MAGNETEK INC
Form 10-Q
May 12, 2006

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D. C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended: April 2, 2006

OR

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

For the transition period from

Commission file number 1-10233

MAGNETEK, INC.

(Exact name of Registrant as specified in its charter)

DELAWARE	**95-3917584**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

8966 Mason Ave.

Chatsworth, California 91311

(Address of principal executive offices)

(818) 727-2216

(Registrant s telephone number, including area code)

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

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 ý No o

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. (Check one):

Large accelerated filer o Accelerated filer ý Non-accelerated filer o

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

Yes o No ý

The number of shares outstanding of Registrant s Common Stock, as of April 28, 2006, was 29,111,133 shares.

2006 MAGNETEK, INC. FORM 10-Q

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MAGNETEK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE THREE MONTHS ENDED

April 2, 2006 and April 3, 2005

(amounts in thousands, except per share data)

(unaudited)

	Three Months Ended (13 weeks) April 2, 2006	(13 weeks) April 3, 2005 (restated)
Net sales	$ 57,212	$ 57,038
Cost of sales	44,833	42,874
Gross profit	12,379	14,164
Research and development	4,214	3,991
Selling, general and administrative	10,717	11,053
Loss from operations	(2,552)	(880)
Interest expense, net	863	418
Other expense	175	68
Loss from continuing operations before provision for income taxes	(3,590)	(1,366)
Provision for income taxes	850	550
Net loss from continuing operations	(4,440)	(1,916)
Income (loss) from discontinued operations	10	(23,085)
Net loss	$ (4,430)	$ (25,001)
Earnings (loss) per common share		
Basic and diluted:		
Net loss from continuing operations	$ (0.15)	$ (0.07)
Income (loss) from discontinued operations	0.00	(0.81)
Net loss	$ (0.15)	$ (0.88)
Weighted shares outstanding:		
Basic	28,911	28,544
Diluted	29,460	28,544

See accompanying notes

MAGNETEK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

FOR THE NINE MONTHS ENDED

April 2, 2006 and April 3, 2005

(amounts in thousands, except per share data)

(unaudited)

	Nine Months Ended (39 Weeks) April 2, 2006	(40 Weeks) April 3, 2005 (restated)
Net sales	$ 173,056	$ 185,245
Cost of sales	130,882	139,358
Gross profit	42,174	45,887
Research and development	11,690	11,180
Selling, general and administrative	30,935	32,136
Income (loss) from operations	(451)	2,571
Interest expense, net	2,065	999
Other (income) expense	700	(1,115)
Income (loss) from continuing operations before provision for income taxes	(3,216)	2,687
Provision for income taxes	2,550	1,725
Net income (loss) from continuing operations	(5,766)	962
Loss from discontinued operations	(1,443)	(25,261)
Net loss	$ (7,209)	$ (24,299)
Earnings (loss) per common share		
Basic and diluted:		
Net income (loss) from continuing operations	$ (0.20)	$ 0.04
Loss from discontinued operations	(0.05)	(0.89)
Net loss	$ (0.25)	$ (0.85)
Weighted shares outstanding:		
Basic	28,905	28,525
Diluted	28,905	29,229

See accompanying notes

MAGNETEK, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

April 2, 2006 and July 3, 2005

(amounts in thousands)

		April 2, 2006 (unaudited)		July 3, 2005
ASSETS				
Current assets:				
Cash	$	1,426	$	6,854
Restricted cash - escrow account		22,602		
Accounts receivable, net		54,918		54,022
Inventories, net		55,335		49,950
Prepaid expenses and other		4,943		5,713
Assets held for sale		6,339		4,727
Total current assets		145,563		121,266
Property, plant and equipment		134,735		129,473
Less accumulated depreciation		(104,437)		(97,534)
Net property, plant and equipment		30,298		31,939
Goodwill		63,820		63,656
Other assets		11,621		12,319
Total assets	$	251,302	$	229,180
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Accounts payable	$	33,598	$	36,974
Accrued liabilities		11,017		8,523
Accrued arbitration award		22,602		22,602
Liabilities held for sale		1,570		1,220
Current portion of long-term debt		29,359		5,702
Total current liabilities		98,146		75,021
Long-term debt, net of current portion		19,168		19,528
Pension benefit obligations, net		73,418		70,568
Other long-term obligations		8,196		7,627
Deferred income taxes		11,522		10,376
Commitments and contingencies				
Stockholders equity:				
Common stock		287		286
Additional paid in capital		129,260		128,664
Retained earnings		32,809		40,018
Accumulated other comprehensive loss		(121,504)		(122,908)
Total stockholders' equity		40,852		46,060

Total liabilities and stockholders' equity	$	251,302	$	229,180

See accompanying notes

MAGNETEK, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOW

FOR THE NINE MONTHS ENDED

April 2, 2006 and April 3, 2005

(amounts in thousands)

(unaudited)

	Nine Months Ended (39 Weeks) April 2, 2006	Nine Months Ended (40 Weeks) April 3, 2005 (restated)
Cash flows from continuing operating activities:		
Net income (loss) from continuing operations	$ (5,766)	$ 962
Adjustments to reconcile net income (loss) from continuing operations to net cash provided by continuing operating activities:		
Depreciation and amortization	6,746	7,270
Tax refund proceeds, net		3,332
Stock based compensation expense	361	
Changes in operating assets and liabilities	818	(5,782)
Total adjustments	7,925	4,820
Net cash provided by continuing operating activities	2,159	5,782
Cash flows from discontinued operations:		
Loss from discontinued operations	(1,443)	(25,261)
Adjustments to reconcile loss from discontinued operations to net cash used in discontinued operations:		
Arbitration award expense		21,977
Depreciation and amortization		94
Changes in operating assets and liabilities	(1,262)	(550)
Capital expenditures		(16)
Net cash used in discontinued operations	(2,705)	(3,756)
Net cash provided by (used in) operating activities	(546)	2,026
Cash flows from investing activities:		
Capital expenditures	(4,146)	(6,076)
Net cash used in investing activities	(4,146)	(6,076)
Cash flows from financing activities:		
Deposit into escrow account	(22,602)	
Proceeds from issuance of common stock	236	366
Borrowings under line-of-credit agreements	3,361	6,024
Principal repayments under capital lease obligations	(180)	(417)
Borrowings under long term notes	20,817	
Repayments of long term notes	(701)	(829)
Increase in deferred financing costs	(1,667)	(82)
Net cash provided by (used in) financing activities	(736)	5,062
Net increase (decrease) in cash	(5,428)	1,012

Cash at the beginning of the period		6,854		2,318
Cash at the end of the period	$	1,426	$	3,330

See accompanying notes

MAGNETEK, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

APRIL 2, 2006

(Amounts in thousands unless otherwise noted, except per share data)

(unaudited)

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements include the accounts of Magnetek, Inc. and its subsidiaries (the Company). All significant intercompany accounts and transactions have been eliminated.

