FLOW INTERNATIONAL CORP
Form 10-Q
February 01, 2007
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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 July 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 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 ¨.

Indicated 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.

The number of shares outstanding of common stock, as of January 26, 2007 is 37,245,132 shares.

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CONDENSED CONSOLIDATED BALANCE SHEETS

(unaudited; in thousands, except per share and share amounts)

	July 31, 2006	April 30, 2006
ASSETS:		
Current Assets:		
Cash and Cash Equivalents	$ 38,955	$ 36,186
Receivables, net	28,127	34,193
Inventories	25,252	22,775
Deferred Income Taxes	106	108
Prepaid Expenses	4,709	4,763
Other Current Assets	786	2,017
Total Current Assets	97,935	100,042
Property and Equipment, net	11,099	11,085
Intangible Assets, net	3,499	3,173
Goodwill	2,764	2,764
Deferred Income Taxes	243	248
Other Assets	1,778	1,956
	$ 117,318	$ 119,268
LIABILITIES AND SHAREHOLDERS EQUITY:		
Current Liabilities:		
Notes Payable	$ 2,254	$ 2,319
Current Portion of Long-Term Obligations	877	928
Accounts Payable	13,778	20,811
Accrued Payroll and Related Liabilities	6,796	6,954
Taxes Payable and Other Accrued Taxes	4,057	4,198
Deferred Income Taxes	2,683	2,416
Deferred Revenue	6,202	6,322
Customer Deposits	8,475	7,396
Other Accrued Liabilities	7,157	6,294
Total Current Liabilities	52,279	57,638
Long-Term Obligations, net	3,246	3,774
Other Long-Term Liabilities	295	716
	55,820	62,128
Commitments and Contingencies (Note 13)		
Shareholders Equity:		
Series A 8% Convertible Preferred Stock $.01 par value, 1,000,000 shares authorized, none issued		
Common Stock $.01 par value, 49,000,000 shares authorized, 37,156,493 and 36,943,161 shares issued and outstanding at July 31, 2006 and April 30, 2006, respectively	366	364
Capital in Excess of Par	139,271	137,192
Accumulated Deficit	(69,375)	(72,417)
Accumulated Other Comprehensive Loss:		
Cumulative Translation Adjustment, net of income tax of $0 and $0	(8,585)	(7,726)
Unrealized Loss on Cash Flow Hedges, net of income tax of $0 and $0	(179)	(273)

Total Shareholders Equity	61,498	57,140
	$ 117,318	$ 119,268

See Accompanying Notes to

Condensed Consolidated Financial Statements

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CONDENSED CONSOLIDATED STATEMENTS OF INCOME

(unaudited; in thousands, except per share and share amounts)

	Three Months Ended July 31, 2006	2005
Sales	$ 53,410	$ 41,986
Cost of Sales	30,378	24,053
Gross Margin	23,032	17,933
Expenses:		
Sales and Marketing	9,597	7,576
Research and Engineering	2,294	1,878
General and Administrative	7,020	6,215
Restructuring Charges		98
	18,911	15,767
Operating Income	4,121	2,166
Interest Income	229	39
Interest Expense	(135)	(965)
Fair Value Adjustment on Warrants Issued		(678)
Other Income (Expense), Net	625	(1,107)
Income (Loss) Before Provision for Income Taxes	4,840	(545)
Provision for Income Taxes	(1,072)	(583)
Income (Loss) From Continuing Operations	3,768	(1,128)
Income From Operations of Discontinued Operations, Net of Income Tax of $0 and $294		1,150
Loss on Sale of Discontinued Operations, Net of Income Tax of $0 and $0	(726)	
Net Income	$ 3,042	$ 22
Income (Loss) Per Share		
Basic		
Income (Loss) Per Share From Continuing Operations	$ 0.10	$ (0.03)
Discontinued Operations, Net of Income Tax	$ (0.02)	$ 0.03
Net Income	$ 0.08	$ 0.00
Diluted		
Income (Loss) Per Share From Continuing Operations	$ 0.10	$ (0.03)
Discontinued Operations, Net of Income Tax	$ (0.02)	$ 0.03
Net Income	$ 0.08	$ 0.00

Weighted Average Shares Used in Computing Basic and Diluted Net Income (Loss) Per Share		
Basic	37,075	34,299
Diluted	37,877	34,299

