GERBER SCIENTIFIC INC
Form 10-Q
March 13, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended January 31, 2006

OR

¨ **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 1-5865

Gerber Scientific, Inc.

(Exact name of registrant as specified in its charter)

Connecticut	06-0640743
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
83 Gerber Road West, South Windsor, Connecticut	06074

(Address of principal executive offices)

(Zip Code)

Registrant's telephone number, including area code: (860) 644-1551

Indicate by check mark whether the 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 x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act)

Yes ¨ No x

Common stock $0.01 par value per share.

22,574,107

Total shares outstanding February 28, 2006

GERBER SCIENTIFIC, INC.
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Quarter Ended January 31, 2006

PART I - FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

GERBER SCIENTIFIC, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Quarter Ended January 31,	
In thousands except per share data	2006	2005
Revenue:		
Product sales	$ 109,324	$ 109,790
Service sales	15,288	14,998
	124,612	124,788
Costs and Expenses:		
Cost of products sold	78,233	79,275
Cost of services sold	9,120	9,289
Selling, general and administrative	28,427	28,564
Research and development	5,959	6,509
Restructuring charges	---	349
	121,739	123,986
Operating income	2,873	802
Other expense, net	(754)	(1,164)
Interest expense	(862)	(1,576)
Earnings (Loss) before income taxes	1,257	(1,938)
Provision (Benefit) for income taxes	1,349	(1,557)

Net loss	$ (92)	$ (381)
	=======	=======
Loss per share:		
Basic	$ 0.00	$ (0.02)
Diluted	$ 0.00	$ (0.02)
Weighted average shares outstanding:		
Basic	22,466	22,263
Diluted	22,466	22,263

See accompanying notes to condensed consolidated financial statements.

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GERBER SCIENTIFIC, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

In thousands except per share data	Nine Months Ended January 31, 2006	2005
Revenue:		
Product sales	$ 341,117	$ 339,772
Service sales	46,220	44,118
	387,337	383,890
Costs and Expenses:		
Cost of products sold	242,303	241,728
Cost of services sold	28,069	28,634
Selling, general and administrative	87,310	86,689
Research and development	18,789	18,730
Restructuring charges	(231)	2,594
	376,240	378,375

Operating income	11,097	5,515
Other expense, net	(1,437)	(2,600)
Loss on early extinguishment of debt	(2,483)	---
Interest expense	(3,818)	(5,326)
Earnings (Loss) before income taxes	3,359	(2,411)
Provision (Benefit) for income taxes	4,658	(1,639)
Net loss	$ (1,299)	$ (772)
	=======	=======
Loss per share:		
Basic	$ (0.06)	$ (0.03)
Diluted	$ (0.06)	$ (0.03)
Weighted average shares outstanding:		
Basic	22,371	22,255
Diluted	22,371	22,255

See accompanying notes to condensed consolidated financial statements.

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GERBER SCIENTIFIC, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

In thousands except share data	January 31, 2006	April 30, 2005
Assets		
Current Assets:		
Cash and cash equivalents	$ 5,055	$ 6,148
Accounts receivable, net of allowance for doubtful accounts of $8,731 and $9,421, respectively	81,932	89,800
Inventories	53,683	52,363

Current deferred tax assets	9,424	7,559
Prepaid expenses and other current assets	6,884	5,295
	156,978	161,165
Property, Plant and Equipment	105,914	122,444
Accumulated depreciation	(67,710)	(82,521)
	38,204	39,923
Intangible Assets:		
Goodwill	51,246	52,315
Pension intangible asset	1,692	1,692
Patents and other intangible assets, net	5,069	5,392
	58,007	59,399
Deferred Tax Assets	24,130	29,788
Other Assets	4,069	6,014
Total Assets	$ 281,388	$ 296,289
	========	========
Liabilities and Shareholders' Equity		
Current Liabilities:		
Current portion of long-term debt	$ 214	$ 29,482
Accounts payable	42,381	47,023
Accrued compensation and benefits	19,163	16,438
Deferred revenue	14,030	15,467
Income taxes payable	1,952	2,822
Advances on sales contracts	717	674
Other accrued liabilities	17,907	20,654
	96,364	132,560

