our periodic reports are being prepared, and that our Internal Controls are effective to provide reasonable assurance that our financial statements are fairly presented in conformity with generally accepted accounting principles.

ITEM 4. SIGNATURES AND CERTIFICATIONS OF THE CHIEF EXECUTIVE OFFICER AND THE CHIEF FINANCIAL OFFICER OF THE COMPANY

The following pages include the Signatures page for this Form 10-QSB, and certain certifications of the Chief Executive Officer (CEO) and the Chief Financial Officer (CFO) of the Company.

The certifications include references to an evaluation of the effectiveness of the design and operation of the company’s “disclosure controls and procedures” and its “internal controls and procedures for financial reporting.” Item 4 of part I of the Quarterly Report presents the conclusions of the CEO and the CFO about the effectiveness of such controls based on and as of the date of such evaluation of the company’s Audit Committee and independent auditors with regard to the deficiencies in internal controls and fraud and related matters (Items 5 and 6 of the certifications).

ITEM 6. EXHIBITS AND REPORTS ON FORM 8-K

a) Exhibits.

The following exhibits are filed in connection with this Report:

No.	Description
31.1	CEO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	CFO Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	CEO Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	CFO Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

b) Reports on 8-K. None.

SIGNATURES

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

SETO Holdings, Inc.
Registrant

By: **/s/ Eugene J. Pian**
Eugene J. Pian, President
President and Chief Executive Officer
Date: September 10, 2003

In accordance with the Exchange Act, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ Eugene J. Pian

Eugene J. Pian
President and Chief Executive Officer
Date: September 10, 2003

/s/ Craig A. Pian

Craig A. Pian
Executive Vice President and
Chief Financial Officer
Date: September 10, 2003