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(unaudited; in thousands)

	Three Months Ended July 31,	
	2006	**2005**
Cash Flows from Operating Activities:		
Net Income	$ 3,042	$ 22
Adjustments to Reconcile Net Income to Cash Provided by Operating Activities:		
Depreciation and Amortization	706	1,165
Loss on Sale of Discontinued Operations	726	
Unrealized Foreign Currency Gains	(843)	(349)
Fair Value Adjustment on Warrants Issued		678
Incentive Stock Compensation Expense	711	712
Other	639	71
Changes in Operating Assets and Liabilities:		
Receivables	5,659	9,700
Inventories	(2,579)	(2,203)
Other Operating Assets	1,293	(1,188)
Customer Deposits	1,106	4,118
Accounts Payable	(6,977)	(5,861)
Deferred Revenue	(121)	(1,630)
Other Operating Liabilities	(314)	537
Cash Provided by Operating Activities	3,048	5,772
Cash Flows from Investing Activities:		
Expenditures for Property and Equipment	(1,085)	(519)
Restricted Cash		(2,137)
Other		(59)
Cash Used in Investing Activities	(1,085)	(2,715)
Cash Flows from Financing Activities:		
Borrowings under Notes Payable, Net		542
Payments on Senior Credit Agreement		(17,759)
Borrowings on Senior Credit Agreement		16,049
Payments of Long-Term Obligations	(465)	(39)
Proceeds from Exercise of Warrants and Options	1,217	
Other		9
Cash Provided By (Used In) Financing Activities	752	(1,198)
Effect of Changes in Exchange Rates on Cash	54	384
Increase in Cash and Cash Equivalents	2,769	2,243
Cash and Cash Equivalents at Beginning of Period	36,186	12,976
Cash and Cash Equivalents at End of Period	$ 38,955	$ 15,219

Supplemental Disclosure of Noncash Financing Activity				
Issuance of compensatory common stock on executive incentive compensation plan	$	884	$	799

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FLOW INTERNATIONAL CORPORATION

CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY

AND COMPREHENSIVE INCOME

(unaudited, in thousands)

	Common Stock				Accumulated	
			Capital		Other	Total
		Par	In Excess	Accumulated	Comprehensive	Shareholders
	Shares	Value	of Par	Deficit	Loss	Equity
Balances, April 30, 2006	36,943	$ 364	$ 137,192	$ (72,417)	$ (7,999)	$ 57,140
Cumulative effect of the adoption of FAS 123R (Note 3)			(313)			(313)
Components of Comprehensive Income:						
Net Income				3,042		3,042
Unrealized Loss on Cash Flow Hedges, Net of Income Tax of $0					(179)	(179)
Reclassification Adjustment for Settlement of Cash Flow Hedges, net of income tax of $0					273	273
Cumulative Translation Adjustment, Net of Income Tax of $0					(859)	(859)
Total Comprehensive Income						2,277
Exercise of Options	122	1	1,216			1,217
Stock Compensation	91	1	1,176			1,177
Balances, July 31, 2006	37,156	$ 366	$ 139,271	$ (69,375)	$ (8,764)	$ 61,498

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(All tabular dollar amounts in thousands, except shares and per share amounts)

(Unaudited)

Note 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 and accruals necessary to fairly present the financial position, results of operations and cash flows of the Company. The financial information as of April 30, 2006 is derived from the Company s audited consolidated financial statements and notes for the fiscal year ended April 30, 2006 included in Item 8 in the fiscal 2006 Annual Report on Form 10-K/A (10-K/A). 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 Company s fiscal 2006 Form 10-K/A. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of the Company s financial statements. Actual results may differ from these estimates. Operating results for the three months ended July 31, 2006 may not be indicative of future results.

For fiscal 2007, Interest Income, Interest Expense and Fair Value Adjustments on Warrants Issued have been shown separately in the Condensed Consolidated Statement of Income and the prior period presentation has been conformed.

Note 2 Segment Information

The Company has identified four reportable segments. These segments, North America Waterjet, Asia Waterjet, Other International Waterjet (together known as Waterjet), and Applications, utilize the Company s released pressure technology. The Waterjet operation includes cutting and cleaning operations, which are focused on providing total solutions for many industries including aerospace, automotive, semiconductor, disposable products, food, glass, job shop, metal cutting, stone, tile, surface preparation, and paper. The Applications operation provides specialty engineered robotic systems designed for material removal and separation of various materials and for factory automation. These systems are primarily used in automotive applications. Segment operating results are measured based on revenue, gross margin and operating income (loss).