Long-term debt	40,892	16,260
Accrued pension benefit liability	26,825	25,264
Other liabilities	5,945	6,399
	73,662	47,923
Commitments and contingencies		
Shareholders' Equity		
Preferred stock, $0.01 par value; authorized 10,000,000 shares; no shares issued	---	---
Common stock, $0.01 par value; authorized 100,000,000 shares; issued 23,206,127 and 22,983,654 shares, respectively	232	230
Additional paid-in capital	66,995	66,045
Retained earnings	66,586	67,885
Treasury stock, at cost (660,570 and 680,398 shares, respectively)	(13,583)	(13,991)
Unamortized value of restricted stock grants	(168)	(130)
Accumulated other comprehensive loss	(8,700)	(4,233)
	111,362	115,806
Total Liabilities and Shareholders' Equity	$ 281,388	$ 296,289
	========	========

See accompanying notes to condensed consolidated financial statements.

GERBER SCIENTIFIC, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Nine Months Ended January 31,	
In thousands	2006	2005
Operating Activities:		
Net loss	$ (1,299)	$ (772)
Adjustments to reconcile net loss to cash provided by operating activities:		
Depreciation and amortization	6,451	8,575
Restructuring charges	(231)	2,594
Deferred income taxes	3,793	(2,742)
Loss on early extinguishment of debt	2,483	---
Other non-cash items	1,597	1,591
Changes in operating accounts:		
Accounts receivable	5,212	12,180
Inventories	(2,360)	(3,764)
Prepaid expenses and other assets	(2,119)	1,287
Accounts payable and accrued liabilities	(2,511)	(3,498)
Provided by Operating Activities	11,016	15,451
Investing Activities:		
Capital expenditures	(6,365)	(4,322)
Investments in intangible assets	(573)	(369)
Proceeds from sale of assets	454	---
Used for Investing Activities	(6,484)	(4,691)
Financing Activities:		
Debt repayments	(268,430)	(238,881)
Debt proceeds	263,794	225,059
Net short-term financing	---	(126)

Debt issue costs	(1,146)	---
Proceeds from stock option exercises	1,144	150
Used for Financing Activities	(4,638)	(13,798)
Effect of exchange rate changes on cash	(987)	836
Decrease in cash and cash equivalents	(1,093)	(2,202)
Cash and cash equivalents at beginning of period	6,148	6,371
Cash and cash equivalents at end of period	$ 5,055	$ 4,169
	======	======

See accompanying notes to condensed consolidated financial statements.

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NOTE 1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Gerber Scientific, Inc. and its subsidiaries (collectively, the "Company") have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial statements and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all significant adjustments (consisting of normal recurring accruals) considered necessary for a fair statement have been included. Operating results for the quarter and nine months ended January 31, 2006 are not necessarily indicative of the results that may be expected for the year ending April 30, 2006. The financial information included in this Quarterly Report on Form 10-Q should be read in conjunction with the consolidated financial statements and notes in the Company's Annual Report on Form 10-K for the fiscal year ended April 30, 2005, filed with the Securities and Exchange Commission (the "SEC") on July 14, 2005. The condensed consolidated balance sheet has been derived from the April 30, 2005 audited consolidated financial statements, but does not include all of the information and disclosures required by accounting principles generally accepted in the United States of America for complete financial statements.

Certain reclassifications have been made to the prior year amounts to conform to the current year presentation. These included reclassifications of all warranty, installation, and training costs from Selling, General and Administrative Expense ("SG&A") to Cost of Products Sold and an improved allocation of the Sign Making and Specialty Graphics segment's overhead costs from SG&A to Cost of Products Sold.

NOTE 2. Stock Option Plans

The Company has stock option plans authorizing grants to officers and employees. The Company applies APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its stock options. No stock-based compensation cost related to stock options has been reflected in the net loss, as all options granted under these plans had an exercise price equal to the quoted market value of the underlying common stock on the date of the grant. The Company has adopted those provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" and Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure, an amendment of Statement of Financial Accounting Standards No. 123," which require the disclosure of pro forma effects on net income and earnings per share as if compensation cost had been recognized based upon the fair value method at the date of grant for options awarded.

