

GERBER SCIENTIFIC INC
Form 10-Q
September 08, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

**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 1-5865

Gerber Scientific, Inc.

(Exact name of registrant as specified in its charter)

Connecticut

(State or other jurisdiction of incorporation or
organization)

06-0640743
(I.R.S. Employer
Identification No.)
06074

83 Gerber Road West, South Windsor, Connecticut

(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 No

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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 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

Common stock \$0.01 par value per share.

22,873,088

Total shares outstanding August 31, 2006

GERBER SCIENTIFIC, INC.
 INDEX
 Quarter Ended July 31, 2006

	<u>Page Number</u>
Part I.	
Financial Information	
Item 1.	
Financial Statements	
Condensed Consolidated Statements of Operations	3
Condensed Consolidated Balance Sheets	4
Condensed Consolidated Statements of Cash Flows	5
Notes to Condensed Consolidated Financial Statements	6-12
Management's Discussion and Analysis of Financial	
Condition and Results of Operations ...	13-21
Quantitative and Qualitative Disclosures about Market Risk	
Item 3.	22
Controls and Procedures	
Item 4.	22
Part II.	
Other Information	
Risk Factors	
Item 1A.	23
Unregistered Sales of Equity Securities and Use of Proceeds	
Item 2.	23
Other Information	
Item 5.	24
Exhibits	
Item 6.	24
Signature	25
Exhibit Index	26

PART I - FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS

GERBER SCIENTIFIC, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

	Quarter Ended <u>July 31,</u>	
<u>In thousands, except per share data</u>	<u>2006</u>	<u>2005</u>
Revenue:		
Product sales	\$ 121,412	\$ 113,417
Service sales	<u>16,076</u>	<u>15,347</u>
	137,488	128,764
Costs and Expenses:		
Cost of products sold	86,248	79,865
Cost of services sold	9,535	9,643
Selling, general and administrative expenses	31,363	29,575
Research and development	5,968	6,312
Restructuring charges	<u>---</u>	<u>(36)</u>
	<u>133,114</u>	<u>125,359</u>
Operating income	4,374	3,405
Other income (expense), net	(159)	(175)
Interest expense	<u>(777)</u>	<u>(1,431)</u>
Income before income taxes	3,438	1,799
Income tax expense	<u>1,414</u>	<u>2,882</u>
Net income (loss)	<u>\$ 2,024</u>	<u>\$ (1,083)</u>
Earnings (Loss) per share of common stock:		
Basic	\$ 0.09	\$ (0.05)
Diluted	\$ 0.09	\$ (0.05)
Weighted average shares outstanding:		
Basic	22,621	22,311
Diluted	23,051	22,311

See accompanying notes to condensed consolidated financial statements.

GERBER SCIENTIFIC, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

<u>In thousands</u>	July 31, <u>2006</u>	April 30, <u>2006</u>
Assets		
Current Assets:		
Cash and cash equivalents	\$ 8,063	\$ 14,145
Accounts receivable, net	89,642	92,422
Inventories	60,171	53,794
Deferred tax assets	10,358	10,651
Prepaid expenses and other current assets	<u>6,855</u>	<u>6,067</u>
Total current assets	<u>175,089</u>	<u>177,079</u>
Property, plant and equipment, net	37,357	38,366
Goodwill	51,840	51,554
Deferred tax assets	27,765	27,696
Other assets, net	<u>15,526</u>	<u>15,785</u>
Total Assets	<u>\$ 307,577</u>	<u>\$ 310,480</u>
Liabilities and Shareholders' Equity		
Current Liabilities:		
Current portion of long-term debt	\$1,600	\$284
Accounts payable	44,237	53,886
Accrued compensation and benefits	20,627	21,670
Other accrued liabilities	22,020	21,539
Deferred revenue	<u>14,126</u>	<u>14,039</u>
	<u>102,610</u>	<u>111,418</u>
Total current liabilities		
Long-term debt	38,778	36,836
Accrued pension benefit liabilities	19,596	19,641
Other liabilities	16,705	16,969
Commitments and contingencies		
Shareholders' Equity:		
Preferred stock	---	---
Common stock	234	233
Additional paid-in capital	68,520	67,339
Retained earnings	71,806	69,782
Treasury stock, at cost	(13,353)	(13,496)
Unamortized value of restricted stock grants	---	(136)
Accumulated other comprehensive income	<u>2,681</u>	<u>1,894</u>
	<u>129,888</u>	<u>125,616</u>
Total Liabilities and Shareholders' Equity	<u>\$ 307,577</u>	<u>\$ 310,480</u>