A summary of operations by reportable segment is as follows:

	North America Waterjet	Asia Waterjet	Other International Waterjet	Applications	Inter-segment Eliminations	Total
Three Months Ended July 31, 2006						
External sales	$ 31,509	$ 7,356	$ 10,641	$ 3,904	$	$ 53,410
Inter-segment sales	5,394	307	45	16	(5,762)	
Gross Margin	14,333	4,466	3,989	446	(202)	23,032
Operating income (loss)	1,707	2,592	566	(542)	(202)	4,121
Three Months Ended July 31, 2005						
External sales	$ 22,927	$ 5,768	$ 8,453	$ 4,838	$	$ 41,986

Inter-segment sales	4,964	485	35	(183)	(5,301)	
Gross Margin	10,947	2,810	3,261	875	40	17,933
Operating income	427	1,345	283	71	40	2,166

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(Unaudited)

A summary reconciliation of total segment operating income to total consolidated income before provision for income taxes is as follows:

	Three Months Ended July 31, 2006	Three Months Ended July 31, 2005
Operating income for reportable segments	$ 4,121	$ 2,166
Interest income	229	39
Interest expense	(135)	(965)
Fair value adjustment on warrants issued		(678)
Other income (expense), net	625	(1,107)
Income (loss) before provision for income taxes	$ 4,840	$ (545)

Note 3 Stock-Based Compensation Plans

The Company maintains several stock-based compensation plans described as follows:

1987 Stock Option Plan for Nonemployee Directors (the 1987 Nonemployee Directors Plan). Approved by the Company s shareholders in September 1987, the 1987 Non-employee Directors Plan, as subsequently amended, provided for the automatic grant of nonqualified options for 10,000 shares of Company common stock to a nonemployee director when initially elected or appointed, and the issuance of 10,000 options annually thereafter during the term of directorship. Options are no longer granted under this plan.

1991 Stock Option Plan (the 1991 SO Plan). The 1991 SO Plan was adopted in October 1991 and amended in August 1993. Incentive and nonqualified stock options up to 700,000 shares could be issued under this plan. Options are no longer granted under this plan.

1995 Long-Term Incentive Plan (the 1995 LTI Plan). The 1995 LTI Plan was adopted in August 1995. In fiscal 2000, the 1995 LTI Plan was amended to increase the number of shares available for grant to 3,350,000 shares. The 1995 LTI Plan was replaced by the 2005 Plan described below. The remaining shares available under this plan of 751,157 will be granted under the 2005 Plan.

2005 Equity Incentive Plan (the 2005 Plan). Upon approval by the shareholders, the 2005 Plan was adopted in September 2005 to attract and retain the most talented employees and promote the growth and success of the business by aligning long-term interests of employees with those of shareholders. The 2005 Plan provides for a pool of 2.5 million shares to be awarded, which includes the remaining 751,157 shares from the 1995 LTI Plan. The Company, at its discretion, may choose to grant the 2.5 million shares in the form of stock, stock units, stock options, stock appreciation rights, or cash awards.

Prior to May 1, 2006, the Company has accounted for these plans under the recognition and measurement provisions of APB Opinion No. 25 (APB 25), Accounting for Stock Issued to Employees and related interpretations. No stock-based employee compensation cost was reflected in the Company s net income to the extent options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant.

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(Unaudited)

Effective May 1, 2006, the beginning of its fiscal year 2007, the Company adopted the fair value recognition provisions of Statement of Financial Accounting Standard No. 123R (FAS 123R), Share-Based Payment (Revised 2004) . The Company elected to use the modified prospective transition method permitted by FAS 123R and therefore has not restated its financial results for prior periods. Under this transition method, the compensation cost recognized by the Company beginning in fiscal 2007 includes (a) compensation cost for all stock-based compensation awards that were granted prior to, but not vested as of May 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of Statement of Financial Accounting Standard No. 123 (FAS 123), Accounting for Stock Based Compensation , and (b) compensation cost for all stock-based compensation awards granted subsequent to May 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of FAS 123R. The Company estimates forfeiture rate based on its historical experience and future expectations. Compensation expense is being recognized on a straight-line basis over the total requisite service period of each award and recorded in operating expenses on the Condensed Consolidated Statements of Income.