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States for interim financial information 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 footnotes required by generally accepted accounting principles for complete financial statements. For further information, refer to the financial statements and footnotes thereto included in the Company s Form 10-K for the year ended July 3, 2005 filed with the Securities and Exchange Commission. In the Company's opinion, these unaudited statements contain all adjustments, consisting of normal recurring adjustments, necessary to present fairly the financial position of the Company as of April 2, 2006, and the results of its operations and its cash flows for the three-month and nine-month periods ended April 2, 2006 and April 3, 2005. Results for the nine-months ended April 2, 2006 are not necessarily indicative of results that may be experienced for the full fiscal year.

The Company uses a fifty-two, fifty-three week fiscal year ending on the Sunday nearest to June 30. Fiscal quarters are the thirteen or fourteen week periods ending on the Sunday nearest September 30, December 31, March 31 and June 30. The three-month periods ended April 2, 2006 and April 3, 2005 each contained 13 weeks; the nine-month periods ended April 2, 2006 and April 3, 2005 contained 39 and 40 weeks, respectively.

2. Summary of Significant Accounting Policies

Restatement - The accompanying condensed consolidated financial statements have been restated for the three- and nine-month periods ended April 3, 2005.

Since fiscal 2002 the Company has provided valuation reserves against its U.S. deferred tax assets that result in a zero net deferred tax position (net deferred assets equal to deferred tax liabilities). In its 2005 fiscal year-end review of its tax accounts, the Company determined that a portion of its deferred tax liability related to tax-deductible amortization of goodwill that is no longer amortized for financial reporting purposes. Under applicable accounting rules, such deferred tax liabilities are considered to have an indefinite life and are therefore ineligible to be considered as a source of future taxable income in assessing the realization of deferred tax assets.

The Company has determined that such deferred tax liabilities existed at July 3, 2005, and therefore increased its valuation allowance for deferred tax assets and the related provision for income taxes for fiscal year 2005 by $1.6 million. The Company further determined that the increased provision for income taxes should have been recorded on a pro-rata basis throughout fiscal year 2005, and as a result, the Company has restated its quarterly results for fiscal 2005. The impact of this restatement on the three- and nine-month periods ended April 3, 2005 was an increase in the Company s valuation allowance for deferred tax assets and related provision for income taxes of $0.4 million and $1.2 million, respectively.

The restatement did not have a material impact on the Company s financial position at the end of the reported period and had no impact on the Company s cash flows for the restated periods.

The table below reflects the impact of the restatement on the Company s results of operations for the three- and nine- month periods ended April 3, 2005:

Condensed Consolidated Statements of Operations

For the periods ended April 3, 2005 (Amounts in thousands except per share amounts)	Three Months Ended As previously reported	Three Months Ended As restated	Nine Months Ended As previously reported	Nine Months Ended As restated
Provision for income taxes	$ 150	$ 550	$ 525	$ 1,725
Net loss	$ (24,601)	$ (25,001)	$ (23,099)	$ (24,299)
Net loss per common share, basic and diluted	$ (0.86)	$ (0.88)	$ (0.81)	$ (0.85)

<u>Use of Estimates</u> - The preparation of financial statements in accordance with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates. Significant areas requiring management estimates include the following key financial areas:

Accounts Receivable

Accounts receivable represent receivables from customers in the ordinary course of business. The Company is subject to losses from uncollectible receivables in excess of its allowances. The Company maintains allowances for doubtful accounts for estimated losses from customers inability to make required payments. In order to estimate the appropriate level of this allowance, the Company analyzes historical bad debts, customer concentrations, current customer creditworthiness, current economic trends and changes in customer payment patterns. If the financial conditions of the Company s customers were to deteriorate and to impair their ability to make payments, additional allowances may be required in future periods. The Company s management believes that all appropriate allowances have been provided.

Inventories

The Company s inventories are stated at the lower of cost or market. Cost is determined by the first-in, first-out (FIFO) method, including material, labor and factory overhead. Inventory on hand may exceed future demand either because the product is obsolete, or the amount on hand is more than can be used to meet future needs. The Company identifies potentially obsolete and excess inventory by evaluating overall inventory levels. In assessing the ultimate realization of inventories, the Company is required to make judgments as to future demand requirements and compare those with the current or committed inventory levels. If future demand requirements are less favorable than those projected by management, additional inventory write-downs may be required.

Reserves for Contingencies

The Company periodically records the estimated impacts of various conditions, situations or circumstances involving uncertain outcomes. The accounting for such events is prescribed under Statement of Financial Accounting Standard (SFAS) No. 5, *Accounting for Contingencies*. SFAS No. 5 defines a contingency as an existing condition, situation, or set of circumstances involving uncertainty as to possible gain or loss to an enterprise that will ultimately be resolved when one or more future events occur or fail to occur.

SFAS No. 5 does not permit the accrual of gain contingencies under any circumstances. For loss contingencies, the loss must be accrued if (1) information is available that indicates it is probable that the loss has been incurred, given the likelihood of uncertain events; and (2) that the amount of the loss can be reasonably estimated.

The accrual of a contingency involves considerable judgment on the part of management. The Company uses its internal expertise, and outside experts, as necessary, to help estimate the probability that a loss has been incurred and the amount (or range) of the loss.

Income Taxes

The Company uses the liability method to account for income taxes. The preparation of consolidated financial statements involves estimating the Company s current tax exposure together with assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the consolidated balance sheets. An assessment of the recoverability of the deferred tax assets is made, and a valuation allowance is established based upon this assessment.

The Company does not record deferred taxes on domestic pre-tax income or losses, due to (1) the availability of net operating loss (NOL) carryforwards that have been fully reserved through valuation allowances for pre-tax income, and (2) uncertainty surrounding the timing of realizing NOL carryforwards generated in the current period in future periods.

With the exception of approximately $3.0 million of foreign earnings that the Company repatriated during the nine months ended April 2, 2006 for various financing needs, the Company presently intends to reinvest any earnings overseas indefinitely.

Pension Benefits

The valuation of the Company s pension plan requires the use of assumptions and estimates to develop actuarial valuations of expenses, assets and liabilities. These assumptions include discount rates, investment returns and mortality rates. Changes in assumptions and future investments returns could potentially have a material impact on the Company s pension expense and related funding requirements.

Revenue Recognition The Company s policy is to recognize revenue when the earnings process is complete. The criteria used in making this determination are persuasive evidence that an arrangement exists, delivery has occurred, the sales price is fixed or determinable, and collectibility is reasonably assured. Sales are recorded net of returns and allowances, which are estimated using historical data at the time of sale.

Revenue is recognized upon shipment, except in those few cases where terms of shipment are FOB destination, or where product is shipped to customers with consignment stock agreements, wherein revenue is recognized when the customer receives the product, or removes the product from consignment stock. With the foregoing exceptions, terms of shipment are FOB shipping point, and payment is not contingent upon resale or any other matter other than passage of time. Amounts billed to customers for shipping costs are reflected in net sales; shipping costs are reflected in cost of sales.