See accompanying notes to condensed consolidated financial statements.

GERBER SCIENTIFIC, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

	Quarter Ended	
	<u>July 31,</u>	
<u>In thousands</u>	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Net earnings (loss)	\$ 2,024	\$ (1,083)
Adjustments to reconcile net earnings (loss)		
to cash (used for) provided by operating activities:		
Depreciation and amortization	2,117	2,190
Deferred income taxes	86	2,711
Restructuring charges	---	(36)
Stock-based compensation cost	304	17
Other non-cash items	248	698
Changes in operating accounts:		
Accounts receivable	2,975	1,200
Inventories	(6,066)	(3,421)
Prepaid expenses and other assets	(723)	(951)
Accounts payable and other liabilities	(9,160)	1,688
Accrued compensation and benefits	<u>(1,183)</u>	<u>1,531</u>
Net cash (used for) provided by operating activities	<u>(9,378)</u>	<u>4,544</u>
Cash flows from investing activities:		
Capital expenditures	(714)	(3,256)
Proceeds from sale of available for sale investments	92	---
Purchases of available for sale investments	(34)	---
Acquisitions of intangible assets	<u>(150)</u>	<u>(144)</u>
Net cash used for investing activities	<u>(806)</u>	<u>(3,400)</u>
Cash flows from financing activities:		
Debt repayments	(70,362)	(70,457)
Debt proceeds	73,613	67,869
Excess tax benefits from stock-based compensation	283	---
Stock issued under employee plans	<u>784</u>	<u>41</u>
Net cash provided by (used for) financing activities	<u>4,318</u>	<u>(2,547)</u>
Effect of exchange rate changes on cash	(216)	(1,362)
Decrease in cash and cash equivalents	(6,082)	(2,765)
Cash and cash equivalents at beginning of year	<u>14,145</u>	<u>6,148</u>
Cash and cash equivalents at end of period	<u>\$ 8,063</u>	<u>\$ 3,383</u>

See accompanying notes to condensed consolidated financial statements.

GERBER SCIENTIFIC, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

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. All significant intercompany transactions have been eliminated in the condensed consolidated financial statements. The condensed consolidated financial statements have been prepared, in all material respects, in accordance with the same accounting principles followed in the preparation of the Company's annual financial statements for the fiscal year ended April 30, 2006, except for the adoption of the Financial Accounting Standards Board's ("FASB") Statement of Financial Accounting Standards ("SFAS") No. 123R, "Share-Based Payment," ("SFAS 123R") on May 1, 2006. Management believes that all adjustments, which include only normal recurring adjustments necessary to fairly present the Company's consolidated financial position, results of operations and cash flows for the periods reported, have been included. The financial information included in this Quarterly Report on Form 10-Q should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company's Annual Report on Form 10-K for the fiscal year ended April 30, 2006, filed with the Securities and Exchange Commission on July 28, 2006. The condensed consolidated balance sheet has been derived from the April 30, 2006 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. Certain reclassifications have been made to the prior year amounts disclosed in the condensed consolidated financial statements to conform to the presentation for the fiscal quarter ended July 31, 2006.

Note 2. Stock-Based Compensation

The Company has stock-based compensation plans under which incentive and non-qualified stock options and restricted stock may be granted to employees from common stock. Directors may receive share grants from treasury stock. Options issued by the Company under its stock option plans have a term of ten years and generally vest ratably over a period of three years. Restricted stock grants are expensed over the vesting period of the award. Under all stock option plans, the exercise price of the stock option is set on the grant date and may not be less than the fair market value per share on that date.