The following table illustrates the effect on net income and net income per share for the three months ended July 31, 2005 if the Company had applied the fair value recognition provisions of FAS 123 to stock-based compensation. Because the Company has a full valuation allowance against its deferred tax assets there are no tax effects presented related to the stock-based compensation items below.

		Three Months Ended July 31, 2005
Net income, as reported	$	22
Add: Employee stock-based compensation under APB 25 included in net income, net of related tax effects		712
Deduct: Total employee stock-based compensation expense determined under fair value based method for all awards, net of tax related effects		(211)
Pro forma net income	$	523
Net income per share basic and diluted:		
As reported	$	.00
Pro forma	$	.02

Stock Options

The Company grants common stock options to employees and directors of the company with service and/or performance conditions. The compensation cost of the stock options are based on their fair value at the grant date and recognized ratably over the service period. Compensation expense is recognized only for those options expected to vest with forfeitures estimated at the grant date based on the Company s historical experience and future expectations. All options become exercisable upon a change in control of the Company unless the surviving company assumes the outstanding options or substitutes similar awards for the outstanding awards of the 2005 Plan. Options generally have a two-year vesting schedule, and are generally granted with an exercise price equal to the fair market value of the Company s common stock on the date of grant. The maximum term of options is 10 years from the date of grant.

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(Unaudited)

The following tables summarize the stock option activities for the three months ended July 31, 2006. The Company did not grant any stock options during the three months ended July 31, 2005.

	Three Months Ended July 31, 2006			
	Number of Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value	Weighted-Average Remaining Contractual Term
Outstanding at May 1, 2006	1,241,991	$ 8.91		
Granted during the period:	21,250	12.81		
Exercised during the period:	(122,166)	9.96		
Forfeited during the period:				
Expired during the period:	(10,777)	9.64		
Outstanding at July 31, 2006	1,130,298	$ 8.86	$ 5,242	4.24
Exercisable at July 31, 2006	1,079,880	$ 8.92	$ 4,944	4.24
Vested or expected to vest at July 31, 2006	1,079,880	$ 8.92	$ 4,944	4.24

	Three Months Ended July 31, 2006
Weighted Average grant-date fair value of stock options granted	$ 4.76
Total intrinsic value of options exercised	$ 469
Total fair value of options vested	$ 28
Cash received from exercise of share options	$ 1,217
Tax benefit realized from stock options exercised	$

The weighted-average fair values at the date of grant for options were estimated using the Black-Scholes option-pricing model, based on the following assumptions:

	Three Months Ended July 31	
	2006	2005
Risk-free interest rates	4.97%	4.01%
Expected lives	Two years	Five years
Expected dividend yields	0%	0%
Expected volatility	61.86%	62.8%

For the three months ended July 31, 2006, the Company recognized compensation expense related to stock options of $53,000, or $0.00 per basic and diluted share. As of July 31, 2006, $140,000 of total unrecognized compensation cost related to nonvested stock options is expected to be recognized over a weighted average period of eight months.

Service-Based Stock Awards

The Company grants common stock or stock units to employees and directors of the Company with service conditions. The compensation cost of the stocks or units are based on their fair value at the grant date and recognized ratably over the service period.

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(Unaudited)

The following table summarizes the service-based stock award activities for the three months ended July 31, 2006:

	Three Months Ended July 31, 2006	
	Number of Shares	Weighted-Average Grant-date Fair Value
Nonvested at May 1, 2006	87,890	$ 4.86
Vested during the period:	(8,760)	3.36
Nonvested at July 31, 2006	79,130	$ 5.03

For the three months ended July 31, 2006 and 2005, the Company recognized compensation expense related to stock-based stock awards of $150,000 and $712,000, respectively. As of July 31, 2006, $398,000 of total unrecognized compensation cost related to such awards is expected to be recognized over a weighted average period of 2.66 years.