Sales to distributors are recorded with appropriate reserves for future returns in accordance with SFAS No. 48, *Revenue Recognition When Right of Return Exists*, and generally do not include future installation obligations or acceptance requirements.

Stock-Based Compensation On December 16, 2004, the Financial Accounting Standards Board (FASB) issued SFAS No. 123 (revised 2004), *Share-Based Payment*, which is a revision of SFAS No. 123, *Accounting for Stock-Based Compensation*. SFAS No. 123(R) supersedes APB Opinion No. 25, *Accounting for Stock Issued to Employees,* and amends SFAS No. 95, *Statement of Cash Flows*. Generally, the approach in SFAS No. 123(R) is similar to the approach described in SFAS No. 123. However, SFAS No. 123(R) requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values. Pro forma disclosure is no longer an alternative.

Prior to fiscal year 2006, as was permitted under SFAS No. 123, *Accounting for Stock-Based Compensation*, the Company accounted for stock-based awards using the intrinsic-value method under APB No. 25. Under APB No. 25, the Company recognized no compensation expense with respect to such awards, as the exercise prices of stock option grants were always equal to or greater than the market price of the stock at the grant date. Accordingly, no stock-based employee compensation expense for stock options is reflected in determining net loss in the accompanying condensed consolidated financial statements for the three- and nine-month periods ended April 3, 2005.

Effective July 4, 2005, the Company adopted SFAS No. 123 (R), which requires all share-based payments to employees, including grants of employee stock options, to be recognized in the Company s financial statements based upon their fair values. The Company selected the modified prospective method of adoption in which compensation cost is recognized beginning with the effective date. Compensation cost recognized for the three- and nine-month periods ended April 2, 2006 is the same as that which would have been recognized had the fair value method of SFAS No. 123 been applied from its original effective date. In accordance with the modified prospective method of adoption, the Company s results of operations for prior periods have not been restated.

In the fourth quarter of fiscal 2005, the Company approved the acceleration of the vesting of all out-of-the-money (underwater) unvested stock options held by the Company s current employees, including executive officers, on June 1, 2005. No stock options held by directors were subject to the acceleration. The decision to accelerate vesting of these underwater options was made primarily to avoid recognizing compensation cost in the consolidated statement of operations upon adoption of SFAS No. 123 (R), as described above. As a result of the acceleration, the

Company reduced the stock option compensation expense it otherwise would be required to record by approximately $1.9 million in fiscal 2006, $1.4 million in fiscal 2007 and less than $0.1 million in fiscal 2008 on a pre-tax basis, resulting in an additional $3.4 million of pro-forma expense in fiscal 2005. The accelerated vesting was a modification of outstanding awards as defined by SFAS No. 123, which resulted in incremental pro-forma compensation expense of $0.3 million in fiscal 2005.

The Company did not issue any stock options during the nine-month period ended April 2, 2006. In August 2005, the Company granted 500,000 shares of restricted stock with a fair value of $2.77 per share. The restricted shares fully vest on January 1, 2009. The total estimated compensation expense of $1.4 million related to the grant will be recorded ratably from the grant date through the vesting date. Compensation expense related to the restricted stock grant included in the condensed consolidated statement of operations for the three- and nine-month periods ended April 2, 2006 is $103 and $252 respectively. The remaining portion of stock-based compensation expense recorded in the three- and nine-month periods ended April 2, 2006, of $36 and $109 respectively, relates to non-vested director stock option grants.

The following table illustrates the effect on net loss and loss per share as if the fair value method had been applied to all outstanding and unvested awards in each period:

(Amounts in thousands, except per share amounts)	**Three Months Ended April 2, 2006**	**Three Months Ended April 3, 2005 (restated)**	**Nine Months Ended April 2, 2006**	**Nine Months Ended April 3, 2005 (restated)**
Net loss, as reported	$ (4,430)	$ (25,001)	$ (7,209)	$ (24,299)
Add: Stock-based compensation expense included in reported net income, net of related tax effects	139		361	
Deduct: Total stock-based compensation expense determined under fair value method for all awards, net of related tax effects	(139)	(1,137)	(361)	(3,521)
Pro forma net loss	$ (4,430)	$ (26,138)	$ (7,209)	$ (27,820)
Loss per share as reported:				
Basic and diluted	$ (0.15)	$ (0.88)	$ (0.25)	$ (0.85)
Pro forma loss per share:				
Basic and diluted	$ (0.15)	$ (0.92)	$ (0.25)	$ (0.98)

The fair value of the Company's stock-based awards to employees was estimated using the Black-Scholes model, assuming no dividends, using the following historical assumptions:

Weighted average assumptions used in recent fiscal years:	**2006**	**Options 2005**	**2004**
Expected life (years)	6.1	6.1	6.1
Expected stock price volatility	72.2%	72.2%	65.8%
Risk-free interest rate	4.9%	4.4%	3.5%

As stated above, no options were issued in the first nine months of fiscal 2006.

In fiscal year 2005, a total of 750,000 options were granted with exercise prices equal to the market price of the stock on the grant date. The weighted average exercise price was $7.48 and the average fair value of the options was $5.04. In addition, the Company issued 240,000 shares of restricted stock in fiscal 2005.

In fiscal year 2004, a total of 1,836,000 options were granted with exercise prices equal to the market price of the stock on the grant date. The weighted average exercise price was $4.58 and the average fair value of the options was $2.83. The Company did not issue any shares of restricted stock in fiscal 2004.

Property, Plant and Equipment Additions and improvement are capitalized at cost, whereas expenditures for maintenance and repair are charged to expense as incurred. Depreciation is provided over the estimated useful lives of the respective assets principally on the straight-line method (machinery and equipment normally five to ten years, buildings and improvements normally ten to forty years).

Goodwill In accordance with SFAS No. 142, *Goodwill and Other Intangible Assets*, the Company reviews the carrying value of goodwill at least annually, and more frequently if indicators of potential impairment arise, using discounted future cash flow analyses as prescribed in SFAS No. 142.

Deferred Financing Costs Costs incurred to obtain financing are deferred and included in other assets in the condensed consolidated balance sheets. Deferred financing costs are amortized over the term of the financing facility.

Warranties The Company offers warranties for certain products that it manufactures, with warranty terms generally ranging from one to two years. Warranty reserves are established for costs expected to be incurred after the sale and delivery of products under warranty, based mainly on known product failures and historical experience. Actual repair costs incurred for products under warranty are charged against the established reserve balance as incurred.

Earnings per Share In accordance with SFAS No. 128, *Earnings per Share*, basic earnings per share are computed using the weighted average number of common shares outstanding during the period. Diluted earnings per share incorporate the incremental shares issuable upon the assumed exercise of stock options as if all exercises had occurred at the beginning of the fiscal period.