On May 1, 2006, the Company adopted the provisions of SFAS 123R, which establishes accounting for equity instruments exchanged for employee services. Under the provisions of SFAS 123R, stock-based compensation cost is measured at the grant date, based on the calculated fair value of the award, and is recognized as an expense over the employee's requisite service period (generally the vesting period of the equity grant). Prior to May 1, 2006, the Company accounted for stock-based compensation to employees in accordance with Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees" ("APB 25"), and related interpretations. The Company also followed the disclosure requirements of SFAS 123, "Accounting for Stock-Based Compensation," as amended by SFAS 148, "Accounting for Stock-Based Compensation - Transition and Disclosure." The Company elected to adopt the prospective transition method as provided by SFAS 123R and, accordingly, financial statement amounts for the prior periods presented in this Form 10-Q have not been restated to reflect the fair value method of expensing stock-based compensation.

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The following table illustrates the effects on net loss and loss per share for the quarter ended July 31, 2005 as if the Company had applied the fair value recognition provisions of SFAS 123 to stock-based employee awards.

<u>In thousands</u>	Quarter Ended <u>July 31, 2005</u>
Net loss, as reported	\$ (1,083)
Add: Stock-based compensation expense included in reported net loss, net of related tax effects	7
Less: Stock-based employee compensation expense determined under the Black-Scholes option pricing model, net of related tax effects	<u>(88)</u>
Net loss, pro forma	<u>\$ (1,164)</u>
Basic and diluted loss per share:	
As reported	\$ (0.05)
Pro forma	\$ (0.05)

The Company's condensed consolidated statements of operations include \$0.2 million, net of \$0.1 million of tax benefits, of stock-based compensation expense for the quarter ended July 31, 2006, which was recorded substantially within selling, general and administrative expenses.

The Company estimates the fair value of stock options using the Black-Scholes valuation model. Key assumptions used to estimate the fair value of stock options include the exercise price of the award, the expected option term, the expected volatility of the Company's stock over the expected option term, the risk-free interest rate over the expected option term, and the Company's expected annual dividend yield. Estimates of fair value are not intended to predict actual future events or the value ultimately realized by employees who receive equity awards.

There were no options granted in the quarters ended July 31, 2006 or 2005.

The Company did not recognize compensation expense for employee stock-based awards for the quarter ended July 31, 2005. The Company did recognize compensation expense under APB 25 related to restricted stock.

Stock option activity under all of the Company's stock plans since April 30, 2006 is summarized as follows:

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	Shares (in thousands)	Weighted-Average Exercise <u>Price</u>	Weighted- Average Remaining Contractual <u>Term</u>	Aggregate Intrinsic Value (in millions)
Outstanding as of April 30, 2006	2,846	\$11.08	5.2 years	
Options granted	---	---		
Options exercised	(124)	\$ 6.49		\$ 0.8
Options canceled	<u>(182)</u>	\$15.24		
Outstanding as of July 31, 2006	<u>2,540</u>	\$11.00	5.2 years	\$14.0
Options exercisable at end of period	<u>2,016</u>			\$10.4

The following table summarizes information about stock options outstanding as of July 31, 2006:

Range of Exercise Prices	Outstanding Options			Exercisable Options		
	Shares (in thousands)	Weighted- Average Remaining Contractual <u>Term</u>	Weighted- Average Exercise <u>Price</u>	Shares (in thousands)	Weighted- Average Exercise <u>Price</u>	
\$3.35 - \$5.03	293	5.8 years	\$ 3.42	293	\$ 3.42	
\$5.04 - \$7.54	640	6.7 years	\$ 6.79	439	\$ 6.90	
\$7.55 - \$11.31	722	7.0 years	\$ 9.32	405	\$ 9.21	
\$11.32 - \$16.96	473	3.0 years	\$14.09	467	\$14.11	
\$16.97 - \$25.44	391	1.9 years	\$22.07	391	\$22.07	
\$25.45 - \$28.12	<u>21</u>	1.2 years	\$27.33	<u>21</u>	\$27.33	
	<u>2,540</u>	5.2 years	\$11.00	<u>2,016</u>	\$11.69	

