STARRETT L S CO
Form 10-K
September 18, 2007

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-K

(check one)

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

For the fiscal year ended June 30, 2007

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 No. 1-367

THE L.S. STARRETT COMPANY
(Exact name of registrant as specified in its charter)

MASSACHUSETTS	**04-1866480**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
121 CRESCENT STREET, ATHOL, MASSACHUSETTS	**01331**
(Address of principal executive offices)	**(Zip Code)**

Registrant’s telephone number, including area code 978-249-3551

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Class A Common - $1.00 Per Share Par Value	**New York Stock Exchange**

Class B Common - $1.00 Per Share Par Value	**Not applicable**

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Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ¨ No x

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes ¨ No x

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein and will not be contained, to the best of Registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or amendment to this Form 10-K. x

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

Large Accelerated Filer ¨ Accelerated Filer x Non-Accelerated Filer ¨

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Act).
Yes ¨ No x

The Registrant had 5,690,239 and 994,858 shares, respectively, of its $1.00 par value Class A and B common stock outstanding on December 23, 2006. On December 22, 2006, the last business day of the Registrant's second fiscal quarter, the aggregate market value of the common stock held by nonaffiliates was approximately $106,360,000.

There were 5,673,894 and 1,000,535 shares, respectively, of the Registrant's $1.00 par value Class A and Class B common stock outstanding as of August 31, 2007.

The exhibit index is located on pages 50-51.

Documents incorporated by reference.

Portions of the Proxy Statement for October 10, 2007 Annual Meeting (Part III)

PART I

Item 1 - Business

The Company was founded in 1880 and incorporated in 1929 and is engaged in the business of manufacturing industrial, professional and consumer products. The total number of different items made and sold by the Company exceeds 5,000. Among the items produced are precision tools, electronic gages, dial indicators, gage blocks, granite surface plates, vision systems, optical measuring projectors, tape measures, levels, chalk products, squares, band saw blades, hole saws, hacksaw blades, jig saw blades, reciprocating saw blades, M1® lubricant and precision ground flat stock and drill rod. Much of the Company's production is concentrated in hand measuring tools (such as micrometers, steel rules, combination squares and many other items for the individual craftsman and other markets) and precision instruments (such as vernier calipers, height gages, depth gages and measuring instruments that manufacturing companies buy for the use of their employees). During fiscal 2007, the Company developed wireless data collection solutions as part of its new product development efforts.

These tools and instruments are sold throughout the United States and Canada and over 100 foreign countries, primarily to distributors. By far the largest consumer of these products is the metalworking industry, but other important consumers are automotive, aviation, marine and farm equipment shops, do-it-yourselfers and tradesmen such as builders, carpenters, plumbers and electricians. The Company's top two customers accounted for approximately 8% of sales during fiscal 2007. The Company ended its relationship with W.W. Grainger, a significant customer, during fiscal 2005. The effect this had on total Company sales and profits can't be specifically quantified since much of the Grainger business has been picked up by other Company distributors during fiscal 2005, 2006 and 2007.

On April 28, 2006, the Company acquired the assets of Tru-Stone Technologies Inc. (Tru-Stone). This represented a strategic acquisition for the Company in that it provided an enhancement of the Company's granite surface plate capabilities. This acquisition provided access to high-end metrology which serves the electronics and flat panel display industries. In addition, profit margins for the Company's standard surface plate business have improved as the Company's existing granite surface plate facility was consolidated into Tru-Stone where average gross margins have been higher.

On July 17, 2007, a wholly owned subsidiary of the Company entered into an asset purchase agreement with Kinemetric Engineering, LLC (Kinemetric Engineering), pursuant to which the Company purchased all of the assets of Kinemetric Engineering. Kinemetric Engineering specializes in precision video-based metrology, specialty motion devices and custom engineered systems for measurement and inspection. A long time technical partner of the Company, Kinemetric Engineering brings a wealth of experience, engineering and manufacturing capability. This business unit will also oversee the sales and support of the Company's high quality line of Starrett Optical Projectors, combining to make a very comprehensive product offering.