Derivative Financial Instruments The Company periodically uses derivative financial instruments to reduce financial market risks. These instruments are used to hedge foreign currency and interest rate market exposures. The Company does not use derivative financial instruments for speculative or trading purposes. The accounting policies for these instruments are based on the Company s designation of such instruments as hedging transactions. The criteria the Company uses for designating an instrument as a hedge include the instrument s effectiveness in risk reduction and the matching of the derivative to the underlying transaction. The resulting gains or losses are accounted for as part of the transactions being hedged, except that losses not expected to be recovered upon the completion of the hedge transaction are expensed. The Company had no derivative financial instruments at April 2, 2006 and July 3, 2005.

Foreign Currency Translation - The Company s foreign entities accounts are measured using local currency as the functional currency. Assets and liabilities are translated at the exchange rate in effect at the fiscal period-end. Revenues and expenses are translated at the rates of exchange prevailing during the reported fiscal period. Unrealized translation gains and losses arising from differences in exchange rates from period to period are included as a component of accumulated other comprehensive loss in stockholders equity.

Reclassifications Certain prior year balances were reclassified to conform to the current year presentation.

Recent Accounting Pronouncements In May 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections*, which changes the accounting for and the reporting of voluntary changes in accounting principles. SFAS No. 154 requires changes in accounting principles to be applied retrospectively to prior period financial statements, where practicable, unless specific transition provisions permit alternative transition methods. SFAS No. 154 will be effective in fiscal years beginning after December 15, 2005. The Company s adoption of SFAS No. 154 is not expected to have a material impact on the Company s results of operations, financial position or cash flows.

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs*, which amends the guidance in ARB No. 43, Chapter 4, *Inventory Pricing*. This amendment clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and wasted material (spoilage). This Statement requires that those items be recognized as current-period charges, regardless of whether they meet the criteria specified in ARB 43 of so abnormal . In addition, this Statement requires that allocation of fixed production overheads to the costs of conversion be based on normal capacity of the production facilities. SFAS No. 151 is effective for financial statements for fiscal years beginning after June 15, 2005. The Company adopted SFAS No. 151 during the three month period ended October 2, 2005, and the adoption did not have a material impact on the results of operations or the financial position of the Company.

3. Discontinued Operations

In the third quarter of fiscal 2005, the Company committed to a plan to divest its telecom power business and began marketing the business. Management determined that the assets and liabilities to be sold constituted a disposal group under SFAS No. 144, *Accounting for the Impairment of Disposal of Long-Lived Assets,* and that all of the assets held for sale criteria outlined in SFAS No. 144 were met. Accordingly, the operating results of this business are classified as discontinued operations in the accompanying condensed consolidated statements of operations and its assets and liabilities are classified as held for sale in the accompanying condensed consolidated balance sheets for all periods presented. The estimated fair value of the disposal group at April 2, 2006 is $4.8 million.

The Company also recorded other expenses related to divested businesses as discontinued operations, primarily legal fees related to a patent infringement claim and a related indemnification agreement provided by the Company upon the sale of its lighting business in prior years. These expenses are reported as other discontinued operations expense in the table below.

The results of discontinued operations are as follows:

	Three Months Ended		Nine Months Ended	
	April 2, 2006	**April 3, 2005**	**April 2, 2006**	**April 3, 2005**
Net Sales	$ 6,921	$ 1,896	$ 14,713	$ 6,893
Income (loss) from telecom business, net of tax	$ 364	$ (435)	$ 230	$ (1,029)
Other discontinued operations expense	(354)	(22,650)	(1,673)	(24,232)
Income (loss) from discontinued operations	$ 10	$ (23,085)	$ (1,443)	$ (25,261)

The Company did not allocate any interest expense to discontinued operations, and no tax benefit was recorded related to discontinued operations for any of the periods presented.

4. Inventories

Inventories at April 2, 2006 and July 3, 2005 consist of the following:

	April 2, 2006	**July 3, 2005**
Raw materials and stock parts	$ 31,097	$ 30,257
Work-in-process	11,907	9,452
Finished goods	12,331	10,241
	$ 55,335	$ 49,950

5. <u>Commitments and Contingencies</u>

Litigation Product Liability

The Company has settled or otherwise resolved all of the product liability lawsuits associated with its discontinued business operations and believes that any new claims associated with discontinued operations would either qualify as an assumed liability, as defined in the various purchase agreements related to the sale of those businesses, or would be barred by an applicable statute of limitations. The Company was a named party in two product liability lawsuits related to the Telemotive Industrial Controls business acquired in December 2002 through the purchase of the stock of MXT Holdings, Inc. The Company tendered both claims to the insurance companies that provided coverage for MXT Holdings, Inc. against such losses and the tenders were accepted by the carriers, subject to a reservation of rights. One of the cases has settled, with the insurer bearing all liability for the claim, and management believes that the insurer will bear all liability, if any, with respect to the remaining case and that the proceedings will not have a material adverse effect on the Company s results of operations, financial position or cash flows.

The Company has been named, along with multiple other defendants, in asbestos-related lawsuits associated with business operations previously acquired by the Company, but which are no longer owned. During the Company s ownership, none of the businesses produced or sold asbestos-containing products. With respect to these claims, the Company is either contractually indemnified against liability for asbestos-related claims or believes that it has no liability for such claims. The Company aggressively seeks dismissal from these proceedings, and has also tendered the defense of these cases to the insurers of the previously acquired businesses and is awaiting their response. The Company has also filed a late claim in the amount of $2.5 million in the Federal-Mogul bankruptcy proceedings to recover attorney s fee paid for the defense of these claims, which the Company believes is an obligation of Federal Mogul although the claim is subject to challenge. Management does not believe the asbestos proceedings, individually or in the aggregate, will have a material adverse effect on its financial position, results of operations or cash flows.

Litigation Patent Infringement

In April 1998, Mr. Ole K. Nilssen (Nilssen) filed a lawsuit in the U.S. District Court for the Northern District of Illinois alleging infringement by the Company of seven of his patents pertaining to electronic ballast technology, and seeking unspecified damages and injunctive relief to preclude the Company from making, using or selling products allegedly infringing his patents. In April 2003, Nilssen s lawsuit against the Company and the Company s counterclaims against Nilssen were dismissed with prejudice and both parties agreed to submit limited issues in dispute to binding arbitration before an arbitrator with a relevant technical background. The arbitration occurred in November, 2004 and a decision awarding Nilssen $23.4 million was issued on May 3, 2005. Nilssen s motion to enter the award as a judgment in U.S. District Court for the Northern District of Illinois and Magnetek s counter-motion to vacate the award on grounds that it was fraudulently obtained are pending in the U.S. District Court for the Northern District of Illinois. Magnetek s request for oral argument was granted and the hearing was held on October 19, 2005. The judge is expected to render his decision by mail after further consideration. An unfavorable decision by the Court could result in payment of the award by the Company to Nilssen in the amount of $22.6 million (the arbitration award of $23.4 million net of previously paid amounts of $0.8 million), which would have a material adverse effect on the Company s cash flows during the period such payment would be made. In November 2005, the Company deposited $22.6 million into an escrow account to ensure that it is able to satisfy the Nilssen arbitration award in the event that its appeal of the award is not successful.