Performance-Based Stock Awards

The Company also grants stock units to an executive of the Company as part of the executive s employment agreement. The stock units are granted at the beginning of the Company s fiscal year and are vested at the year end upon achieving predetermined performance targets for that fiscal year. The compensation cost of the stock units are based on its fair value at the grant date and recognized ratably over the service period. The Company granted 45,000 shares in the first quarter of each of fiscal 2007 and fiscal 2006. For the three months ended July 31, 2006 and 2005, the Company recognized compensation expense related to these awards of $144,000, and $140,000, respectively. As of July 31, 2006, total unrecognized compensation cost related to such award of $432,000 is expected to be recognized over a period of nine months.

Under an annual incentive plan adopted for each fiscal year, the Company grants executives and certain employees annual bonuses in the form of cash and common stock of the Company. Awards are based on the Company s performance and individual goals and are usually granted following the conclusion of the Company s fiscal year end. The shares of the common stock were not known at the grant date and the amount of the stock was equivalent to a fixed monetary amount. These awards have been recorded as liability awards under FAS 123R. Prior to May 1, 2006, the common stock portion of the awards were recorded as equity under APB 25. A cumulative effect adjustment of $690,000 was recognized upon adoption of FAS 123R to record the amounts from previously recorded capital in excess of par as a liability. For the three months ended July 31, 2006, the Company recognized compensation expense related to the annual incentive plan of $116,000. No such expense was recognized in the same period of the prior fiscal year as the achievement of the performance objectives was not deemed probable. As of July 31, 2006, $347,000 of total unrecognized compensation cost related to such awards is expected to be recognized over a weighted average period of nine months.

Starting fiscal 2006, the Company initiated Long-Term Incentive Plans (the LTIPs) under which the executive officers will receive stock awards based on the Company s performance measures over three-year performance periods. These plans are adopted annually with new performance targets. Awards vary based on the degree to which the Company s performance exceeds predetermined thresholds at the end of the performance period. No payout will occur unless the Company exceeds certain minimum threshold performance objectives.

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(Unaudited)

Compensation expense is based upon current performance projections for the three-year period and the percentage of the requisite service that has been rendered. During Fiscal 2006, accrued compensation expense for the LTIP was adjusted in each reporting period for changes in the value of the Company s common stocks as required by the variable accounting method under APB 25. Upon adopting FAS 123R in fiscal 2007 the Company ceased using the variable accounting, and now records compensation cost for the unvested portion of the LTIP awards based on their grant-date fair value. The LTIPs permit employees to elect to net-settle a portion of the award paid in stock to meet the employee s share of minimum withholding requirements which the Company accounted for as a liability before adopting FAS 123R. FAS 123R allows such awards with net-settlement features for the employee s share of the minimum withholding requirements to be accounted for as an equity award, as such, a cumulative effect adjustment of $377,000 was recognized upon adoption of FAS 123R to record the amounts previously recorded as liabilities in capital in excess of par.

The following table summarizes the LTIPs activities for the three months ended July 31, 2006:

	Three Months Ended July 31, 2006	
	Number of Shares	Weighted-Average Grant-date Fair Value
Nonvested at May 1, 2006	279,000	$ 7.81
Granted during the period	137,500	$ 13.50
Nonvested at July 31, 2006	416,500	$ 9.69

For the three months ended July 31, 2006, the company recognized compensation expense related to LTIPs of $204,000. No such expense was recognized in the same period of the prior fiscal year as the achievement of the performance objectives was not deemed probable. As of July 31, 2006, $3.1 million of total unrecognized compensation cost related to such awards is expected to be recognized over a weighted average period of 2.34 years.

Note 4 Restructuring

During the three months ended July 31, 2005, the Company announced the closing and relocation of its Wixom, Michigan facility to its Burlington, Ontario facility and terminated 13 employees. In connection with this restructuring, the Company recorded severance benefits of $74,000 which were paid in the quarter and also wrote off $24,000 of inventory with no future value. The Company did not incur any restructuring costs for the three months ended July 31, 2006.

The remaining accrued facility exit costs for all segments at July 31, 2006 of $ 790,000, which consist of long-term lease commitments, net of expected sublease income, will be paid primarily over the next two years.