Most of the Company's products are made from steel purchased from steel mills. Forgings, castings and a few small finished parts are purchased from other manufacturers. Raw materials have always been readily available to the Company and, in most cases, the Company does not rely on sole sources. In the event of unavailability of purchased materials, the Company would be adversely affected, as would its competitors. Similarly, the ability of the Company to pass along raw material price increases is dependent on the competitive situation and cannot be assured.

At June 30, 2007, the Company had 2,113 employees, approximately 54% of whom were domestic. This represents a net decrease from June 24, 2006 of 16 employees. The decreased employment is primarily due to work force reductions in Charleston, S.C. and Brazil. These decreases were partially offset by the addition of 32 Tru-Stone and 22 Dominican Republic employees. None of the Company's operations is subject to collective bargaining agreements. In general, the Company considers its relations with its employees to be excellent. Because of various stock ownership

plans, Company domestic personnel hold a large share of Company stock and the Company believes that this dual role of owner-employee has been good for morale over the years.

The Company is one of the largest producers of mechanics' hand measuring tools and precision instruments. In the United States, there are three other major companies and numerous small competitors in the field, including direct foreign competitors. As a result, the industry is highly competitive. During the fiscal year ended June 30, 2007, there were no material changes in the Company's competitive position. However, during recent years, the Company's revenues have been negatively affected by the general migration of manufacturing to low cost production areas, such as China, where the Company does not have a substantial market presence. In addition, margins on the Company's consumer products, such as tape measures and levels, are under constant pressure due to the increasing market dominance of the large national home and hardware retailers. The Company is currently responding to such competition by expanding its manufacturing and distribution in China and has developed a low cost manufacturing site in the Dominican Republic.

In saws and precision ground flat stock in the United States, the Company competes with many manufacturers. The Company competes principally through the high quality of its products and the service it provides its customers. The market for most of the Company's products is subject to economic conditions affecting the industrial manufacturing sector, including capital spending by industrial companies.

The operations of the Company's foreign subsidiaries are consolidated in its financial statements. The subsidiaries located in Brazil, Scotland and China are actively engaged in the manufacture and distribution of hacksaw blades, band saw blades, hole saws and a limited line of precision tools and measuring tapes. Subsidiaries in Canada, Australia, Mexico and Germany are engaged in distribution of the Company's products. During fiscal 2005, the Company completed the establishment of manufacturing operations in the Dominican Republic, primarily for its Evans Rule division. The Company expects its foreign subsidiaries to continue to play a significant role in its overall operations. A summary of the Company's foreign operations is contained in Note 12 to the Company's fiscal 2007 financial statements under the caption "OPERATING DATA" found in Item 8 of this Form 10-K.

The Company generally fills orders from finished goods inventories on hand. Sales order backlog of the Company at any point in time is negligible. Total inventories amounted to $57.3 million at June 30, 2007 and $56.0 million at June 24, 2006. The Company uses the last-in, first-out (LIFO) method of valuing most domestic inventories (approximately 55% of all inventories). LIFO inventory amounts reported in the financial statements are approximately $28.4 million and $24.0 million, respectively, lower than if determined on a first-in, first-out (FIFO) basis at June 30, 2007 and June 24, 2006.

When appropriate, the Company applies for patent protection on new inventions and presently owns a number of patents. Its patents are considered important in the operation of the business, but no single patent is of material importance when viewed from the standpoint of its overall business. The Company relies on its continuing product research and development efforts, with less dependence on its present patent position. It has for many years maintained engineers and supporting personnel engaged in research, product development and related activities. The expenditures for these activities during fiscal years 2007, 2006 and 2005 were approximately $2.6 million, $2.9 million and $3.3 million respectively, all of which was expensed in the Company's financial statements.

The Company uses trademarks with respect to its products. All of its important trademarks are registered.

Compliance with federal, state and local provisions that have been enacted or adopted regulating the discharge of materials into the environment or otherwise relating to protection of the environment is not expected to have a material effect on the capital expenditures, earnings and competitive position of the Company. Specifically, the Company has taken steps to reduce and control water discharges and air emissions.

Where To Find More Information

The Company makes its public filings with the Securities and Exchange Commission (“SEC”), including its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all exhibits and amendments to these reports, available free of charge at its website, www.starrett.com, as soon

as reasonably practicable after the Company files such material with the SEC. Information contained on the Company's website is not part of this Annual Report on Form 10-K.

Item 1A – Risk Factors

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Annual Report on Form 10-K and the Company's 2007 Annual Report to Stockholders, including the President's letter, contains forward-looking statements about the Company's business, competition, sales, gross margins, expenditures, foreign operations, plans for reorganization, interest rate sensitivity, debt service, liquidity and capital resources, and other operating and capital requirements. In addition, forward-looking statements may be included in future Company documents and in oral statements by Company representatives to security analysts and investors. The Company is subject to risks that could cause actual events to vary materially from such forward-looking statements, including the following risk factors:

Risks Related to Reorganization: The Company continues to evaluate plans to consolidate and reorganize some of its manufacturing and distribution operations. There can be no assurance that the Company will be successful in these efforts or that any consolidation or reorganization will result in revenue increases or cost savings to the Company. The implementation of these reorganization measures may disrupt the Company's manufacturing and distribution activities, could adversely affect operations, and could result in asset impairment charges and other costs that will be recognized if and when reorganization or restructuring plans are implemented or obligations are incurred. This has occurred with the Company's move to the Dominican Republic from South Carolina. Indeed, the relocation, restructuring and closure of the Company's Evans Rule Division's Charleston, South Carolina facility and start up of that division's Dominican Republic operations was a factor contributing to the Company's fiscal 2006 loss. If the Company is unable to maintain consistent profitability, additional steps will have to be taken, including further plant consolidations and workforce reductions.

Risks Related to Technology: Although the Company's strategy includes investment in research and development of new and innovative products to meet technology advances, there can be no assurance that the Company will be successful in competing against new technologies developed by competitors.

Risks Related to Foreign Operations: Approximately 39% of the Company's sales and 40% of net assets relate to foreign operations. Foreign operations are subject to special risks that can materially affect the sales, profits, cash flows, and financial position of the Company, including taxes and other restrictions on distributions and payments, currency exchange rate fluctuations, political and economic instability, inflation, minimum capital requirements, and exchange controls. In particular, the Company's Brazilian operations, which constitute over half of the Company's revenues from foreign operations, can be very volatile, changing from year to year due to the political situation and economy. As a result, the future performance of the Brazilian operations may be difficult to forecast.

Risks Related to Industrial Manufacturing Sector: The market for most of the Company's products is subject to economic conditions affecting the industrial manufacturing sector, including the level of capital spending by industrial companies and the general movement of manufacturing to low cost foreign countries where the Company does not have a substantial market presence. Accordingly, economic weakness in the industrial manufacturing sector may, and in some cases has, resulted in decreased demand for certain of the Company's products, which adversely affects sales and performance. Economic weakness in the consumer market will also adversely impact the Company's performance. In the event that demand for any of the Company's products declines significantly, the Company could be required to recognize certain costs as well as asset impairment charges on long-lived assets related to those products.

Risks Related to Competition: The Company's business is subject to direct and indirect competition from both domestic and foreign firms. In particular, low cost foreign sources have created severe competitive pricing pressures.

Under certain circumstances, including significant changes in U.S. and foreign currency relationships, such pricing pressures tend to reduce unit sales and/or adversely affect the Company’s margins.

Risks Related to Customer Concentration: Sales to the Company's top two customers accounted for approximately 8% of revenues in fiscal 2007. The Company ended its relationship with W.W. Grainger, which was previously one of the three largest customers, during fiscal 2005. Sears sales and unit volume has decreased significantly during fiscal 2006 and 2007. This situation is problematic and if the Sears brands (i.e., Craftsman) we support continue to have declining sales, this would have a negative effect on the Company's financial performance. The further loss or reduction in orders by Sears or any of the Company's remaining large customers, including reductions due to market, economic or competitive conditions could adversely affect business and results of operations. Moreover, the Company's major customers have, and may continue to, place pressure on the Company to reduce its prices. This pricing pressure may affect the Company's margins and revenues and could adversely affect business and results of operations.

Risks Related to Insurance Coverage: The Company carries liability, property damage, workers' compensation, medical, and other insurance coverages that management considers adequate for the protection of its assets and operations. There can be no assurance, however, that the coverage limits of such policies will be adequate to cover all claims and losses. Such uncovered claims and losses could have a material adverse effect on the Company. Depending on the risk, deductibles can be as high as 5% of the loss or $500,000.

Risks Related to Raw Material and Energy Costs: Steel is the principal raw material used in the manufacture of the Company's products. The price of steel has historically fluctuated on a cyclical basis and has often depended on a variety of factors over which the Company has no control. During fiscal 2007, the cost of steel rose approximately 7%. Because of competitive pressures, the Company generally has not been able to pass on these increases to the customer resulting in reduction to the gross margins. The cost of producing the Company's products is also sensitive to the price of energy. The selling prices of the Company's products have not always increased in response to raw material, energy or other cost increases, and the Company is unable to determine to what extent, if any, it will be able to pass future cost increases through to its customers. The Company's inability to pass increased costs through to its customers could materially and adversely affect its financial condition or results of operations.

Risks Related to Stock Market Performance: Although the Company's domestic defined benefit pension plan is significantly overfunded, a significant (over 30%) drop in the stock market, even if short in duration, could cause the plan to become temporarily underfunded and require the temporary reclassification of prepaid pension cost on the balance sheet from an asset to a contra equity account, thus reducing stockholders' equity and book value per share. There would also be a similar risk for the Company's UK plan, which was underfunded during fiscal 2005, 2006 and 2007.

Risks Related to Acquisitions: Acquisitions, such as our acquisition of Tru-Stone in fiscal 2006 and Kinemetric Engineering in July 2007, involve special risks, including, the potential assumption of unanticipated liabilities and contingencies, difficulty in assimilating the operations and personnel of the acquired businesses, disruption of the Company's existing business, dissipation of the Company's limited management resources, and impairment of relationships with employees and customers of the acquired business as a result of changes in ownership and management. While the Company believes that strategic acquisitions can improve its competitiveness and profitability, these activities could have an adverse effect on the Company's business, financial condition and operating results.

Item 1B – Unresolved Staff Comments

None.

Item 2 - Properties

The Company's principal plant is located in Athol, Massachusetts on about 15 acres of Company-owned land. The plant consists of 25 buildings, mostly of brick construction of varying dates, with approximately 535,000 square feet

of production and storage area.

The Webber Gage Division, Cleveland, Ohio, owns and occupies two buildings totaling approximately 50,000 square feet.

The Company-owned facility in Mt. Airy, North Carolina consists of two buildings totaling approximately 356,000 square feet. It is occupied by the Company's Saw Division, Metrology Systems Division, Ground Flat Stock Division and a distribution center.

The Company's Evans Rule Division, located in North Charleston, South Carolina, owns and occupies a 173,000 square foot building, which was shut down during fiscal 2006 and its operations moved to a new 50,000 square foot facility in the Dominican Republic. During fiscal 2006 the division also vacated its manufacturing space in Mayaquez, Puerto Rico and moved its operations to the Company's new 50,000 square foot leased facility in Santo Domingo, Dominican Republic. The Company plans on closing the sale of the North Charleston facility during fiscal 2008.

The Company's Exact Level Division has relocated to a 27,000 square foot facility in the Dominican Republic adjacent to the Evans facility. Its 50,000 square foot building located in Alum Bank, Pennsylvania was sold on September 21, 2006.

The Company's subsidiary in Itu, Brazil owns and occupies several buildings totaling 209,000 square feet. The Company's subsidiary in Jedburgh, Scotland owns and occupies a 175,000 square foot building. Its 33,000 square foot building in Skipton was sold during fiscal 2005. A band saw weld center operating in Sheffield, England was closed in fiscal 2005. Two wholly owned subsidiaries in Suzhou and Shanghai of the People's Republic of China lease approximately 41,000 square feet and 5,000 square feet, respectively.