The following table summarizes the activity for the Company's nonvested shares of restricted stock during the fiscal quarter ended July 31, 2006:

	Shares	Weighted- Average Fair Value
<u>In thousands except per share amounts</u>		
Nonvested as of April 30, 2006	23	\$8.03
Granted	---	---
Vested	(4)	\$6.92
Forfeited	---	---
Nonvested as of July 31, 2006	<u>19</u>	\$8.27

As of July 31, 2006, there was \$2.3 million of unrecognized compensation cost related to nonvested stock-based compensation arrangements granted under the Company's stock plans. That cost is expected to be recognized over a weighted-average period of 2.8 years.

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Note 3. Inventories

Inventories, net of reserves, were as follows:

<u>In thousands</u>	<u>July 31, 2006</u>	<u>April 30, 2006</u>
Raw materials and purchased parts	\$ 47,828	\$ 41,061
Work in process	2,002	1,497
Finished goods	<u>10,341</u>	<u>11,236</u>
Total inventories	<u>\$ 60,171</u>	<u>\$ 53,794</u>

Note 4. Restructuring

The Company's restructuring accrual as of April 30, 2006 was related to a leased facility consolidation in the Sign Making and Specialty Graphics segment that was initiated in the fiscal year ended April 30, 2004. During the quarter ended July 31, 2006, payments of \$0.1 million reduced the accrual to an ending balance of \$1.4 million. The remaining cash payments will continue over the life of the lease, through the fiscal year ending April 30, 2019.

Note 5. Goodwill and Intangible Assets

The table below presents the gross carrying amount and accumulated amortization of the Company's acquired intangible assets other than goodwill included in Other assets, net on the Company's Condensed Consolidated Balance Sheets:

<u>In thousands</u>	<u>July 31, 2006</u>		<u>April 30, 2006</u>	
	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>	<u>Gross Carrying Amount</u>	<u>Accumulated Amortization</u>
Amortized intangible assets:				
Patents	\$ 7,338	\$ 2,801	\$ 7,313	\$ 2,775
Other	<u>541</u>	<u>204</u>	<u>525</u>	<u>194</u>
Total amortized intangible assets	<u>\$ 7,879</u>	<u>\$ 3,005</u>	<u>\$ 7,838</u>	<u>\$ 2,969</u>

Intangible asset amortization expense was \$0.1 million for the quarter ended July 31, 2006 and \$0.2 million for the quarter ended July 31, 2005. Intangible asset amortization is estimated to be approximately \$0.5 million annually for fiscal years ending April 30, 2007 and 2008, and \$0.4 million for fiscal years ending April 30, 2009 through 2012.

There were no impairments or dispositions of goodwill during the quarters ended July 31, 2006 or 2005. Balances and changes in the carrying amount of goodwill for the quarter ended July 31, 2006 were as follows:

<u>In thousands</u>	<u>Sign Making and Specialty Graphics</u>	<u>Apparel and Flexible Materials</u>	<u>Ophthalmic Lens Processing</u>	<u>Total</u>
Balance as of April 30, 2006	\$ 22,060	\$ 12,498	\$ 16,996	\$51,554
Effects of currency translation	<u>367</u>	<u>(81)</u>	<u>---</u>	<u>286</u>
Balance as of July 31, 2006	<u>\$ 22,427</u>	<u>\$ 12,417</u>	<u>\$ 16,996</u>	<u>\$51,840</u>

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Note 6. Segment Reporting

The Company's operations are classified into three reportable operating segments: Sign Making and Specialty Graphics, Apparel and Flexible Materials and Ophthalmic Lens Processing. The Sign Making and Specialty Graphics reportable operating segment is comprised of the Gerber Scientific Products and Spandex, Ltd. business units.

The following table presents revenue by operating segment.

<u>In thousands</u>	Quarter Ended	
	<u>2006</u>	<u>2005</u>
Sign Making and Specialty Graphics:		
Gerber Scientific Products	\$ 23,137	\$ 22,794
Spandex	<u>50,022</u>	<u>47,126</u>
Sign Making and Specialty Graphics	73,159	69,920
Apparel and Flexible Materials	46,543	42,229
Ophthalmic Lens Processing	<u>17,786</u>	<u>16,615</u>
Consolidated revenue	<u>\$ 137,488</u>	<u>\$ 128,764</u>

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

<u>In thousands</u>	Quarter Ended	
	<u>2006</u>	<u>2005</u>
Sign Making and Specialty Graphics:		
Gerber Scientific Products	\$ 1,706	\$ 2,123
Spandex	<u>1,532</u>	<u>957</u>
Sign Making and Specialty Graphics	3,238	3,080
Apparel and Flexible Materials	5,967	5,068
Ophthalmic Lens Processing	<u>260</u>	<u>(682)</u>
Segment operating income	9,465	7,466
Corporate operating expenses	<u>(5,091)</u>	<u>(4,061)</u>
Consolidated operating income	<u>\$ 4,374</u>	<u>\$ 3,405</u>

Note 7. Comprehensive Income (Loss)

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

<u>In thousands</u>	Quarter Ended	
	<u>2006</u>	<u>2005</u>
Net income (loss)	\$ 2,024	\$ (1,083)
Other comprehensive income (loss):		
Foreign currency translation adjustments	830	(6,350)
Unrealized investment loss	<u>(43)</u>	<u>---</u>
Total comprehensive income (loss)	<u>\$ 2,811</u>	<u>\$ (7,433)</u>

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Note 8. Earnings (Loss) Per Share

Basic and diluted earnings per common share are calculated in accordance with the provisions of FASB Statement of Financial Accounting Standards No. 128, "Earnings per Share." Basic earnings per common share are equal to net income divided by the weighted average number of common shares outstanding during the period. Diluted earnings per common share are equal to net income divided by the weighted average number of common shares outstanding during the period, including the effect of stock options and stock awards, where such effect is dilutive. The following table sets forth the computation of basic and diluted net earnings (loss) per common share:

	Quarter Ended July 31, 2006			Quarter Ended July 31, 2005		
	Net Income	Average Shares	Per Share Amount	Net Loss	Average Shares	Per Share Amount
<u>In thousands except per share amounts</u>						
Basic earnings per share	\$ 2,024	22,621	\$ 0.09	\$ (1,083)	22,311	\$ (0.05)
Effect of dilutive options and awards	---	430	---	---	---	---
Diluted earnings per share	<u>\$ 2,024</u>	<u>23,051</u>	<u>\$ 0.09</u>	<u>\$ (1,083)</u>	<u>22,311</u>	<u>\$ (0.05)</u>

For the quarter ended July 31, 2005, stock options exercisable for an additional 0.2 million shares of common stock were excluded from the calculation of diluted loss per share because the Company reported a net loss.

Note 9. Guarantees

The Company extends financial and product performance guarantees to third parties. There have been no material changes to guarantees outstanding during the quarter ended July 31, 2006.

Changes in the carrying amounts of product warranties were as follows:

<u>In thousands</u>	Quarter Ended July 31,	
	2006	2005
Beginning balance	\$ 2,445	\$ 1,782
Warranties issued in the current period	1,567	1,437
Reductions for costs incurred	<u>(1,665)</u>	<u>(1,268)</u>
Ending balance	<u>\$ 2,347</u>	<u>\$ 1,951</u>

Note 10. Employee Benefit Plans

Components of net periodic benefit cost were as follows:

<u>In thousands</u>	Quarter Ended July 31,	
	2006	2005
Service cost	\$ 614	\$ 765
Interest cost	1,575	1,484
Expected return on plan assets	(1,533)	(1,512)
Amortization of:		
Prior service cost	73	73
Actuarial loss	<u>188</u>	<u>457</u>
Net periodic benefit cost	<u>\$ 917</u>	<u>\$ 1,267</u>

For the quarter ended July 31, 2006, \$0.8 million in cash contributions were made to the Gerber Scientific, Inc. and Participating Subsidiaries Pension Plan. The Company expects to contribute \$4.1 million to this plan in the fiscal year ending April 30, 2007.