The following table summarizes accrued restructuring activity, all incurred as facility exit costs:

	North America Waterjet	Other International Waterjet	Applications	Consolidated
Balance, April 30, 2006	$ 67	$ 164	$ 684	$ 915
Cash payments	(9)	(7)	(109)	(125)
Balance, July 31, 2006	$ 58	$ 157	$ 575	$ 790

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(All tabular dollar amounts in thousands, except shares and per share amounts)

(Unaudited)

Note 5 Other Income (Expense), Net

The Company s subsidiaries have adopted the local currency of the country in which they operate as the functional currency. All assets and liabilities of these foreign subsidiaries are translated at period-end rates. Income and expense accounts of the foreign subsidiaries are translated at the average rates in effect during the period. Assets and liabilities (including inter-company accounts that are transactional in nature) of the Company which are denominated in currencies other than the functional currency of the entity are translated based on current exchange rates and gains or losses are included in the Condensed Consolidated Statement of Income.

The following table shows the detail of Other Income (Expense), Net, in the accompanying Condensed Consolidated Statements of Income:

	Three Months Ended July 31,	
	2006	2005
Realized Foreign Exchange Gains, Net	$ 38	$ 17
Unrealized Foreign Exchange Gains (Losses), Net	843	(1,089)
Hedge Costs	(160)	
Other	(96)	(35)
	$ 625	$ (1,107)

For the three months ended July 31, 2006, the Company recorded an expense of $160,000 related to hedges terminated during the period. The Company uses derivative instruments to manage exposures to foreign currency risks and records the hedge transactions in accordance with Statement of Financial Accounting Standards No. 133 (FAS 133), Accounting for Derivative Instruments and Hedging Activities . In fiscal 2006, the Company entered into derivative instruments to hedge against two aerospace systems to be paid in Eurodollars. In June 2006, the Company was directed by the customer to suspend work on these two systems as a result of possible changes in the timing or scope of the projects. The Company consequently cancelled the related hedges and discontinued hedge accounting in accordance with FAS 133.

Note 6 Income Taxes

For the three months ended July 31, 2006, the tax provision consists of current expense related to operations in foreign jurisdictions which are profitable and without loss carryforwards. In addition, certain operations in jurisdictions (principally Germany and the US) reported net income against which the Company offset net operating losses. However, because the operations in these jurisdictions have not shown a history of net income, the Company has not recognized a benefit for these unutilized net operating losses as it is currently more likely than not that such benefit will not be realized.

The Company continues to provide a full valuation allowance against its net operating losses and certain other net deferred tax assets, arising in selected tax jurisdictions because the realization of such assets is not more likely than not. For the quarter ended July 31, 2006, the valuation allowance decreased by $.5 million from net operating losses in Germany and the US being applied against net income realized in these jurisdictions for the quarter. The domestic net operating losses can be carried forward 20 years to offset domestic profits in future periods and expire from fiscal 2022 through fiscal 2026 while the foreign net operating losses have no expiration dates.

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(All tabular dollar amounts in thousands, except shares and per share amounts)

(Unaudited)

Note 7 Discontinued Operations

On October 31, 2005, the Company completed the sale of certain of its non-core businesses as a result of the strategy to divest itself of operations that do not rely upon its core ultra-high-pressure water pump business (the Avure Business). The Company has classified the financial results of its Avure Business as discontinued operations on the Condensed Consolidated Statements of Income for all periods presented. The Condensed Consolidated Statements of Cash Flows for the three months ended July 31, 2005 do not reflect discontinued operations treatment for the Avure Business as the Company has elected not to reclassify its cash flows for this discontinued operation.

The purchaser of the Avure Business (Purchaser) subsequently claimed that it was entitled to a further working capital adjustment of $1.4 million, which claim the Company disputed. The Company and the Purchaser agreed to resolve this claim in accordance with an arbitration procedure agreed on at the time of sale. The Company and the Purchaser also agreed that the Purchaser would have a limited right to prepay, at a 12.5% discount, the balance of the promissory note which is due 3 years after closing. The prepayment right expired on October 31, 2006. The Company received a partial payment on the promissory note of $990,000 in the second quarter of fiscal 2007.

The Company initially recorded a loss of $1,147,000, net of income taxes of $334,000, on the sale. During the third quarter of its fiscal year 2006, the Company increased its Loss on Sale of Discontinued Operations by $300,000 as its best estimate of the amount required to settle the working capital dispute, and by $107,000 as a discount on the 3 year note, for a total of $407,000.

Summarized financial information for the discontinued operations is set forth below: