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, 2003

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 0-12448

FLOW INTERNATIONAL CORPORATION

WASHINGTON	**91-1104842**

(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

23500 - 64th Avenue South

Kent, Washington 98032

(253) 850-3500

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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x.

The number of shares outstanding of common stock, as of March 24, 2003 is 15,358,759 shares.

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CONSOLIDATED BALANCE SHEETS

(unaudited; in thousands, except share amounts)

	January 31, 2003	April 30, 2002
ASSETS		
Current Assets:		
Cash and Cash Equivalents	$ 6,599	$ 7,120
Receivables, Net	44,092	62,774
Inventories	45,096	48,164
Deferred Income Taxes		1,980
Other Current Assets	15,235	11,608
Total Current Assets	111,022	131,646
Equipment Held for Lease, Net	2,368	5,968
Property and Equipment, Net	15,238	16,996
Patents and Other Intangible Assets, Net of Accumulated Amortization of $9,715 and $8,735, respectively	12,622	13,182
Goodwill	10,205	16,332
Deferred Income Taxes		5,115
Other Assets	10,349	17,237
	$ 161,804	$ 206,476
LIABILITIES, MINORITY INTEREST AND STOCKHOLDERS EQUITY		
Current Liabilities:		
Notes Payable	$ 5,253	$ 374
Current Portion of Long-Term Obligations	90,276	6,114
Accounts Payable	8,406	11,617
Accrued Payroll and Related Liabilities	4,636	4,844
Other Accrued Taxes	1,711	2,530
Deferred Revenue	5,285	3,613
Other Accrued Liabilities	15,502	14,920
Total Current Liabilities	131,069	44,012
Long-Term Obligations		81,625
Customer Deposits	5,811	7,909
Total Liabilities	136,880	133,546
Minority Interest	2,337	2,246
Stockholders Equity:		
Series A 8% Convertible Preferred Stock $.01 par value, 1,000,000 shares authorized, none issued		
Common Stock $.01 par value, 20,000,000 shares authorized, 15,358,759 shares outstanding at January 31, 2003, 15,281,759 shares outstanding at April 30, 2002	154	153
Capital in Excess of Par	55,711	55,158
Retained Earnings (Accumulated Deficit)	(25,251)	29,206

Accumulated Other Comprehensive Loss	(8,027)	(13,833)
Total Stockholders Equity	22,587	70,684
	$ 161,804	$ 206,476

See Accompanying Notes to

Condensed Consolidated Financial Statements

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FLOW INTERNATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited; in thousands, except per share data)

	Three Months Ended January 31,	
	2003	**2002**
Revenues	$ 30,865	$ 41,483
Cost of Sales	31,635	24,259
Gross Margin	(770)	17,224
Expenses:		
Marketing	10,853	8,036
Research and Engineering	3,696	3,538
General and Administrative	7,411	4,072
Goodwill Impairment	7,145	
	29,105	15,646
Operating (Loss) Income	(29,875)	1,578
Interest Expense, Net	3,198	2,203
Other Expense, Net	3,234	128
Loss Before (Provision) Benefit for Income Taxes	(36,307)	(753)
(Provision) Benefit for Income Taxes	(5,312)	248
Net Loss	$ (41,619)	$ (505)
Basic Loss Per Share	$ (2.71)	$ (.03)
Diluted Loss Per Share	$ (2.71)	$ (.03)
Weighted Average Shares Used in Computing Basic and Diluted Loss Per Share		
Basic	15,359	15,254
Diluted	15,359	15,254

See Accompanying Notes to

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FLOW INTERNATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(unaudited; in thousands, except per share data)

	Nine Months Ended January 31,	
	2003	2002
Revenues	$ 113,553	$ 132,323
Cost of Sales	86,552	78,056
Gross Margin	27,001	54,267
Expenses:		
Marketing	27,132	23,280
Research and Engineering	10,324	10,825
General and Administrative	16,772	12,536
Goodwill Impairment	7,145	
	61,373	46,641
Operating (Loss) Income	(34,372)	7,626
Interest Expense, Net	8,201	6,761
Other Expense, Net	4,053	430
(Loss) Income Before Provision for Income Taxes	(46,626)	435
Provision for Income Taxes	(7,831)	(144)
Net (Loss) Income	$ (54,457)	$ 291
Basic (Loss) Earnings Per Share	$ (3.55)	$ .02
Diluted (Loss) Earnings Per Share	$ (3.55)	$ .02
Weighted Average Shares Used in Computing Basic and Diluted (Loss) Earnings Per Share		
Basic	15,345	15,221
Diluted	15,345	16,284

See Accompanying Notes to

Condensed Consolidated Financial Statements

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FLOW INTERNATIONAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited; in thousands)

	Nine Months Ended January 31,	
	2003	2002
Cash Flows from Operating Activities:		
Net (Loss) Income	$ (54,457)	$ 291
Adjustments to Reconcile Net (Loss) Income to Cash Used in Operating Activities:		
Depreciation and Amortization	7,638	4,968
Provision for Deferred Tax Assets	7,095	485
Goodwill Impairment	7,145	
Loss on Valuation of Operating Assets	8,052	591
Provision for Losses on Trade Accounts Receivable	3,269	(173)
Provision for Losses on Inventory	3,272	188
Other Non-Cash Items	884	881
	17,102	7,231
Decrease (Increase) in Operating Assets	11,624	(8,324)
Decrease in Operating Liabilities	(4,020)	(1,327)
Cash Used in Operating Activities	(9,498)	(2,420)
Cash Flows from Investing Activities:		
Expenditures for Property and Equipment	(3,635)	(6,812)
Proceeds from Sale of Property and Equipment	2,769	697
Cash Used in Investing Activities	(866)	(6,115)
Cash Flows from Financing Activities:		
Borrowings (Repayments) under Line of Credit Agreements, Net	11,421	(15,846)
Payments of Long-Term Obligations	(4,856)	(7,760)
Proceeds from Long-Term Obligations		25,723
Proceeds from Issuance of Warrants		9,277
Proceeds from Issuance of Common Stock	428	1,307
Cash Provided by Financing Activities	6,993	12,701
Effect of Changes in Exchange Rates	2,850	(3,378)
(Decrease) Increase in Cash and Cash Equivalents	(521)	788
Cash and Cash Equivalents at Beginning of Period	7,120	6,808
Cash and Cash Equivalents at End of Period	$ 6,599	$ 7,596