Note 11. Income Taxes

The Company's effective tax rates were 41.1 percent and 160.2 percent for the quarters ended July 31, 2006 and 2005, respectively, as compared with the statutory rate of 35.0 percent. The higher consolidated tax rate in the quarter ended July 31, 2006 was attributable to losses in certain foreign jurisdictions where the Company was not able to record a tax benefit. In the first quarter of fiscal 2006, the Company recorded a tax charge of \$2.3 million as a result of a change in United Kingdom tax law. Excluding this tax charge, the Company's consolidated tax rate from continuing operations for the first quarter of fiscal 2006 would have been 32.7 percent compared with the statutory rate of 35.0 percent. The lower consolidated tax rate in fiscal 2006 was primarily attributable to benefits related to export tax incentives and research and development tax credits.

Note 12. Recently Issued Accounting Standards

In July 2006, the FASB issued Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109" ("FIN 48"). FIN 48 prescribes a comprehensive model for how a company should recognize, measure, present and disclose in its financial statements uncertain tax positions that the company has taken or expects to take on a tax return (including a decision whether to file or not file a return in a particular jurisdiction). Under FIN 48, the financial statements will reflect expected future tax consequences of such positions presuming the taxing authorities' full knowledge of the position and all relevant facts, but without considering time values. FIN 48 substantially changes the applicable accounting model and is likely to cause greater volatility in income statements as more items are recognized discretely within income tax expense. The Interpretation also revises disclosure requirements and introduces a prescriptive, annual tabular rollforward of the unrecognized tax benefits. FIN 48 is effective for the Company beginning May 1, 2007. The Company is evaluating the impact of adopting FIN 48 on its consolidated financial position and results of operations.

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

CAUTIONARY NOTE CONCERNING FACTORS THAT MAY INFLUENCE FUTURE RESULTS

This Management's Discussion and Analysis of Financial Condition and Results of Operations contains statements which, to the extent they are not statements of historical or present fact, constitute forward-looking statements under the securities laws. These forward-looking statements are intended to provide management's current expectations or plans for the future operating and financial performance of the Company, based on assumptions currently believed to be reasonable. Forward-looking statements can be identified by the use of words such as "believe," "expect," "intend," "foresee," "may," "plan," "anticipate" and other words of similar meaning in connection with a discussion of future operating or financial performance. These include, among others, statements relating to:

- expected financial condition, future earnings, levels of growth, or other measures of financial performance, or the future size of market segments or geographic markets;
- future cash flows and uses of cash and debt reduction strategies;
- prospective product developments and business growth opportunities, as well as competitor product developments;
- demand for the Company's products and services;
- the impact of recently enacted and proposed international environmental laws on the Company's international revenue;
- methods of and costs associated with potential geographic expansion;
- regulatory and market developments and the impact of such developments on future operating results;
- future effective income tax rates;
- the outcome of contingencies;
- the availability and cost of raw materials; and
- pension plan assumptions and future contributions.

All forward-looking statements involve risks and uncertainties that may cause actual results to differ materially from those expressed or implied in the forward-looking statements. Certain risk factors that could cause actual results to differ from expectations are set forth in Item 1A. "Risk Factors" of the Annual Report on Form 10-K for the fiscal year ended April 30, 2006. The Company cannot assure that its financial position, result of operations or cash flows will not be adversely affected by one or more of these factors. The Company does not undertake to update any forward-looking statement made in this report or that may from time to time be made by or on behalf of the Company, except as required by law.