In June 2001, the Company sold its lighting business to Universal Lighting Technologies, Inc. (ULT), and agreed to provide a limited indemnification against certain claims of infringement that Nilssen might allege against ULT. In February 2003, Nilssen filed a lawsuit in the U.S. District Court for the Northern District of Illinois alleging infringement by ULT of 29 of his patents pertaining to electronic ballast technology, and seeking unspecified damages and injunctive relief to preclude ULT from making, using or selling products allegedly infringing his patents. ULT made a claim for indemnification, which the Company accepted, subject to the limitations set forth in the sale agreement. A response was filed denying that the products infringe any valid patent and asserting affirmative defenses, as well as a counterclaim for a judicial declaration that the patents are unenforceable and invalid. The case was removed to the District Court for the Central District of Tennessee and Nilssen voluntarily dismissed claims related to all but four of the patents. The Patent and Trademark Office (PTO) has accepted ULT s request for reexamination of the four remaining patents. A motion for summary judgment that various claims of the patents at issue are invalid and that the accused ULT products do not infringe a claim of one of the patents was filed on November 1, 2005 but no hearing had been set as of January 5, 2006 when the Court granted ULT s motion to stay proceedings in the lawsuit pending the PTO reexamination. The Company will continue to aggressively defend the claims against ULT however, a decision in the lawsuit that is ultimately unfavorable to ULT could have a material adverse effect on the Company s financial position, cash flows and results of operations as a result of its indemnification obligations.

Environmental

From time to time, Magnetek has taken action to bring certain facilities associated with previously owned businesses into compliance with applicable environmental laws and regulations. Upon the subsequent sale of those businesses, the Company agreed to indemnify the buyers against environmental claims associated with the divested operations, subject to certain conditions and limitations. Remediation activities, including those related to the Company s indemnification obligations, did not involve material expenditures during the third quarter of fiscal year

2006 and are not expected to result in material expenditures for the remainder of fiscal 2006.

Magnetek has also been identified by the United States Environmental Protection Agency and certain state agencies as a potentially responsible party for cleanup costs associated with alleged past waste disposal practices at several previously owned facilities and offsite locations. Its remediation activities as a potentially responsible party were not material during the third quarter of fiscal year 2006 and are not expected to be material during the remainder of fiscal 2006. Although the materiality of future expenditures for environmental activities may be affected by the level and type of contamination, the extent and nature of cleanup activities required by governmental authorities, the nature of the Company s alleged connection to the contaminated sites, the number and financial resources of other potentially responsible parties, the availability of indemnification rights against third parties and the identification of additional contaminated sites, the Company s estimated share of liability, if any, for environmental remediation, including its indemnification obligations, is not expected to be material.

Environmental - Century Electric (McMinnville, Tennessee)

Prior to the Company s purchase of Century Electric, Inc. (Century Electric) in 1986, Century Electric acquired a business from Gould Inc. (Gould) in May 1983 that included a leasehold interest in a fractional horsepower electric motor manufacturing facility located in McMinnville, Tennessee. Gould agreed to indemnify Century Electric from and against liabilities and expenses arising out of the handling and cleanup of certain waste materials, including but not limited to cleaning up any polychlorinated biphenyls (PCBs) at the McMinnville facility (the 1983 Indemnity). The presence of PCBs and other substances, including solvents, in the soil and in the groundwater underlying the facility and in certain offsite soil, sediment and biota samples has been identified. The McMinnville plant is listed as a Tennessee Inactive Hazardous Waste Substance Site and plant employees were notified of the presence of contaminants at the facility. Gould has completed an interim remedial excavation and disposal of onsite soil containing PCBs and a preliminary investigation and cleanup of certain onsite and offsite contamination. The Company believes the cost of further investigation and remediation (including ancillary costs) are covered by the 1983 Indemnity. The Company sold its leasehold interest in the McMinnville plant in August 1999 and while the Company believes that Gould will continue to perform substantially under its indemnity obligations, Gould s substantial failure to perform such obligations could have a material adverse effect on the Company s financial position, cash flows and results of operations.

Environmental - Effect of Fruit of the Loom Bankruptcy (Bridgeport, Connecticut)

In 1986, the Company acquired the stock of Universal Manufacturing Company (Universal) from a predecessor of Fruit of the Loom (FOL), and the predecessor agreed to indemnify the Company against certain environmental liabilities arising from pre-acquisition activities at a facility in Bridgeport, Connecticut. Environmental liabilities covered by the indemnification agreement include completion of additional cleanup activities, if any, at the Bridgeport facility (sold in connection with the sale of the transformer business in June 2001) and defense and indemnification against liability for potential response costs related to offsite disposal locations. FOL, the successor to Universal s indemnification obligation, filed a petition for Reorganization under Chapter 11 of the Bankruptcy Code in 1999 and the Company filed a proof of claim in the proceeding for obligations related to the environmental indemnification agreement. The Company believes that FOL had substantially completed the clean-up obligations required by the indemnification agreement prior to the bankruptcy filing. In November 2001, the Company and FOL entered into an agreement involving the allocation of certain potential tax credits and Magnetek withdrew its claims in the bankruptcy proceeding. FOL s obligation to the state of Connecticut was not discharged in the reorganization proceeding. FOL s inability to satisfy its remaining obligations related to the Bridgeport facility and any offsite disposal locations, or the discovery of additional environmental contamination at the Bridgeport facility could have a material adverse effect on the Company s financial position, results of operations or cash flows.

6. Comprehensive Loss

For the three- and nine-month periods ended April 2, 2006 and April 3, 2005, comprehensive loss consisted of the following:

	Three Months Ended		Nine Months Ended	
	April 2, 2006	April 3, 2005 (restated)	April 2, 2006	April 3, 2005 (restated)
Net loss	$ (4,430)	$ (25,001)	$ (7,209)	$ (24,299)
Currency translation adjustment	1,247	(2,874)	1,404	4,817
Comprehensive loss	$ (3,183)	$ (27,875)	$ (5,805)	$ (19,482)

7. Earnings (Loss) Per Share

The following table sets forth the computation of basic and diluted earnings (loss) per share for the three- and nine- month periods ended April 2, 2006 and April 3, 2005.