See Accompanying Notes to

Condensed Consolidated Financial Statements

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FLOW INTERNATIONAL CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE OPERATIONS

(unaudited, in thousands)

	Three Months Ended January 31,	
	2003	**2002**
Net Loss	$ (41,619)	$ (505)
Other Comprehensive Income (Loss):		
Unrealized Gain on Equity Securities Available for Sale, Net of Tax	469	190
Unrealized (Loss) Gain on Cash Flow Hedges, Net of Tax	(32)	1,045
Cumulative Translation Adjustment	3,851	85
Comprehensive (Loss) Income	$ (37,331)	$ 815

	Nine Months Ended January 31,	
	2003	**2002**
Net (Loss) Income	$ (54,457)	$ 291
Other Comprehensive Income (Loss):		
Unrealized Gain on Equity Securities Available for Sale, Net of Tax	663	153
Unrealized Gain (Loss) on Cash Flow Hedges, Net of Tax	62	(400)
Cumulative Translation Adjustment	5,081	(3,378)
Comprehensive Loss	$ (48,651)	$ (3,334)

See Accompanying Notes to

Condensed Consolidated Financial Statements

FLOW INTERNATIONAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Nine Months Ended January 31, 2003

(unaudited)

1. Basis of Presentation

In the opinion of the management of Flow International Corporation (the Company), the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring items, accruals and asset impairment charges necessary to fairly present the financial position, results of operations and cash flows of the Company. These interim financial statements do not include all information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States, and should be read in conjunction with the April 30, 2002 consolidated financial statements included in the Company s Annual Report filed with the Securities and Exchange Commission on Form 10-K. Operating results for the three and nine months ended January 31, 2003 may not be indicative of future results.

2. Recent Developments

On January 3, 2003, Stephen R. Light assumed the role of President and CEO of the Company. Upon commencement of his employment, Mr. Light faced several challenges, including the following:

The Company s debt levels were very high and not supportable and the Company was in default of its financial loan covenants with both its senior and subordinated lenders (collectively Lenders). In addition, the Company s senior credit facility was expiring in September 2003.

The Company had a market leadership position in its core ultrahigh-pressure cutting business, but the machine tool industry was in recession, and most economic forecasts anticipated it would be several quarters before business levels would show signs of recovery.

The Avure Technologies (Avure) business segment was losing money, as the general press business was experiencing a cyclical decline in revenue and the food processing business, while making progress in proving the commercial viability of its products, continued to require further investment to generate sufficient sales volume to become profitable.

The Company had more than twenty locations throughout the world, burdening the Company with significant overhead and diminishing management s focus and direction.

These factors prompted Mr. Light to meet with the Company s Lenders to discuss strategic alternatives directed toward reducing the current debt levels and improving the Company s operating results. Mr. Light, using the knowledge and previous efforts of his executive team, then developed a comprehensive plan aimed at improving cash flow and profitability by redefining and refocusing the Company s strategy. This plan is comprised of three primary objectives: a) obtaining support from the Company s Lenders to ensure continued

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FLOW INTERNATIONAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Nine Months Ended January 31, 2003

(unaudited)

borrowing capability, b) conducting a comprehensive financial review of the Company s assets and obligations and c) restructuring the Company to reduce structural expenses and resolve current operational issues within the core business.

Lenders. At January 31, 2003, the Company was in violation of its financial covenants with its Lenders. The Company s current senior credit facility expires September 2003. Rather than work with the senior lenders to obtain forbearance of the covenant defaults, the Company has begun initial discussions with the senior lenders regarding a new long-term credit facility which takes into consideration the Company s current operating performance and the restructuring plan. The senior lenders have expressed their willingness to enter into a new long-term credit facility with the Company and have informed the Company that they are preparing a proposal for the Company s review. Although the timing of finalization of a new long-term credit facility with the Company s senior lenders is uncertain, the Company anticipates having the new facility in place before the filing of its annual report on Form 10-K for the period ending April 30, 2003. The Company also expects to work with its subordinated lender on modifications to the existing subordinated note agreement, which take into consideration the current operating environment and the near term impact of the restructuring. The Company believes that the subordinated lender will modify the agreement before the Company files its annual report on Form 10-K for the period ending April 30, 2003. The completion of these agreements is dependent on concurrence by all parties and is not totally in the Company s control.

As the Company is in default of its financial covenants, all debt outstanding to the Lenders has been classified as current as of January 31, 2003. To date, none of the Lenders have exercised any default rights including default interest rates. Notwithstanding the discussions between the Company and its Lenders, the current default enables the Lenders to accelerate and call the debt. If the debt were called, the Company would not be in a position to repay its Lenders and would be subject to the authority of its Lenders as provided in the credit and subordinated private placement agreements. The Company s Lenders may pursue any number of plans to reduce the outstanding debt, including liquidation of some or all of the Company s assets.