OVERVIEW

In the first quarter of fiscal 2007, the Company produced solid revenue growth over the corresponding quarter in the prior year. Excluding the favorable impact of foreign currency translation, revenue increased almost 5 percent, compared with the first quarter of fiscal 2006. Revenue growth occurred across all three operating segments. The growth was largely attributable to China-based revenue and sales of key new products compared with the same period in the prior year.

The Company reported its highest quarterly revenue ever in China during the first quarter of fiscal 2007; benefiting from its investment in China and other Asian markets, primarily within its Apparel and Flexible Materials segment. Increased revenue in China and other Asian markets was primarily generated by higher sales volume. In terms of revenue contribution, the most significant of the Company's new products to date in fiscal 2007 is the Solara UV2 inkjet printer developed for the Sign Making and Specialty Graphics segment.

The Company's Ophthalmic Lens Processing segment reported \$0.3 million of operating income in the first quarter of fiscal 2007, which represented an improvement of \$0.9 million compared with the first quarter of fiscal 2006. The Company believes that the stabilization of this segment after prior years' restructuring activities is reflected in this improvement and those activities are expected to continue producing favorable results.

The Company increased operating income by \$1.0 million in the first quarter of fiscal 2007 compared with the same period of the prior year. Gross margin contributed \$2.4 million to the higher operating income, driven by the success of new products and increased revenue in China. Partially offsetting the additional gross margin contribution were higher selling, general and administrative expenses of \$1.8 million, as compared to the same quarter in the prior year, which included additional charges of \$0.3 million for the expensing stock option compensation costs as of May 1, 2006 in conjunction with the Company's adoption of Statement of Financial Accounting Standards No. 123R, "Share-Based Payment."

The Company began its implementation of the Gerber Business System late in fiscal 2006. This initiative focuses on the implementation of "lean" processes throughout the Company. These improved processes are expected to contribute to improved gross margins and the control of selling, general and administrative expenses.

The overall increase in net income in the first quarter of fiscal 2007 compared with the same quarter in the prior year reflects the operating income improvements referred to above, as well as the Company's lower cost of debt compared with periods prior to the October 31, 2005 refinancing. Additionally, the prior year results included incremental tax expense of \$2.3 million related to a United Kingdom tax legislation change.

RESULTS OF OPERATIONS

Revenue

	Quarter Ended July 31,		Percent
	<u>2006</u>	<u>2005</u>	

In thousands

			<u>Change</u>
Revenue	\$ 137,488	\$ 128,764	6.8%

Adjusting for the effect of foreign currency translation of approximately \$2.6 million, revenue increased by \$6.2 million across all segments. This increase was primarily attributable to sales volume improvements, particularly the Company's improved revenue performance in China, which increased by \$2.6 million, and the success of key new products, which increased by \$1.6 million compared with the same period in the prior year.

The following table shows equipment and software product revenue and aftermarket supplies and service revenue as a percentage of total revenue for the quarters ended July 31, 2006 and July 31, 2005.

	Quarter Ended July 31,	
	<u>2006</u>	<u>2005</u>
Equipment and software revenue	31%	30%
Aftermarket supplies and service revenue	69%	70%

On a geographic basis and adjusted for foreign currency translation, the Company's first quarter of fiscal 2007 business volume was higher in each geographic region, consisting of North America, Europe and the Rest of World, compared with the first quarter of fiscal 2006. The largest increases were in North America and the Rest of World regions. The North American revenue increases were across all segments, and reflected the positive market reaction of the Company's new products and sales volume increases for aftermarket supplies. The Rest of World region increase was primarily within the Apparel and Flexible Materials segment and principally reflected increased equipment revenue within China.