	Three Months Ended		Nine Months Ended	
	April 2, 2006	April 3, 2005 (restated)	April 2, 2006	April 3, 2005 (restated)
Numerator:				
Net income (loss) from continuing operations	$ (4,440)	$ (1,916)	$ (5,766)	$ 962
Income (loss) from discontinued operations	10	(23,085)	(1,443)	(25,261)
Net loss	$ (4,430)	$ (25,001)	$ (7,209)	$ (24,299)
Denominator:				
Weighted average shares for basic earnings per share	28,911	28,544	28,905	28,525
Add dilutive effective of stock options outstanding	549			704
Weighted average shares for diluted earnings per share	29,460	28,544	28,905	29,229
Basic & Diluted:				
Net income (loss) per share from continuing operations	$ (0.15)	$ (0.07)	$ (0.20)	$ 0.04
Income (loss) per share from discontinued operations	$ 0.00	$ (0.81)	$ (0.05)	$ (0.89)
Net loss per share	$ (0.15)	$ (0.88)	$ (0.25)	$ (0.85)

Due to the net loss from continuing operations and the net loss for the three- and nine-month periods ended April 2, 2006, and the loss from discontinued operations for the nine-month period ended April 2, 2006, the effect of 0.5 million and 0.4 million shares of stock options, respectively, was excluded from the calculations of diluted loss per share, as their impact would be anti-dilutive. Similarly, the dilutive effect of stock options outstanding was not included in the calculation of diluted loss per share from discontinued operations or net loss per share for the three- and nine-month periods ended April 3, 2005, nor was it included in the calculation of diluted loss per share from continuing operations in the three-month period ended April 3, 2005.

8. Warranties

The Company offers warranties for certain products that it manufactures, with warranty terms generally ranging from one to two years. Warranty reserves are established for costs expected to be incurred after the sale and delivery of products under warranty, based mainly on known product failures and historical experience. Actual repair costs incurred for products under warranty are charged against the established reserve balance as incurred. Changes in the warranty reserve for the nine months ended April 2, 2006 and April 3, 2005 were as follows:

	Nine Months Ended	
	April 2, 2006	April 3, 2005
Balance, beginning of fiscal year	$ 315	$ 204
Additions charged to earnings for product warranties	450	363
Use of reserve for warranty obligations	(415)	(288)
Balance, end of period	$ 350	$ 279

Warranty reserves are included in accrued liabilities in the condensed consolidated balance sheets.

9. Restructuring Costs

The Company began restructuring activities during the second quarter of fiscal 2004, which included a workforce reduction of approximately 200 positions in Europe and the relocation of those positions to lower cost facilities in Eastern Europe and China. The Company completed these restructuring activities in fiscal 2005, and as a result, did not incur any costs related to these activities in the three- and nine-month periods ended April 2, 2006. The Company incurred restructuring costs for the three- and nine-month periods ended April 3, 2005 of $0.1 million and $0.3 million, respectively, which are included in selling, general and administrative expense in the accompanying condensed consolidated statements of operations.

In the fourth quarter of fiscal 2004, the Company began the consolidation of its Glendale Heights, IL operation into its Menomonee Falls, WI facility. The Company completed these restructuring activities by the end of fiscal 2005, and as a result, did not incur any costs related to these activities in the three- and nine-month periods ended April 2, 2006. Costs incurred in the three-month period ended April 3, 2005 were $0.4 million, which are included in selling, general and administrative expense in the accompanying condensed consolidated statements of operations. Costs incurred in the nine-month period ended April 3, 2005 were $0.9 million, of which $0.3 million are included in cost of goods sold and $0.6 million are included in selling, general and administrative expense in the accompanying condensed consolidated statements of operations.

During the three-month period ended April 2, 2006, the Company began negotiations with the labor union in Italy to further reduce the workforce at its Valdarno, Italy facility by up to 75 additional positions. A final agreement between the Company and the union has not yet been reached, and as a result, the total cost of the workforce reduction, as well as the timing of the reduction and related expense and future cash outflows, is not known at this time. While the Company currently estimates the total cost of the reduction at Euro 2 million (approximately $2.5 million), the accompanying condensed consolidated statements of operations do not include any costs related to this action.

10. Stock-Based Compensation Plans

The Company has two stock option plans (the Plans), one of which provides for the issuance of both incentive stock options (under Section 422A of the Internal Revenue Code of 1986) and non-qualified stock options at exercise prices not less than the fair market value of the Company s common stock at the date of grant, and one of which only provides for the issuance of non-qualified stock options at exercise prices not less than the fair market value of the Company s common stock at the date of grant. One of the Plans also provides for the issuance of stock appreciation rights, restricted stock, incentive bonuses and incentive stock units. The total number of shares of the Company s common stock authorized to be issued upon exercise of the stock options and other stock rights under the Plans is 2,100,000. Options granted under these Plans vest in equal annual installments of two, three or four years.

The accompanying condensed consolidated statements of operations for the three- and nine-month periods ended April 2, 2006, include compensation expense related to all stock-based awards of $0.1 million and $0.4 million, respectively (see Note 2 of Notes to Condensed Consolidated Financial Statements). The three- and nine-month periods ended April 3, 2005, do not include any compensation expense related to stock-based awards, as the Company was accounting for stock-based compensation using the intrinsic-value method under APB No. 25, which permitted footnote disclosure only of the impact of stock-based awards on a pro forma basis. The pro forma expense related to stock-based awards for the three- and nine-month periods ended April 3, 2005 was $1.1 million and $3.5 million respectively.

A summary of certain information with respect to options under the Plans follows:

Stock Option Activty Nine Months Ended April 2, 2006	Shares		Weighted-Average Exercise Price		Aggregate Intrinsic Value ($000s)
Options outstanding, July 3, 2005	8,178,294	$	8.77		
Options granted					
Options exercised	(2,500)	$	3.35		
Options cancelled	(789,790)	$	9.98		
Options outstanding, April 2, 2006	7,386,004	$	8.65	$	209
Exercisable options	7,326,004	$	8.68	$	156

As of April 2, 2006, there was $0.1 million of total unrecognized compensation cost related to unvested stock option awards granted under the Plans. This cost is expected to be recognized over a weighted-average period of 0.75 years.

The following table provides information regarding exercisable and outstanding options as of April 2, 2006:

Range of exercise price per share	Options exercisable		Exercisable Weighted average exercise price per share	Weighted average remaining contractual life (years)	Options outstanding		Outstanding Weighted average exercise price per share	Weighted average remaining contractual life (years)
Under $5.00	1,655,000	$	3.91	7.28	1,701,168	$	3.87	7.57
$5.00 - $10.00	3,553,140		7.80	5.54	3,664,540		7.80	5.79
$10.00 - $15.00	1,192,875		11.45	4.79	1,242,601		11.44	5.04
Over $15.00	924,989		17.03	2.28	928,989		17.03	2.52
Total	7,326,004	$	8.68	5.40	7,537,298	$	8.65	5.67

The following table provides information regarding unvested restricted stock activity for the nine months ended April 2, 2006:

Unvested Shares	Shares		Weighted-Average Grant Date Fair Value
Unvested at July 3, 2005			
Granted	500,000	$	2.77
Vested			
Forfeited			
Unvested at April 2, 2006	500,000	$	2.77

As of April 2, 2006, there was $1.1 million of total unrecognized compensation cost related to unvested restricted stock arrangements granted under the Plans. This cost is expected to be recognized over a weighted-average period of 2.75 years.

11. Pension Expense

For the three- and nine-month periods ended April 2, 2006 and April 3, 2005, pension expense related to the Company s defined benefit pension plan consisted of the following:

	Three Months Ended		Nine Months Ended	
	April 2, 2006	**April 3, 2005**	**April 2, 2006**	**April 3, 2005**
Interest cost	$ 2,440	$ 2,699	$ 7,320	$ 7,602
Expected return on plan assets	(2,552)	(3,066)	(7,656)	(8,635)
Recognized net actuarial losses	1,062	760	3,186	2,140
Total net pension expense	$ 950	$ 393	$ 2,850	$ 1,107

The net pension expense amounts above are included in selling, general and administrative expense in the accompanying condensed consolidated statements of operations.

12. Income Taxes

Since fiscal 2002 the Company has provided valuation reserves against its U.S. deferred tax assets that result in a zero net deferred tax position (net deferred assets equal to deferred tax liabilities). In its 2005 fiscal year-end review of its tax accounts, the Company determined that a portion of its deferred tax liability related to tax-deductible amortization of goodwill that is no longer amortized for financial reporting purposes. Under applicable accounting rules, such deferred tax liabilities are considered to have an indefinite life and are therefore ineligible to be considered as a source of future taxable income in assessing the realization of deferred tax assets.

The Company has determined that such deferred tax liabilities existed at July 3, 2005, and therefore increased its valuation allowance for deferred tax assets and the related provision for income taxes for fiscal year 2005 by $1.6 million. The Company further determined that the increased provision for income taxes should have been recorded on a pro-rata basis throughout fiscal year 2005, and as a result, the Company has restated its quarterly results for fiscal 2005. The impact of this restatement on the three- and nine-month periods ended April 3, 2005 was an increase in the Company s valuation allowance for deferred tax assets and related provision for income taxes of $0.4 million and $1.2 million, respectively.

Similarly, the Company s tax provision of $0.9 million for the three months ended April, 2006 also included an amount of $0.4 million to increase the Company s valuation allowance for deferred tax assets related to tax-deductible amortization of goodwill. The remaining tax provision of $0.5 million for the three months ended April 2, 2006 was comprised of income taxes of the Company s foreign subsidiaries. The Company s tax provision of $2.6 million for the nine months ended April 2, 2006 included an amount of $1.2 million to increase the Company s valuation allowance for deferred tax assets related to tax-deductible amortization of goodwill. The remaining tax provision of $1.4 million for the nine months ended April 2, 2006 was comprised of income taxes of the Company s foreign subsidiaries.

13. Bank Borrowing Arrangements

At July 3, 2005, the Company had an asset based credit agreement for North American operations with Chase Bank (formerly Bank One). The Company was in violation of certain covenants under this agreement at July 3, 2005, and in July 2005, in exchange for a waiver of the covenant defaults and the lender's willingness to continue to extend credit under the agreement, the Company agreed to a permanent reduction in the aggregate lending commitment and a change in the facility termination date from July 15, 2006 to September 30, 2005. The Company also agreed to use its best efforts to obtain financing from other sources that would enable the Company to fully repay all indebtedness under the agreement.

On September 30, 2005, the Company entered into an agreement with Ableco, Inc. providing for an $18 million term loan and an agreement with Wells Fargo Foothill, Inc. providing for a $13 million revolving credit facility. Borrowings under the term loan bear interest at the lender s reference rate plus 5%, or, at the Company s option, the London Interbank Offering Rate (LIBOR) plus 7.5%. Such rates may be increased by up to one percentage point depending upon the level of U.S. funded debt to EBITDA as defined in the agreement. The term loan requires quarterly principal payments of $1 million beginning in October 2006. Borrowings under the revolving credit facility bear interest at the bank s prime lending rate plus 2.5% or, at the Company s option, LIBOR plus 4%. Borrowings under the revolving credit facility are determined by a borrowing base formula as defined in the agreement, based on the level of eligible domestic accounts receivable and inventory. The revolving credit facility also supports the issuance of letters of credit. Borrowings under the term loan and revolving credit facility are secured by substantially all of the Company s domestic assets. The Company used the proceeds from the revolving credit facility to fully repay all outstanding obligations under its previous financing agreement with Chase Bank.

In November 2005 the Company deposited $22.6 million into an escrow account to ensure that it is able to satisfy the Nilssen arbitration award in the event that its appeal of the award is not successful (see Note 5 of Notes to Condensed Consolidated Financial Statements). The deposit was funded by borrowings under the $18.0 million term loan and by $4.6 million from the revolving credit facility, and is reported as restricted cash in the accompanying condensed consolidated balance sheet as of April 2, 2006. As of April 2, 2006, the $18.0 million term loan was outstanding, and approximately $9.3 million was outstanding under the revolving credit facility. The total of these two amounts, $27.3 million, is included in current portion of long-term debt in the accompanying condensed consolidated balance sheet. This classification reflects certain provisions in the term loan and revolving credit agreements which allow the lenders to declare a default and accelerate the loans should certain events occur which could be expected to result in a Material Adverse Effect (as defined in the agreements) on the Company. Such provisions are considered subjective acceleration clauses under accounting guidelines which require the classification of debt balances as current although the related agreements have termination dates that are beyond one year from the balance sheet date.

As of April 2, 2006, the Company was in violation of a covenant which required it to divest its telecom power business prior to the end of the second quarter of fiscal 2006. On April 20, 2006, the Company entered into an amendment with its lenders which extends the period to divest its telecom power business to September 30, 2006 and also adjusts the levels of certain financial covenants for the periods ending March 31, 2006 and June 30, 2006.

The Company s European subsidiary maintains revolving borrowing arrangements with local banks, primarily to support working capital needs. Available borrowings under these arrangements aggregate approximately Euro 20.0 million depending in part upon levels of accounts receivable, and bear interest at various rates ranging from 3% to 8%. In addition, the Company s European subsidiary has an agreement with a European bank to provide borrowings secured by the subsidiary s land and building. Borrowings under this agreement bear interest at EURIBOR plus 1.5%. The initial commitment to lend under this agreement was Euro 7.0 million, and the commitment has been reduced ratably on a quarterly basis beginning March 31, 2004 and ending September 30, 2013. The Company s European subsidiary also has certain long-term notes and capital leases outstanding related mainly to equipment purchases. As of April 2, 2006, total amounts outstanding under all European borrowing arrangements were $21.2 million, of which $2.1 million is included in current portion of long-term debt and $19.1 million is included in long term debt in the accompanying condensed consolidated balance sheet as of April 2, 2006.

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

<u>Restatement of Fiscal 2005 Interim Periods and Reclassification</u>

As stated in Note 2 of Notes to Condensed Consolidated Financial Statements, we have restated our financial statements for the interim periods of fiscal 2005 with respect to accounting for income taxes.

Since fiscal 2002 we have provided valuation reserves against our U.S. deferred tax assets that result in a zero net deferred tax position (net deferred assets equal to deferred tax liabilities). In our 2005 fiscal year-end review of our tax accounts, we determined that a portion of our deferred tax liability related to tax-deductible amortization of goodwill that is no longer amortized for financial reporting purposes. Under applicable accounting rules, such deferred tax liabilities are considered to have an indefinite life and are therefore ineligible to be considered as a source of future taxable income in assessing the realization of deferred tax assets.

We determined that such deferred tax liabilities existed at July 3, 2005, and therefore increased our valuation allowance for deferred tax assets and the related provision for income taxes for fiscal year 2005 by $1.6 million. We further determined that the increased provision for income taxes should have been recorded on a pro-rata basis throughout fiscal year 2005, and as a result, we have restated our quarterly results for fiscal 2005. The impact of this restatement on the three and nine months ended April 2, 2006 was an increase in our valuation allowance for deferred tax assets and related provision for income taxes of $0.4 million and $1.2 million, respectively. The restatement did not have a material impact on our financial position as of April 2, 2006, and had no impact on our cash flows for the restated periods.

During fiscal year 2005, we reclassified the assets and liabilities of our telecom power business as held for sale, and the results of operations of this business as discontinued operations (see Note 3 of Notes to Condensed Consolidated Financial Statements). We also recorded other expenses related to divested businesses as discontinued operations, including certain expenses for patent infringement claims, product liability claims, environmental issues, and asbestos claims. Prior period amounts related to the telecom business or other divested businesses have been reclassified in the accompanying condensed consolidated financial statements in order to conform to the current year presentation. All of these issues relate to businesses we no longer own and most relate to indemnification agreements we provided when we divested those businesses.

Overview

We are a global provider of digital power-electronic products, including electronic converters, inverters, rectifiers and systems. These products are used primarily in industrial, telecommunications, data processing, consumer, imaging, alternative energy, power generation and other applications requiring precise, efficient, reliable power. We believe that with our technical and productive resources we are well positioned to respond to increasing demand for such power. We operate in a single business segment, Digital Power Products, which includes two broad product categories, systems and components.

Our power control systems consist primarily of programmable motion control and power conditioning systems used in the following applications: cranes and hoists; transportation (elevators and railway); fuel cell, wind and photovoltaic markets; street light monitoring and control; and utility grid monitoring.

Our embedded power control products, which are sold primarily to original equipment manufacturers for installation in their products, include: AC-to-DC switching power supplies, AC-to-DC rectifiers and battery chargers, DC to-DC power converters, DC-to-AC power inverters and peripheral component interconnects. These products are used primarily in telecommunications (telecom), data processing and storage, digital imaging, semiconductor processing and testing equipment, medical instrumentation and home appliances.

We continue to see fluctuating demand in our traditional telecommunications and information technology markets (embedded power products), stable to growing demand in our traditional systems markets (crane & hoist and elevators), and increased interest in our alternative energy and utility products. Our operating results in the third quarter of fiscal 2006 were negatively impacted by delays in new program introductions at certain key customers, continued relocation of production, start-up costs associated with new systems offerings, and volume-related variances at our manufacturing operation in Italy. In an effort to improve our competitive position and our operating results, during fiscal 2004 and 2005 we completed certain restructuring actions in both North America and Europe and doubled our production capacity in China. At the same time, we increased our investment in research and development (R&D) spending on new products, and are focused on gaining share in systems markets through new product introductions in transportation, utility and alternative energy markets. Our current growth rates for these new products are not as strong as we anticipated, and as a result, we have experienced unfavorable manufacturing variances in Italy, where we have relatively large production capacity. As a result, during the third quarter of fiscal 2006, we began the process to further reduce our workforce in Italy by up to 75 additional positions and to shift additional production to China. Negotiations with the labor union in Italy are in progress and we expect to have an agreement in place within several months.

Third-quarter fiscal 2006 bookings (new orders received) were $65.1 million and our backlog (undelivered orders) as of April 2, 2006 was $72.7 million. Bookings for the third quarter of fiscal 2005 were $55.3 million and our backlog as of April 3, 2005 was $65.0 million. The increase in bookings versus the prior year is primarily related to an increase in bookings for embedded power products. Net sales for the third quarter of fiscal 2006 were $57.2 million comparable to net sales of $57.0 million in the third quarter of fiscal 2005. Net sales for the nine months ended April 2, 2006 were $173.1 million, a decrease of $12.1 million compared to net sales of $185.2 million for the nine months ended April 3, 2005. The decrease is due to lower sales of embedded power products, and in addition, the first nine months of fiscal 2005 contained 40 weeks while the first nine months of fiscal 2006 contained 39 weeks. We continue to focus on gaining share in systems markets and on new product introductions in industrial, transportation, utility, and alternative energy markets, and our future sales growth is largely dependent on the success of this strategy.

Gross profit in the third quarter of fiscal 2006 was $12.4 million, down from $14.2 million in the third quarter of fiscal 2005, due to the aforementioned program delays, production relocation, systems start-up costs and volume variances.

Our R&D expense was $4.2 million in the third quarter of fiscal 2006, compared to $4.0 million in the third quarter of fiscal 2005. We continue to invest in developing new products for existing and new markets, including alternative energy products for solar and wind applications and monitoring and control systems for utility markets. Selling, general and administrative (SG&A) expense was $10.7 million in the third quarter of fiscal 2006 compared to $11.1 million in the third quarter of fiscal 2005, mainly due to the absence of restructuring costs in fiscal 2006 and reduced rent expense, partially offset by higher pension expense, which increased by $0.6 million in the third quarter of fiscal 2006 compared to the third quarter of fiscal 2005. Our future annual pension expense will depend on future interest rate levels, values in equity and fixed income markets, and contributions we may elect to make to the plan.

Mainly as a result of reduced gross profit, our loss from operations increased to $2.6 million in the third quarter of fiscal 2006 from $0.9 in the third quarter of fiscal 2005. Our net loss from continuing operations in the third quarter of fiscal 2006 was $4.4 million, or $0.15 per share, and reflects interest expense of $0.9 million as well as a provision for income taxes of $0.9 million. Our net loss from continuing operations in the third quarter of fiscal 2005 was $1.9 million, or $0.07 per share (as restated).

In September 2005, we entered into agreements with lenders providing for an $18 million term loan and a $13 million revolving credit facility, expanding our credit facilities for greater operating flexibility (see Note 13 of Notes to Condensed Consolidated Financial Statements) . In November 2005, we deposited $22.6 million into an escrow account to be used to satisfy the Nilssen arbitration award in the event our appeal of the award is not successful (see Note 5 of Notes to Condensed Consolidated Financial Statements). The source of funds for the escrow deposit was the $18 million term loan and $4.6 million from our revolving credit facility, and is included in the current portion of long term debt in the accompanying condensed consolidated balance sheet as of April 2, 2006. The funds in escrow are reported as restricted cash in the accompanying condensed consolidated balance sheet as of April 2, 2006.

We consumed $0.5 million in cash from operating activities during the nine months ended April 2, 2006, compared to cash generation of $2.0 million for the nine months ended April 3, 2005. Capital expenditures in the first nine months of fiscal 2006 were $4.1 million, while depreciation and amortization expense was $6.7 million, compared to capital expenditures of $6.1 million and depreciation a