Comprehensive Financial Review. During the third quarter, the economy continued to decline creating increasing concern over the collectibility of accounts receivable and the levels and carrying value of inventories. Moreover, the Company s highly leveraged position made debt reduction a priority. In response, the Company revised its approach to receivable collection, inventory reduction and investigated other cash-generating initiatives. As part of these activities, the Company reviewed the carrying values of those assets that it expected to convert to cash in the short-term, as well as long-lived tangible and intangible assets and adjusted the carrying value of such assets to reflect their estimated current net realizable value. In addition, the Company conducted a review of potential liabilities. The total of these adjustments was $32.8 million and is included in the Consolidated Statement of Operations for the three and nine months ended January 31, 2003. These adjustments,

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Nine Months Ended January 31, 2003

(unaudited)

which are summarized below, were highly influenced by the economic environment the Company and its customers are facing.

As of January 31, 2003, the Company increased its allowance for doubtful accounts by $2.4 million. This increase is based on extensive collection efforts in the quarter and the results of a worldwide receivable-by-receivable review, including evaluation of the impact of current economic conditions, which have restricted customers ability to pay their account balances. The Company expects that it will negotiate discounts or assign accounts to collection agencies to accelerate cash collections.

At January 31, 2003, the Company evaluated its ability to convert inventories, including evaluation and demonstration units, into cash in the short term by their sale or disposition. This evaluation led to a total adjustment of $5.4 million to arrive at the estimated net realizable value of the Company s inventories.

At January 31, 2003, the Company conducted a detailed review of the carrying value of its goodwill. Statement of Financial Accounting Standard No. 142 (FAS 142), Goodwill and Other Intangible Assets , requires a company to perform impairment testing when certain triggering events affecting a business unit have occurred. The triggering events were the expectation of sale or full or partial disposal of certain Flow divisions and the continuing deterioration of the economic climate. The Company s review resulted in impairment charges of $7.1 million during the quarter ended January 31, 2003. The impairment resulted primarily from continued weakness in the automotive industry, as well as poor performance at the Company s European operations.

Although the Company s former CEO remains obligated to perform consulting services though May 2005, the remaining term of his consulting contract, the Company has determined that no significant future services are likely to be required of him. Therefore, the Company accrued all remaining contractual fees and related benefits aggregating approximately $1.1 million.

As of January 31, 2003, in an effort to accelerate cash collections, the Company was in discussions to sell $10.3 million of its long-term notes receivable at a discount. Based on the status of existing negotiations, the Company recorded a discount of $1.2 million or 12% of the face value of the notes.

The Company has accrued an additional $1.8 million for potential losses related to several recourse/repurchase obligations on European sales. The Company has, from time to time, entered into recourse obligations with third party leasing companies. In response to continued concerns about the financial health of several customers, as well as a recent bankruptcy, the Company has revised its estimate of potential future exposure. Included in the $1.8 million accrual is $760,000 for the estimated loss on the repurchase and subsequent sale of a general press system, where the Company has a recourse obligation for

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a bankrupt customer. The Company guaranteed the customer s obligation on this transaction and anticipates having to take possession of the unit for future resale.

The Company had deferred $0.8 million in professional fees associated with previous ongoing strategic transactions, consisting of a planned equity offering and spin-off of Avure Technologies. The Company has abandoned these plans and accordingly expensed all of these fees in the third quarter in connection with the recent hiring of The Food Partners, LLC (Food Partners) to assist in the strategic analysis of Avure.

During the quarter ended January 31, 2003, the Company reversed percentage of completion revenue previously recognized on three food systems (one customer) based on the customer s failure to fulfill its obligations under the contract terms. The total revenue reversed in the quarter was $4.3 million with an associated gross margin of $2.3 million. During the quarter, the Company received new orders totaling $3.0 million. The Company plans to deliver two substantially completed systems from inventory for these new orders. Accordingly, these specific contracts do not qualify for percentage of completion accounting and the corresponding revenue will be recognized upon delivery and acceptance.

During the quarter ended January 31, 2003, the Company assessed its ability to realize its net deferred tax assets. Recognizing the magnitude of the losses generated during the quarter and year-to-date, the Company determined it appropriate to establish a valuation allowance for its net deferred tax assets amounting to $5.3 million.

Based upon management s new strategy to downsize and streamline its operations and convert non-core or excess assets to cash, the Company adjusted various other asset values and reserves to appropriately reflect their net realizable value to the Company on a prospective basis. These adjustments totaled $5.4 million.

Restructuring. On February 19, 2003, the Company announced a comprehensive two-year restructuring plan intended to return the Company to profitability through reductions in headcount, consolidation of facilities and operations, and closure or divestiture of selected Company operations. The Company expects to invest between $11 million and $13 million in the restructuring program, which will affect roughly half of the Company s locations and will reduce the total square footage occupied by nearly half. The Company anticipates that headcount will be reduced by more than one quarter. The Company also anticipates consolidating the production of its shapecutting systems from its European facilities to its North American facilities and standardizing shapecutting systems between the European, North American and Asian markets. The Company believes that these actions will achieve significant cost savings. The Company anticipates being able to fund the restructuring program within its current credit facility if the senior lenders do not restrict access to these funds. In addition, the Company expects to incur significant non-cash expenses associated with the implementation of the restructuring program. Under current accounting rules, the

FLOW INTERNATIONAL CORPORATION

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associated restructuring expenses will generally be recognized in the period they are incurred. To date, the Company has incurred no significant restructuring expenses.

The Company concurrently announced the engagement of Food Partners to develop and implement strategic alternatives for Avure Technologies. The Company and Food Partners are currently preparing a detailed review of Avure and are discussing a strategy for realizing the best value for this business. The Company anticipates that it will complete any actions that result from this review prior to the end of the calendar year.

Effective January 1, 2003, the Company negotiated a new 10-year lease with its landlord for the existing Kent facility. The cost of relocating to another facility and the potential disruption of a move to the Company s business, especially in light of the anticipated restructuring plan, weighed against a move to another facility. The new lease provides a monthly cost reduction in lease expense of approximately $30,000 with an early termination option at the end of five years.

2. Impairment

At January 31, 2003, the Company conducted a detailed review of the carrying value of its goodwill. FAS 142 requires a company to perform impairment testing when certain triggering events affecting a business unit have occurred. The triggering events were the expectation of sale or full or partial disposal of certain Flow divisions and the continuing deterioration of the economic climate. The Company s review resulted in impairment charges of $7.1 million during the quarter ended January 31, 2003. The impairment resulted primarily from continued weakness in the automotive industry, as well as poor performance at the Company s European operations. The fair value of those reporting units was estimated using the expected present value of future cash flows.

3. Earnings (Loss) Per Share

Basic earnings per share represents net income available to common stockholders divided by the weighted average number of shares outstanding during the period. Diluted earnings per share represents net income available to common stockholders divided by the weighted average number of shares outstanding including the potentially dilutive impact of stock options and warrants, except when the effect of their inclusion would be anti-dilutive.

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FLOW INTERNATIONAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Nine Months Ended January 31, 2003

(unaudited)

The table below summarizes the weighted average shares outstanding for the Company for the three and nine months ended January 31, 2003 and 2002:

	Three Months Ended January 31,	
	2003	**2002**
	(in thousands)	
Weighted Average Basic Shares Outstanding	15,359	15,254
Potentially Dilutive Common Shares from Employee Stock Options		
Potentially Dilutive Common Shares from Warrants		
Weighted Average Diluted Shares Outstanding	15,359	15,254

	Nine Months Ended January 31,	
	2003	**2002**
	(in thousands)	
Weighted Average Basic Shares Outstanding	15,345	15,221
Potentially Dilutive Common Shares from Employee Stock Options		297
Potentially Dilutive Common Shares from Warrants		766
Weighted Average Diluted Shares Outstanding	15,345	16,284

Diluted earnings (loss) per share excludes the effects of 3,274,418 and 3,138,248 antidilutive stock options at January 31, 2003 and 2002, respectively. A total of 860,000 potentially dilutive shares from warrants have been excluded from the diluted weighted average share denominator for the three and nine months ended January 31, 2003 as their effect would be anti-dilutive.

4. Segment Information

Based upon a change in reporting structure effective May 1, 2002, the Company has redefined its two reportable segments, Flow Waterjet Systems and Avure Technologies, replacing the two previous reportable segments of UHP Systems and Fresher Under Pressure®. The Flow Waterjet Systems segment includes cutting and cleaning operations, which are focused on providing total solutions for the aerospace, automotive, job shop, surface preparation and paper industries. The Avure segment includes the Fresher Under Pressure food processing technology, as well as the isostatic and flexform press (General Press) operations. The Fresher Under Pressure technology provides food safety and quality enhancement solutions for food producers, while the General Press business manufactures systems which produce and strengthen advanced materials for the aerospace, automotive and medical industries. The accounting policies of the segments are the same as those described in the Summary of Significant Accounting Policies included in the

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FLOW INTERNATIONAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Nine Months Ended January 31, 2003

(unaudited)

Company s Annual Report filed with the Securities and Exchange Commission on Form 10-K. Segment operating results are measured on income (loss) from operations.

A summary of operations by reportable segment is as follows:

(in thousands)	Three Months Ended January 31,	
	2003	2002
Revenues		
Flow Waterjet Systems	$ 30,532	$ 30,101
Avure Technologies	333	11,382
	$ 30,865	$ 41,483
Operating (Loss) Income		
Flow Waterjet Systems	$ (20,980)	$ 950
Avure Technologies	(8,895)	628
	$ (29,875)	$ 1,578

	Nine Months Ended January 31,	
	2003	2002
Revenues		
Flow Waterjet Systems	$ 96,545	$ 96,817
Avure Technologies	17,008	35,506
	$ 113,553	$ 132,323
Operating (Loss) Income		
Flow Waterjet Systems	$ (21,954)	$ 4,657
Avure Technologies	(12,418)	2,969

	$ (34,372)	$ 7,626

5. Receivables

Receivables consist of the following:

	January 31, 2003	April 30, 2002
	(in thousands)	
Trade Accounts Receivable	$ 36,099	$ 39,042
Unbilled Revenues	12,224	24,694
	48,323	63,736
Less: Allowance for Doubtful Accounts	(4,231)	(962)
	$ 44,092	$ 62,774

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Nine Months Ended January 31, 2003

(unaudited)

6. Inventories

Inventories consist of the following:

	January 31, 2003	April 30, 2002
	(in thousands)	
Raw Materials and Parts	$ 21,847	$ 25,194
Work in Process	13,976	9,163
Finished Goods	9,273	13,807
	$ 45,096	$ 48,164

7. Income Taxes

During the quarter ended January 31, 2003, the Company assessed its ability to realize its net deferred tax assets. Recognizing the magnitude of the losses generated during the quarter and year-to-date, the Company determined it appropriate to establish a valuation allowance for its net deferred tax assets amounting to $5.3 million. The valuation allowance of $5.3 million on net deferred tax assets generated in prior periods is included in the Provision for Income Taxes in the Consolidated Statement of Operations and shown as a reduction of both Current and Long-Term Deferred Income Taxes on the Consolidated Balance Sheet. The US net operating losses can be carried forward 20 years to offset US profits in future periods.

8. Debt

At January 31, 2003, the Company was in violation of its financial covenants with its Lenders. The Company s current senior credit facility expires September 2003. Rather than work with the senior lenders to obtain forbearance of the covenant defaults, the Company has begun initial discussions with the senior lenders regarding a new long-term credit facility which takes into consideration the Company s current operating performance and the restructuring plan. The senior lenders have expressed their willingness to enter into a new long-term credit facility with the Company and have informed the Company that they are preparing a proposal for the Company s review. Although the timing of finalization of a new long-term credit facility with the Company s senior lenders is uncertain, the Company anticipates having the new facility in place before the filing of its annual report on Form 10-K for the period ending April 30, 2003. The Company also expects to work with its subordinated lender on modifications to the existing subordinated note agreement, which take into consideration the current operating environment and the near term impact of the restructuring. The Company believes that the subordinated lender will modify the agreement before the Company files its annual report on Form 10-K for the period ending April 30, 2003. The completion of these agreements is dependent on concurrence by all parties and is not totally in the Company s control.

In February 2003, the Company completed both the eighth and ninth amendments to its senior credit agreement. The eighth amendment required the Company to provide additional security interests consisting of bank control agreements and interests in Flow subsidiaries stock. The ninth amendment provided the Company with forbearance from its Fixed Charges Coverage ratio covenant default at October 31, 2002. A forbearance is not

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(unaudited)

a waiver or amendment of the covenant, however it indicates the senior lenders do not intend to exercise their default remedies. The Company had anticipated also obtaining a similar second quarter forbearance from its subordinated lender subsequent to amendment completion by the senior lenders. However, given the financial results for the third quarter, the Company will no longer attempt to obtain an October 31, 2002 forbearance, rather, the Company will work with its subordinated lender to modify the terms and covenants of the existing agreement to be in compliance effective April 30, 2003.

As the Company is in default of its financial covenants, all debt outstanding to the Lenders has been classified as current as of January 31, 2003. To date, none of the Lenders have exercised any default rights including default interest rates. Based on current debt levels, the senior default interest rate of prime plus 7% (11.25% at January 31, 2003) and subordinated default interest rate of 17% would increase the Company s interest expense by $3.2 million per year.

The current default enables the Lenders to accelerate and call the debt. If the debt were called, the Company would not be in a position to repay its Lenders and would be subject to the authority of its Lenders as provided in the credit and subordinated private placement agreements. The Company s Lenders may pursue any number of plans to reduce the outstanding debt, including liquidation of some or all of the Company s assets.

9. Warranty Obligations

The Company s obligations for warranty are accrued concurrently with the revenue recognized. The Company makes provisions for its warranty obligations based upon historical costs incurred for such obligations adjusted, as necessary, for current conditions and factors. Due to the significant uncertainties and judgments involved in estimating the Company s warranty obligations, including changing product designs and specifications, the ultimate amount incurred for warranty costs could change in the near term from the current estimate.

The following table shows the fiscal 2003 year-to-date activity for the Company s warranty accrual (in thousands):

Accrued warranty balance as of April 30, 2002	$	552
Accruals for warranties on fiscal 2003 year-to-date sales		778
Accruals related to pre-existing warranties (including changes in estimates)		523
Warranty labor and materials provided fiscal 2003 year-to-date		(793)
Accrued warranty balance as of January 31, 2003	$	1,060

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For the Nine Months Ended January 31, 2003

(unaudited)

10. New Accounting Pronouncements

In June 2001, the FASB issued Statement of Financial Accounting Standards No. 143 (FAS 143), Accounting for Asset Retirement Obligations. FAS 143 provides accounting and reporting standards for recognizing obligations related to asset retirement costs associated with the retirement of tangible long-lived assets. Under FAS 143, legal obligations associated with the retirement of long-lived assets are to be recognized at their fair value in the period in which they are incurred if a reasonable estimate of fair value can be made. The fair value of the asset retirement costs is capitalized as part of the carrying amount of the long-lived asset and subsequently allocated to expense over the asset s useful life. Any subsequent changes to the fair value of the liability due to passage of time or changes in the amount or timing of estimated cash flows is recognized in the statement of operations as an accretion expense. The Company will be required to adopt FAS 143 no later than May 1, 2003. The Company does not expect FAS 143 to have a material impact on its financial condition, results of operations or cash flows.

In November 2002, the FASB issued FASB Interpretation No. 45 (FIN 45), Guarantor s Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. FIN 45 clarifies that a guarantor is required to recognize, at the inception of a guarantee, a liability for the fair value of the obligation undertaken in the guarantee. FIN 45 also elaborates on the disclosures to be made by a guarantor in both interim and annual financial statements about its obligations under certain guarantees that it has issued. The Company does not expect that adoption of FIN 45 will have a material impact on its financial position, results of operations or cash flows.

In December 2002, the FASB issued Statement of Financial Accounting Standards No. 148 (FAS 148), Accounting for Stock-Based Compensation Transition and Disclosure An Amendment of FAS 123 . The statement amends the transition and disclosure provisions of Statement of Financial Accounting Standards No. 123 (FAS 123), Accounting for Stock-Based Compensation . Specifically, FAS 148 provides more transition alternatives for companies that wish to adopt the fair-value based provisions of FAS 123 and increases the disclosure required of companies that continue to account for their stock-based compensation under the intrinsic-value method prescribed under APB No. 25, Accounting for Stock Issued to Employees . The disclosure and transition provisions of FAS 148 are effective for interim periods beginning after December 15, 2002. The Company will implement the disclosure provisions of this statement in the fourth quarter of fiscal 2003.

11. Commitments and Contingencies

The Company committed $5 million to fund the construction of a new manufacturing facility for its Taiwanese operations in July 2000. As of January 31, 2003, the Company has a remaining commitment of $4.6 million, which will be funded over the next six months. The Company intends to explore the potential of a sale and leaseback arrangement or other financing for the building.

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(unaudited)

The Company has a recourse obligation for a bankrupt customer. The Company guaranteed the customer s obligation on this transaction and anticipates having to take possession of the unit for future resale at a total cost of $4.6 million. Estimated losses relating to this guarantee have been accrued at January 31, 2003.

12. Reclassifications

Certain fiscal 2002 amounts have been reclassified to conform to the fiscal 2003 presentation. Such reclassifications had no impact on net loss, shareholders equity or cash flows.

13. Subsequent Events

On March 17, 2003, the Company received $7.8 million from the sale of certain long-term notes receivable. As anticipated, the Company discounted the notes 12% in the sale, using the proceeds to reduce its net overall debt on that date to $88.2 million. Since the notes were offered for sale at January 31, 2003, they have been classified as Other Current Assets in the Consolidated Balance Sheet.

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Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

SAFE HARBOR STATEMENT:

Statements made in this filing that are not historical facts are forward-looking statements that involve risks and uncertainties. Forward-looking statements typically are identified by the use of such terms as may, will, expect, believe, anticipate, estimate, plan and similar words, although some forward-looking statements are expressed differently. You should be aware that our actual results could differ materially from those contained in any forward-looking statement due to a number of factors, which include, but are not limited to the following: the special risk factors and uncertainties set forth below; our exposure to additional costs relating to our restructuring plan; risks related to a potential failure to realize anticipated benefits in connection with the liquidation of inventories and other assets of operations or product lines to be discontinued; our ability to control costs and expenses; relations with and performance of suppliers; our ability to successfully develop and sell products in the competitive markets that we serve; access to capital; maintaining satisfactory relationships with our lending partners; political and trade relations; the overall level of consumer spending on capital equipment; global economic conditions and additional threatened terrorist attacks and responses thereto, including war. Additional information on these and other factors that could affect our financial results is set forth below and in our Form 10-K for the year ended April 30, 2002. Finally, there may be other factors not mentioned above or included in our SEC filings that may cause our actual results to differ materially from those in any forward-looking statement. You should not place undue reliance on these forward-looking statements. We assume no obligation to update any forward-looking statements as a result of new information, future events or developments, except as required by federal securities laws.

All references to fiscal years are references to our fiscal year end of April 30.

Special Risk Factors and Uncertainties

Our business has been adversely affected by our overall financial position. Following our announcement of our loss for the third quarter of 2003, we experienced some reluctance from certain customers to buy from us. Our management believes that this may be indicative of fears by customers that we will become unreliable in supplying our products or that our brand image will be harmed. If our customers lose confidence in our ability to supply quality products reliably, our business may be materially harmed. In addition, the willingness of suppliers to do business with us or changes in our trade terms with suppliers could negatively impact future margins and costs.

We had a substantial loss in fiscal year 2002 and in the first nine months of fiscal 2003 and may continue to incur losses in future periods. Our net loss for the fiscal year ended April 30, 2002 was $6.0 million. Our net loss for the three months ended January 31, 2003 was $41.6 million. We incurred a net loss of $54.5 million during the nine months ended January 31, 2003. As described in the notes to the financial statements, we intend to significantly restructure our operations. We believe these restructuring and cost-cutting initiatives will reduce overall spending. If our restructuring efforts fail to adequately reduce costs, or if our sales are less than we project, we may continue to incur losses in

future periods.

We are in default of our loan agreements. As of January 31, 2003 we are out of compliance with financial debt covenants with our Lenders. The current senior credit agreement expires

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September 2003. To date, the Lenders have not limited our access to borrow funds as needed, even in our default position. Our ability to continue operating is dependent on the senior lenders willingness to enter into a new long-term credit facility that takes into account the announced restructuring, and the willingness of the subordinated lender to agree to certain changes to the terms of the existing subordinated note agreement. If we are unable to effectuate these changes, our ability to continue operating would be seriously impaired unless we are able to obtain alternative financing from another source. Given our current financial position, obtaining alternative financing is unlikely, especially in the short term. If we are unable to reach the necessary agreements with our Lenders, the Lenders would be in the position to exercise default remedies which include applying a default interest rate and calling the debt. If the debt were called, it is unlikely we would be able to pay off our Lenders and we would be subject to the authority of our Lenders as provided in the credit and subordinated private placement agreements. Our Lenders may pursue any number of plans to reduce the outstanding debt, including a liquidation of some or all of our assets.

There can be no assurance that the efforts discussed above will be successful, particularly that the senior lenders will agree to the new long-term credit facilities upon acceptable terms, or that the subordinated lender will agree to acceptable modifications to the subordinated note agreement.

We may be unsuccessful in the implementation of our restructuring plan. Our comprehensive two-year restructuring plan will include reductions in headcount, consolidation of facilities and operations, and closure or divestiture of selected operations. The plan will affect roughly half of our locations and will reduce the total square footage occupied by nearly half. We anticipate that headcount will be reduced by more than a quarter. We also anticipate consolidating the production of our shapecutting products from our European facilities to our North American facilities and standardizing shapecutting products between the European, North American and Asian markets. The success of the restructuring is also dependent on the initial cooperation of our Lenders and the continued cooperation of our Lenders throughout the restructuring period. But, as with any restructuring, there are numerous risks that could affect the success of the restructuring, including those mentioned below.

During the period that we are restructuring and perhaps for a period thereafter, we will be subject to risks that companies are exposed to during periods of restructuring. These risks result from the uncertainties, force reductions, facility closings, divestitures of operations, and rapid changes that accompany restructurings. As a result, one or more of the following adverse consequences could occur to at least some degree: the hiring and/or retaining of employees may be more difficult, customer and vendor relationships can be damaged, there can be disruptions in the delivery and servicing of product, there may be manufacturing cost overruns and competitors may try to attract customers by suggesting that we may not be able to successfully restructure

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Recent Developments

On January 3, 2003, Stephen R. Light assumed the role of President and CEO. Upon commencement of his employment, Mr. Light faced several challenges, including the following:

- Our debt levels were very high and not supportable and we were in default of our financial loan covenants with both our senior and subordinated lenders (collectively Lenders). In addition, our senior credit facility was expiring in September 2003.

- We had a market leadership position in our core ultrahigh-pressure cutting business, but the machine tool industry was in recession, and most economic forecasts anticipated it would be several quarters before business levels would show signs of recovery.

- The Avure Technologies (Avure) business segment was losing money, as the general press business was experiencing a cyclical decline in revenue and the food processing business, while making progress in proving the commercial viability of its products, continued to require further investment to generate sufficient sales volume to become profitable.

- We had more than twenty locations throughout the world, burdening us with significant overhead and diminishing our management s focus and direction.

These factors prompted Mr. Light to meet with our Lenders to discuss strategic alternatives directed toward reducing the current debt levels and improving our operating results. Mr. Light, using the knowledge and previous efforts of his executive team, then developed a comprehensive plan aimed at improving cash flow and profitability by redefining and refocusing our strategy. This plan is comprised of three primary objectives: a) obtaining support from our Lenders to ensure continued borrowing capability, b) conducting a comprehensive financial review of our assets and obligations and c) restructuring to reduce structural expenses and resolve current operational issues within the core business.

Lenders. At January 31, 2003, we were in violation of our financial covenants with our Lenders. Our current senior credit facility expires September 2003. Rather than work with the senior lenders to obtain forbearance of the covenant defaults, we have begun initial discussions with the senior lenders regarding a new long-term credit facility which takes into consideration our current operating performance and the restructuring plan. The senior lenders have expressed their willingness to enter into a new long-term credit facility with us and have informed us that they are preparing a proposal for our review. Although the timing of finalization of a new long-term credit facility with the senior lenders is uncertain, we anticipate having the new facility in place before the filing of our annual report on Form 10-K for the period ending April 30, 2003. We also expect to work with our subordinated lender on modifications to the existing subordinated note agreement, which take into consideration the current operating environment and the near term impact of the restructuring. We believe that

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the subordinated lender will modify the agreement before we file our annual report on Form 10-K for the period ending April 30, 2003. The completion of these agreements is dependent on concurrence by all parties and is not totally in our control.

As we are in default of our financial covenants, all debt outstanding to the Lenders has been classified as current as of January 31, 2003. To date, none of the Lenders have exercised any default rights including default interest rates. Notwithstanding the discussions with our Lenders, the current default enables the Lenders to accelerate and call the debt. If the debt were called, we would not be in a position to repay the Lenders and would be subject to the authority of the Lenders as provided in the credit and subordinated private placement agreements. Our Lenders may pursue any number of plans to reduce the outstanding debt, including liquidation of some or all of our assets.

Comprehensive Financial Review. During the third quarter, the economy continued to decline creating increasing concern over the collectibility of accounts receivable and the levels and carrying value of inventories. Moreover, our highly leveraged position made debt reduction a priority. In response, we revised our approach to receivable collection, inventory reduction and investigated other cash-generating initiatives. As part of these activities, we reviewed the carrying values of those assets that we expected to convert to cash in the short-term, as well as long-lived tangible and intangible assets and adjusted the carrying value of such assets to reflect their estimated current net realizable value. In addition, we conducted a review of potential liabilities. The total of these adjustments was $32.8 million and is included in the Consolidated Statement of Operations for the three and nine months ended January 31, 2003. These adjustments, which are summarized below, were highly influenced by the economic environment our customers and we are facing**.**

As of January 31, 2003, we increased our allowance for doubtful accounts by $2.4 million. This increase is based on extensive collection efforts in the quarter and the results of a worldwide receivable-by-receivable review, including evaluation of the impact of current economic conditions, which have restricted customers ability to pay their account balances. We expect that we will negotiate discounts or assign accounts to collection agencies to accelerate cash collections.

At January 31, 2003, we evaluated our ability to convert inventories, including evaluation and demonstration units, into cash in the short term by their sale or disposition. This evaluation led to a total adjustment of $5.4 million to arrive at the estimated net realizable value of our inventories.

At January 31, 2003, we conducted a detailed review of the carrying value of our goodwill. Statement of Financial Accounting Standard No. 142 (FAS 142), Goodwill and Other Intangible Assets , requires a company to perform impairment testing when certain triggering events affecting a business unit have occurred. The triggering events were the expectation of sale or full or partial disposal of certain of our divisions and the continuing deterioration of the economic climate. Our review resulted in impairment charges of $7.1

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million during the quarter ended January 31, 2003. The impairment resulted primarily from continued weakness in the automotive industry, as well as poor performance at our European operations.

Although our former CEO remains obligated to perform consulting services though May 2005, the remaining term of his consulting contract, we have determined that no significant future services are likely to be required of him. Therefore we accrued all remaining contractual fees and related benefits aggregating approximately $1.1 million.

As of January 31, 2003, in an effort to accelerate cash collections, we were in discussions to sell $10.3 million of our long-term notes receivable at a discount. Based on the status of existing negotiations, we recorded a discount of $1.2 million or 12% of the face value of the notes.

We have accrued an additional $1.8 million for potential losses related to several recourse/repurchase obligations on European sales. We have from time to time entered into recourse obligations with third party leasing companies. In response to continued concerns about the financial health of several customers, as well as a recent bankruptcy, we have revised our estimate of potential future exposure. Included in the $1.8 million accrual is $760,000 for the estimated loss on the repurchase and subsequent sale of a general press system, where we have a recourse obligation for a bankrupt customer. We guaranteed the customer s obligation on this transaction and anticipate having to take possession of the unit for future resale.

We had deferred $0.8 million in professional fees associated with previous ongoing strategic transactions, consisting of a planned equity offering and spin-off of Avure Technologies. We have abandoned these plans and accordingly expensed all of these fees in the third quarter in connection with the recent hiring of The Food Partners, LLC (Food Partners) to assist in the strategic analysis of Avure.

During the quarter ended January 31, 2003, we reversed percentage of completion revenue previously recognized on three food systems (one customer) based on the customer s failure to fulfill its obligations under the contract terms. The total revenue reversed in the quarter was $4.3 million with an associated gross margin of $2.3 million. During the quarter, we received new orders totaling $3.0 million. We plan to deliver two substantially completed systems from inventory for these new orders. Accordingly, these specific contracts do not qualify for percentage of completion accounting and the corresponding revenue will be recognized upon delivery and acceptance.

During the quarter ended January 31, 2003, we assessed our ability to realize our net deferred tax assets. Recognizing the magnitude of the losses generated during the quarter and year-to-date, we determined it appropriate to establish a valuation allowance for our net deferred tax assets amounting to $5.3 million.

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Based upon our management s new strategy to downsize and streamline our operations and convert non-core or excess assets to cash, we adjusted various other asset values and reserves to appropriately reflect their net realizable value on a prospective basis. These adjustments totaled $5.4 million.

Restructuring. On February 19, 2003, we announced a comprehensive two-year restructuring plan intended to return the Company to profitability through reductions in headcount, consolidation of facilities and operations, and closure or divestiture of selected operations. We expect to invest between $11 million and $13 million in the restructuring program, which will affect roughly half of our locations and will reduce the total square footage occupied by nearly half. We anticipate that headcount will be reduced by more than one quarter. We also anticipate consolidating the production of our shapecutting systems from our European facilities to our North American facilities and standardizing shapecutting systems between the European, North American and Asian markets. We believe that these actions will achieve significant cost savings. We anticipate being able to fund the restructuring program within our current credit facility if the senior lenders do not restrict access to these funds. In addition, we expect to incur significant non-cash expenses associated with the implementation of the restructuring program. Under current accounting rules, the associated restructuring expenses will generally be recognized in the period they are incurred. To date, we have incurred no significant restructuring expenses.

We concurrently announced the engagement of Food Partners to develop and implement strategic alternatives for Avure Technologies. Food Partners and we are currently preparing a detailed review of Avure and are discussing a strategy for realizing the best value for this business. We anticipate that we will complete any actions that result from this review prior to the end of the calendar year.

Effective January 1, 2003, we negotiated a new 10-year lease with our landlord for the existing Kent facility. The cost of relocating to another facility and the potential disruption of a move to our business, especially in light of the anticipated restructuring plan, weighed against a move to another facility. The new lease provides a monthly cost reduction in lease expense of approximately $30,000 with an early termination option at the end of five years.

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Operational Data as a Percentage of Sales

	Three Months Ended January 31,		Nine months Ended January 31,	
	2003	2002	2003	2002
Revenue	100%	100%	100%	100%
Cost of Sales	103%	58%	76%	59%
Gross Margin	(3)%	42%	24%	41%
Expenses:				
Marketing	35%	19%	24%	18%
Research & Engineering	12%	9%	9%	8%
General & Administrative	24%	10%	15%	9%
Goodwill Impairment	23%	0%	6%	0%
	94%	38%	54%	35%
Operating (Loss) Income	(97)%	4%	(30)%	6%
Interest Expense, net	10%	6%	7%	6%
Other Expense, net	11%	0%	4%	0%
(Loss) Income Before (Provision) Benefit for Income Taxes	(118)%	(2)%	(41)%	0%
(Provision) Benefit for Income Taxes	(17)%	1%	(7)%	(0)%
Net (Loss) Income	(135)%	(1)%	(48)%	0%

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Segment Overview

Dollars in thousands, except per share data	**Three months ended January 31, 2003**			**Three months ended January 31, 2002**		
	Flow Waterjet Systems	**Avure Technologies**	**Consolidated**	**Flow Waterjet Systems**	**Avure Technologies**	**Consolidated**
Revenues	$ 30,532	$ 333	$ 57,174	57,207		
TOTAL ASSETS	$286,738	$288,031				
LIABILITIES AND SHAREHOLDERS' EQUITY						
CURRENT LIABILITIES						
Trade payables	$45,989	$37,393				
Other accounts payable and accrued expenses	35,197	31,523				
Total current liabilities	81,186	68,916				
LONG TERM LIABILITIES						
Long term employees liabilities	3,769	4,175				
Long term liabilities others	2,269	2,262				
Total long term liabilities	6,038	6,437				
TOTAL LIABILITIES	87,224	75,353				
SHAREHOLDERS' EQUITY	199,514	212,678				
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$286,738	$288,031				

ALVARION LTD.& ITS SUBSIDIARIES
Consolidated Statement of Cash Flows
U.S. dollars in thousands

	Three Months ended June 30, 2010
Cash flows from operating activities:	
Net loss	$(10,600)
Adjustments to reconcile net loss to net cash provided by operating activities:	
Depreciation	1,676
Capital Loss	343
Stock based compensation expenses ASC 718	352
Accrued interest from long term investment	(88)
Amortization of intangibles assets	33
Increase in trade receivables	(205)
Decrease in other accounts receivable and prepaid expenses	265
Increase in inventories	(10,805)
Increase in trade payables	8,596
Increase in other accounts payables and accrued expenses	2,491
Decrease in long term employees liabilities	(406)
Increase in long term liabilities	7
Net cash used in operating activities	(8,341)
Cash flows from investing activities:	
Purchase of fixed assets	(1,316)
Investment in long term investment	(2,000)
Net cash used in investing activities	(3,316)
Cash flows from financing activities:	
Proceeds from exercise of employees' stock options	13
Net cash provided by financing activities	13
Decrease in cash, cash equivalents, short-term and long-term investments	(11,644)
Cash, cash equivalents, short-term and long-term investments at the beginning of the period	103,067
Cash, cash equivalents, short-term and long-term investments at the end of the period	$91,423