Gross Profit Margins

	Quarter Ended July 31,		Percent
	<u>2006</u>	<u>2005</u>	
<u>In thousands</u>			<u>Change</u>
Gross profit	\$ 41,705	\$ 39,256	6.2%
Gross profit margin	30.3%	30.5%	

Gross profit increased in the quarter ended July 31, 2006 by \$2.4 million compared with the quarter ended July 31, 2005. Sales volume contributed \$2.0 million of the total increase. Gross profit margin declined by a modest 0.2 percentage points, primarily related to the sales mix of equipment, software and aftermarket materials. The Company has launched several programs to strengthen gross profit margins, including low-cost sourcing of key parts and components of new equipment products and the implementation of the Gerber Business System.

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Selling, General and Administrative Expenses

<u>In thousands</u>	Quarter Ended		Percent
	<u>July 31,</u>		
	<u>2006</u>	<u>2005</u>	
			<u>Change</u>
Selling, general and administrative expenses	\$ 31,363	\$ 29,575	(6.0%)
Percentage of revenue	22.8%	23.0%	

Adjusting for the effect of foreign currency translation, selling, general and administrative expenses increased \$1.4 million in the first quarter of fiscal 2007 from the first quarter of fiscal 2006. The increase was primarily attributable to higher professional fees of \$0.4 million primarily associated with fiscal 2006 year-end financial statement audit procedures, costs of \$0.3 million associated with the Gerber Business System initiatives, stock option compensation expense of \$0.3 million and increased sales and marketing expenses primarily related to the timing of trade shows. Slightly offsetting these increases was lower pension expense of approximately \$0.3 million compared with the first quarter of fiscal 2006.

Research and Development

<u>In thousands</u>	Quarter Ended		Percent
	<u>July 31,</u>		
	<u>2006</u>	<u>2005</u>	
			<u>Change</u>
Research and development	\$ 5,968	\$ 6,312	5.4%
Percentage of revenue	4.3%	4.9%	

Research and development ("R&D") expenses decreased in dollars and as a percentage of revenue in the first quarter of fiscal 2007 primarily due to lower external project spending related to the Company's new products.

Other Income (Expense), net

Other expenses were relatively stable for the quarter ended July 31, 2006 compared with the quarter ended July 31, 2005. The primary components of other expenses are bank fees and foreign currency exchange gains and losses.

16

Interest Expense

<u>In thousands</u>	Quarter Ended		Percent
	<u>July 31,</u>		
	<u>2006</u>	<u>2005</u>	
			<u>Change</u>
Interest expense	\$ 777	\$ 1,431	45.7%
Weighted-average credit facility interest rates	9.0%	13.3%	

The decrease in interest expense of \$0.7 million was primarily attributable to lower debt balances and lower weighted-average interest rates associated with the credit facility refinancing in fiscal 2006. Average debt balances under the Company's credit facility were \$31.9 million in the first quarter of fiscal 2007 compared with \$40.4 million in the first quarter of fiscal 2006.

Income Tax Expense

The Company's effective tax rates were 41.1 percent and 160.2 percent for the quarters ended July 31, 2006 and 2005, respectively, as compared with the statutory rate of 35.0 percent. The higher consolidated tax rate in the quarter ended July 31, 2006 was attributable to losses in certain foreign jurisdictions where the Company was not able to record a tax benefit. In the first quarter of fiscal 2006, the Company recorded a tax charge of \$2.3 million as a result of a change in United Kingdom tax law. Excluding this tax charge, the Company's consolidated tax rate from continuing operations for the first quarter of fiscal 2006 would have been 32.7 percent compared with the statutory rate of 35.0 percent. The

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lower consolidated tax rate in fiscal 2006 was primarily attributable to benefits related to export tax incentives and research and development tax credits.

SEGMENT REVIEW

Sign Making and Specialty Graphics

	Quarter Ended <u>July 31, 2006</u>			Quarter Ended <u>July 31, 2005</u>		
	<u>GSP¹</u>	<u>Spandex¹</u>	<u>Total</u>	<u>GSP¹</u>	<u>Spandex¹</u>	<u>Total</u>
<u>In thousands</u>						
Revenue	\$ 23,137	\$ 50,022	\$ 73,159	\$ 22,794	\$ 47,126	\$ 69,920
Segment operating profit	1,706	1,532				