The following table illustrates the effect on net loss and loss per share as if compensation cost had been recognized for the Company's stock based compensation based on the fair value of the options at the grant dates using the Black-Scholes (intrinsic value method) fair value method for option pricing:

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	Quarter Ended January 31,		Nine Months Ended January 31,	
In thousands except per share amounts	2006	2005	2006	2005
Net loss, as reported	$ (92)	$ (381)	$ (1,299)	$ (772)
Add: Stock based employee compensation expense included in net loss, net of related tax effects	**11**	9	**25**	50
Less: Total stock-based employee compensation expense determined under Black-Scholes option pricing model, net of related tax effects	(168)	(137)	(345)	(672)
Pro forma net loss	$ (249)	$ (509)	$ (1,619)	$ (1,394)
	======	======	======	======
Loss per share:				
Basic, as reported	$ 0.00	$ (0.02)	$ (0.06)	$ (0.03)
Basic, pro forma	$ (0.01)	$ (0.02)	$ (0.07)	$ (0.06)
Diluted, as reported	$ 0.00	$ (0.02)	$ (0.06)	$ (0.03)
Diluted, pro forma	$ (0.01)	$ (0.02)	$ (0.07)	$ (0.06)

The weighted-average assumptions used to estimate the fair value of stock options granted in the quarter and nine months ended January 31, 2006 were as follows: risk-free interest rate of 4.4 percent, expected option life of 5.7 years, expected volatility of 73 percent, and no expected dividend yield.

The weighted-average assumptions used to estimate the fair value of stock options granted in the quarter and nine months ended January 31, 2005 were as follows: risk-free interest rate of 3.5 percent and 3.7 percent, respectively; expected option life of 4.7 years, expected volatility of 74 percent, and no expected dividend yield.

In April 2005, the SEC delayed the required adoption date for Statement of Financial Accounting Standards No. 123(R), "Share-Based Payment" ("SFAS 123(R)"). SFAS 123(R) is effective for the Company beginning on May 1, 2006. The Company expects to adopt using the prospective method and is currently evaluating the impact of adopting SFAS 123(R) on its consolidated financial position and results of operations. The Company believes that the pro forma disclosures provide an appropriate short-term indicator of the level of expense that will be recognized in accordance with SFAS 123(R); however, the total expense recorded in future periods will depend on several factors, including the number of share-based awards issued and the fair value of those awards.

NOTE 3. Inventories

Inventories, net of reserves, were as follows:

In thousands	January 31, 2006	April 30, 2005
Raw materials and purchased parts	$ 43,513	$ 39,800
Work in process	1,968	1,326
Finished goods	8,202	11,237
	$ 53,683	$ 52,363
	======	======

NOTE 4. Restructuring Charges

Fiscal 2005 Restructuring

During the fiscal year ended April 30, 2005, the Company recorded restructuring charges of $3.0 million consisting of employee separation costs of $2.6 million and an adjustment to the fiscal 2004 expected facility consolidation costs of $0.4 million. The employee separation costs were primarily attributable to the relocation of the Ophthalmic Lens Processing segment's operations in Muskogee, Oklahoma and efforts to reduce Spandex's costs in the Sign Making and Specialty Graphics segment. During fiscal 2006, the Company expensed $0.1 million for changes in employee separation cost estimates. The facility consolidation adjustment related to the sublease of a vacant facility in the Sign Making and Specialty Graphics segment.

The following table presents a rollforward of the accruals at April 30, 2005 to January 31, 2006 by segment:

In thousands	Employee Separation Accrual
Sign Making and Specialty Graphics	
Balance at April 30, 2005	$ 395

Cash payments	(359)
Change in estimates	(36)
Balance at January 31, 2006	---
Ophthalmic Lens Processing	
Balance at April 30, 2005	508
Cash payments	(590)
Change in estimates	87
Balance at January 31, 2006	5
Fiscal 2005 balance at January 31, 2006	$ 5
	=====

Fiscal 2004 Restructuring

The following table presents a rollforward of the accruals established in fiscal 2004 by segment:

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In thousands	Facility Consolidation Accrual
Sign Making and Specialty Graphics	
Balance at April 30, 2005	$ 1,775
Cash payments	(253)
Balance at January 31, 2006	1,522
Ophthalmic Lens Processing	
Balance at April 30, 2005	65
Cash payments	(33)
Change in estimates	(32)

Balance at January 31, 2006	---
Fiscal 2004 balance at January 31, 2006	$ 1,522
	======

Of the remaining balance at January 31, 2006, $0.1 million is expected to be paid in the fiscal year ending April 30, 2006, $0.3 million in the fiscal year ending April 30, 2007, $0.2 million in the fiscal year ending April 30, 2008, $0.1 million in the fiscal year ending April 30, 2009, $0.1 million in the fiscal year ending April 30, 2010, and $0.7 million thereafter.

Fiscal 2003 Restructuring

The remaining accrual of $0.1 million at April 30, 2005 related to a fiscal 2003 facility consolidation charge, which was paid in the nine months ended January 31, 2006.

Fiscal 2002 Restructuring

As of April 30, 2005, the remaining accrual of $0.3 million related to severance costs payable to a former employee of the Company. During the second quarter of fiscal 2006, it was determined that this amount would not be paid and the remaining accrual was reversed to Restructuring Charges.

NOTE 5. Goodwill and Other Intangible Assets

Goodwill and other intangible assets include:

	January 31, 2006			April 30, 2005		
In thousands	Gross Carrying Amount	Accumulated Amortization	Net Intangible Assets	Gross Carrying Amount	Accumulated Amortization	Net Intangible Assets
Amortized intangible assets:						
Patents	$ 7,584	$ 2,911	$ 4,673	$ 8,010	$ 3,095	$ 4,915
Other	585	189	396	703	226	477
	8,169	3,100	5,069	8,713	3,321	5,392
Unamortized intangible assets:						
Goodwill	51,246	---	51,246	52,315	---	52,315
Pension intangible						

asset	1,692	---	1,692	1,692	---	1,692
	52,938	---	52,938	54,007	---	54,007
	$ 61,107	$ 3,100	$ 58,007	$ 62,720	$ 3,321	$ 59,399
	======	=====	=====	======	=====	=====

Intangible amortization expense was $0.1 million for the quarters ended January 31, 2006 and 2005 and $0.4 million for the nine-month periods ended January 31, 2006 and 2005. Intangible amortization expense is estimated to be approximately $0.4 million annually for fiscal years ending April 30, 2006 through 2011.

The following table presents the changes in the carrying amount of goodwill by operating segment for the nine months ended January 31, 2006:

In thousands	Sign Making and Specialty Graphics	Apparel and Flexible Materials	Ophthalmic Lens Processing	Total
Balance as of April 30, 2005	$ 22,583	$ 12,736	$ 16,996	$ 52,315
Effects of currency translation	(795)	(274)	---	(1,069)
Balance as of January 31, 2006	$ 21,788	$ 12,462	$ 16,996	$ 51,246
	======	======	======	======

NOTE 6. Derivative Instruments and Hedging Activities

The Company is exposed to fluctuations in foreign currency exchange rates because of its global presence and international sales and purchase activities. These foreign currency exposures are identified and managed at the operating unit level historically. To manage some of these risks, the Company has used forward exchange contracts. As of January 31, 2006, the Company was not party to any forward exchange contracts.

NOTE 7. Segment Information

The Company's operations are classified into three operating segments: Sign Making and Specialty Graphics; Apparel and Flexible Materials; and Ophthalmic Lens Processing. Those segments are determined based on management's evaluation of the Company's businesses.

The following table presents revenue by operating segment:

	Quarter Ended January 31,		Nine Months Ended January 31,	
In thousands	2006	2005	2006	2005

Sign Making and Specialty Graphics	$ 62,481	$ 65,290	$203,437	$203,433
Apparel and Flexible Materials	44,301	42,629	131,183	126,326
Ophthalmic Lens Processing	17,830	16,869	52,717	54,131
Consolidated revenue	$124,612	$124,788	$387,337	$383,890
	=======	=======	=======	=======

The table below presents operating income (loss) by segment and a reconciliation to consolidated operating income:

	Quarter Ended January 31,		Nine Months Ended January 31,	
In thousands	2006	2005	2006	2005
Sign Making and Specialty Graphics	$ 1,236	$ (98)	$ 6,975	$ 1,962
Apparel and Flexible Materials	4,958	5,149	15,770	16,377
Ophthalmic Lens Processing	329	(557)	317	(1,637)
Corporate Operating Expenses	(3,650)	(3,692)	(11,965)	(11,187)
Consolidated operating income	$ 2,873	$ 802	$ 11,097	$ 5,515
	=======	=======	=======	======

NOTE 8. Comprehensive Income (Loss)

The Company's total comprehensive income (loss) was as follows:

	Quarter Ended January 31,		Nine Months Ended January 31,	
In thousands	2006	2005	2006	2005
Net loss	$ (92)	$ (381)	$ (1,299)	$ (772)
Other comprehensive income (loss):				
Foreign currency translation adjustments	1,668	2,251	(4,467)	8,379
Cash flow hedging gain (loss), net of tax		55		(26)
	---		---	
Total comprehensive income (loss)	$ 1,576	$ 1,925	$ (5,766)	$ 7,581

	=======	=======	=======	=======

NOTE 9. Earnings (Loss) Per Share

The following table sets forth the computation of basic and diluted loss per share:

	Quarter Ended January 31,		Nine Months Ended January 31,	
In thousands except per share amounts	2006	2005	2006	2005
Numerator:				
Net loss	$ (92)	$ (381)	$ (1,299)	$ (772)
Denominators:				
Denominator for basic loss per share - weighted-average shares outstanding	22,466	22,263	22,371	22,255
Effect of dilutive securities:				
Stock options	---	---	---	---
Denominator for diluted loss per share - adjusted weighted-average shares outstanding	22,466	22,263	22,371	22,255
	======	======	======	======
Basic loss per share	$ 0.00	$ (0.02)	$ (0.06)	$ (0.03)
	======	======	======	======
Diluted loss per share	$ 0.00	$ (0.02)	$ (0.06)	$ (0.03)
	======	======	======	======

For the quarterly and nine-month periods ended January 31, 2006, stock options exercisable for 0.3 million shares and 0.2 million shares, respectively, of common stock were excluded from the calculation of diluted loss per share because the Company reported a net loss for those periods.

For the quarterly and nine-month periods ended January 31, 2005, stock options exercisable for 0.2 million and 0.1 million shares of common stock, respectively, were excluded from the calculation of diluted loss per share because the Company reported a net loss for those periods.

NOTE 10. Commitments and Contingencies

The Company currently has lawsuits and claims pending against it, the ultimate resolution of which management believes will not have a material effect on its consolidated financial condition, results of operations or cash flows. There were no significant changes to the commitments and contingencies during the nine months ended January 31, 2006 from those previously disclosed in the Company's Annual Report on Form 10-K for the year ended April 30, 2005.

NOTE 11. Guarantees

The Company extends financial and product performance guarantees to third parties. There have been no material changes to guarantees outstanding since April 30, 2005.

The changes in the carrying amount of product warranties for the nine months ended January 31, 2006 and 2005 were as follows:

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	Nine Months Ended January 31,	
In thousands	2006	2005
Beginning balance	$ 5,765	$ 4,827
Reductions for payments made	(4,156)	(3,887)
Changes in accruals related to warranties issued in the current period	4,100	4,398
Changes in accruals related to pre-existing warranties	72	(109)
Ending balance	$ 5,781	$ 5,229
	======	======

NOTE 12. Employee Benefit Plans

Components of net periodic benefit cost for the quarter and nine months ended January 31, 2006 and 2005 are presented below.

	Quarter Ended January 31,			
	Qualified Pension Plan		Non-Qualified Pension Plan	
In thousands	2006	2005	2006	2005

Service cost	$ 723	$ 653	$ 41	$ 39
Interest cost	1,383	1,337	101	123
Expected return on plan assets	(1,402)	(1,331)	(109)	(111)
Amortization of prior service cost	74	74	(1)	---
Amortization of net loss	427	233	30	42
Net periodic benefit cost	$ 1,205	$ 966	$ 62	$ 93
	======	======	======	======

	Nine Months Ended January 31,			
	Qualified Pension Plan		Non-Qualified Pension Plan	
In thousands	2006	2005	2006	2005
Service cost	$ 2,171	$ 1,961	$ 123	$ 120
Interest cost	4,148	4,011	304	369
Expected return on plan assets	(4,207)	(3,994)	(327)	(333)
Amortization of prior service cost	222	222	(3)	(2)
Amortization of net loss	1,281	698	89	125
Net periodic benefit cost	$ 3,615	$ 2,898	$ 186	$ 279
	======	======	======	======

Employer Contributions

For the nine months ended January 31, 2006, $2.3 million in cash contributions have been made to the Gerber Scientific, Inc. and Participating Subsidiaries Pension Plan. The Company expects to contribute a total of $3.1 million to this plan for the fiscal year ending April 30, 2006.

NOTE 13. Debt and Financing Arrangements

On October 31, 2005, the Company entered into a credit agreement with Citizens Bank of Massachusetts, the Export-Import Bank of the United States ("Ex-Im") and Sovereign Bank, and completed a refinancing of its former senior credit facilities. The financing consisted of a $50.0 million asset-based revolving line of credit that includes a

$13.0 million working capital loan guarantee from Ex-Im (the "Revolver"), a $6.5 million standby letter of credit, and a $1.2 million term loan (the "Term Loan"), collectively, the "Credit Facility." The Revolver matures on October 31, 2008. The Term Loan requires 60 equal monthly principal payments that began in December 2005 and matures in November 2010.

The Credit Facility obligations are secured by first priority liens on, and security interests in, selected assets of the Company in the United States and its subsidiaries in the United Kingdom and Canada, including inventory, accounts receivable, and real estate and leasehold improvements. The Credit Facility obligations are also secured by the capital stock of subsidiaries of the Company and secured by the capital stock held by its subsidiaries in the United Kingdom and Canada.

The initial borrowings under the Credit Facility were used to repay all borrowings under the Company's four-year $110.0 million senior credit facility entered into on May 9, 2003; to pay fees and expenses and for general working capital purposes. Subsequent to the repayment of the amounts due related to the $110.0 million facility, the facility was terminated by the Company.

Under the Revolver, the Company can terminate its commitment at any time, subject to a prepayment fee of 3.0 percent of the outstanding balance during the first year, 2.0 percent during the second year and 1.0 percent during the third year. The Company may permanently reduce the Revolver commitment by up to $10.0 million without any prepayment fee.

Revolver borrowings are subject to a borrowing base formula based upon eligible accounts receivable, eligible inventory and eligible demonstration equipment. The Company must maintain a minimum availability under the revolver of $1.0 million. Obligations under the Revolver bear interest at a floating rate, which is, at the Company's option, either at the lender's prime rate or LIBOR plus 1.75 percent. At January 31, 2006, the Company had $5.9 million available for borrowing on the revolver based on its borrowing base.

The Company is required to pay a monthly commitment fee of 0.25 percent of the average daily difference between the total commitment amount of the Revolver and the aggregate outstanding principal amount of the loans under the Revolver.

The Term Loan is payable in 60 equal monthly installments. Obligations under the Term Loan bear interest at either the lender's prime rate or LIBOR plus 2.0 percent, at the Company's option.

The Company is required to maintain two financial covenants set forth in the agreement including leverage and debt service coverage ratios. The agreement also includes limitations on additional indebtedness and liens, investments, legal entity restructurings, changes in control and restrictions on dividend payments, as well as other customary covenants and representations. The Company was in compliance with all of the covenants under its financing arrangements at January 31, 2006.

Effective January 31, 2006, the Company entered into an amendment with its lender to remove as an event of default the occurrence of a Material Adverse Effect, as defined in the Credit Facility. This eliminated the sole subjective acceleration clause from the Credit Facility. As a result of that amendment, only amounts due in one year or less are classified as a current liability on the Company's balance sheet at January 31, 2006.

Previous Senior Credit Facility

Prior to entering into the above mentioned credit facility, the Company was party to a senior secured credit facility. The senior secured credit facility was completely paid in full and terminated in connection with the above refinancing.

The Company incurred a $2.5 million pre-tax charge as part of the early extinguishment of its previous senior credit facility, primarily related to the write-off of unamortized deferred financing costs.

NOTE 14. Income Taxes

During the quarter and nine months ended January 31, 2006, the Company recorded tax expense of $1.3 million and $4.7 million. Included in the nine months expense was a $2.3 million non-cash charge attributable to the elimination of a deferred tax asset associated with a tax legislation change in the United Kingdom. Excluding this tax charge, the Company's consolidated tax rate would have been 70.4 percent compared with the statutory rate of 35.0 percent for the nine months ended January 31, 2006. The Company's consolidated tax rate was 107.3 percent for the quarter ended January 31, 2006 as compared with the statutory rate of 35.0 percent. The higher consolidated tax rates in both periods were primarily attributable to the application of interim tax reporting requirements related to losses incurred in foreign jurisdictions where the Company is unable to take a financial statement benefit.

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

The following discussion should be read in conjunction with the condensed consolidated financial statements for the quarter and nine months ended January 31, 2006 and 2005 and related notes included elsewhere in this report, as well as with the Company's Annual Report on Form 10-K for the fiscal year ended April 30, 2005.

OVERVIEW

For the third quarter and first nine months of fiscal 2006, the Company reported revenue of $124.6 million and $387.3 million, respectively, operating income of $2.9 million and $11.1 million, respectively, and a net loss of $0.1 million and $1.3 million, respectively. Included in the first nine months results were two significant one-time, non-operating charges, including a pre-tax $2.5 million loss on the early extinguishment of the Company's former senior credit facility and a tax charge of $2.3 million attributable to a change in tax law in the United Kingdom.

After adjusting for the unfavorable effect of foreign currency translation of $5.0 million and $2.2 million in the third quarter and first nine months of fiscal 2006, respectively, revenue reported for the third quarter and first nine months of fiscal 2006 was higher than the third quarter and first nine months of fiscal 2005. The increase was driven primarily by increased equipment revenue and higher service revenue across all segments, offset by a decrease in aftermarket revenue.

The Company is expecting to increase revenue through new product launches. Increased revenue contribution from new products coupled with leveraging the existing infrastructure is expected to improve operating profitability and enhance operating cash flow generation. During the third quarter of fiscal 2006, the Company launched the Solara UV2 wide format UV printer, the high-speed generator platform DTL with a cut-to-polish feature and the CMX50 lens polisher. The Company also enhanced current product offerings with upgraded Gerber OMEGA 2.5 software for the sign industry and the new spreading system XLs50 during its third quarter of fiscal 2006.

The Company's primary objective for its Apparel and Flexible Materials segment continues to be increasing market share in growth markets, particularly China. The lifting of the quotas mandated by the World Trade Organization, which occurred on December 31, 2004, is expected to have a significant favorable impact on the success of the Company's China initiative, since it is expected to benefit China. The United States and other countries, however, have planned, and in some cases introduced, protective trade measures. The United States reached an agreement with China that curtails the growth of Chinese exports through 2008, which is less restrictive than the original protective trade measures. The Company expects this agreement will encourage growth in Chinese manufacturing and will create potential opportunities for the Company. Overall, however, the timing of the benefit to China of the lifting of quotas remains uncertain.

The Sign Making and Specialty Graphics and Ophthalmic Lens Processing segments reported an operating income increase over both the third quarter and first nine months of fiscal 2005. The first nine months improvement was primarily related to fiscal 2005 pre-tax operating charges of $3.9 million that did not recur in fiscal 2006 and lower restructuring charges in the first nine months of fiscal 2006 as compared with the first nine months of fiscal 2005. Of the pre-tax operating charges, $3.6 million of charges were related to improving the Spandex operations within the Sign Making and Specialty Graphics segment and $0.3 million was attributable to the Ophthalmic Lens Processing segment. The Apparel and Flexible Materials segment reported a slight decline in operating profit related to higher employee incentive compensation costs, which were significantly offset by improved gross profit margins as compared with the prior year.

The Company's tax rate in the third quarter of fiscal 2006 was adversely affected by the establishment of valuation allowances on projected losses at certain foreign locations, which were required to be established due to these locations cumulative pre-tax losses. The Company expects these operations will return to profitability and, at that time, these reserves and the effective tax rate may be reduced; however, until such time that profitability is demonstrated, the reserves are required.

During fiscal 2006, the Company completed a refinancing of its former senior credit facilities with a lower-cost credit facility. The Company anticipates that, as a result of the lower interest rates under its new facility, it will continue to incur lower interest expense for the remainder of fiscal 2006 and subsequent periods as compared with the prior year periods; however, if market interest rates rise, our interest expense will increase. The Company amended its new senior credit facility, effective January 31, 2006, to remove an event of default, the occurrence of a Material Adverse Effect, as defined in the credit facility. As a result of this amendment, only amounts due in one year or less are classified as a current liability on the Company's balance sheet at January 31, 2006.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements requires management to make estimates and assumptions that affect amounts reported. Actual results could differ from management's estimates. The Company described the critical accounting policies that require management's most difficult, subjective, or complex judgments in the Company's Annual Report on Form 10-K for the fiscal year ended April 30, 2005. There were no significant changes to the critical accounting policies during the nine months ended January 31, 2006 from those previously disclosed.

RESULTS OF OPERATIONS

	Quarter Ended January 31,	Nine Months Ended January 31,
In thousands		