In addition, the Company operates warehouses and/or sales-support offices in Georgia, Canada, Australia, New Zealand, Mexico, Germany, Japan, and Argentina. The warehouse in Elmhurst, Illinois was sold during fiscal 2005.

A warehouse in Glendale, Arizona encompassing 35,000 square feet was closed in fiscal 2006 and the building is expected to be sold during fiscal 2008.

With the acquisition of Tru-Stone in fiscal 2006, the Company added a 90,000 square foot facility in Waite Park, Minnesota.

With the acquisition of Kinemetrics in July 2007, the Company added a 9,000 square foot leased facility in Laguna Hills, California.

In the Company's opinion, all of its property, plant and equipment is in good operating condition, well maintained and adequate for its needs.

Item 3 - Legal Proceedings

The Company is, in the ordinary course of business, from time to time involved in litigation that is not considered material to its financial condition or operations.

Item 4 - Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of the fiscal year ended June 30, 2007.

PART II

Item 5 - Market for the Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's Class A common stock is traded on the New York Stock Exchange. Quarterly dividend and high/low closing market price information is presented in the table below. The Company's Class B common stock is generally nontransferable, except to lineal descendants, and thus has no established trading market, but it can be converted into Class A common stock at any time. The Class B common stock was issued on October 5, 1988, and the Company has paid the same dividends thereon as have been paid on the Class A common stock since that date. On June 30, 2007, there were approximately 5,100 registered holders of Class A common stock and approximately 1,900 registered holders of Class B common stock.

Quarter Ended	Dividends	High	Low
September 2005	$ 0.10	$ 18.41	$ 16.26
December 2005	0.10	19.30	15.20
March 2006	0.10	17.09	14.00
June 2006	0.10	15.47	12.84
September 2006	0.10	15.30	12.69
December 2006	0.10	17.12	13.51
March 2007	0.10	20.00	15.15
June 2007	0.10	19.47	14.53

Summary of Stock Repurchases:

A summary of the Company's repurchases of shares of its common stock for the three months ended June 30, 2007 is as follows:

ISSUER PURCHASES OF EQUITY SECURITIES

Period	Shares Purchased	Average Price	Shares Purchased Under Announced Programs	Shares yet to be Purchased Under Announced Programs
3/25/07- 4/28/07	40,000	18.69	None	None
4/29/07- 5/26/07	21,400	17.80	None	None
5/27/07- 6/30/07	13,430	16.27	None	None

Average price paid per share includes commissions and is rounded to the nearest two decimal places.

The following graph sets forth information comparing the cumulative total return to holders of the Company's Class A common stock over the last five fiscal years with (1) the cumulative total return of the Russell 2000 Index ("Russell 2000") and (2) a peer group index (the "Peer Group") reflecting the cumulative total returns of certain small cap manufacturing companies as described below. The Company's Peer Group consists of: Badger Meter, Inc., Baldor Electric Co., Chicago Rivet & Machine Co., Cuno Inc., The Eastern Company, Esco Technologies Inc., Federal Screw Works, National Presto Industries, Inc., Park-Ohio Holdings Corp., Penn Engineering & Manufacturing Corp. (through 2004), Regal-Beloit Corp., Tecumseh Products Co., Tennant Co. and WD-40 Co.

	BASE	FY2003	FY2004	FY2005	FY2006	FY2007
STARRETT	100.00	68.60	87.75	101.36	77.80	83.61
RUSSELL 2000	100.00	89.83	119.80	131.12	150.23	191.53
PEER GROUP	100.00	110.05	132.90	165.64	204.86	200.50

Item 6 - Selected Financial Data

	Years ended in June ($000 except per share data)				
	2007	**2006**	**2005**	**2004**	**2003**
Net sales	$ 222,356	$ 200,916	$ 195,909	$ 179,996	$ 175,711
Earnings (loss) before change in accounting	6,653	(3,782)	4,029	(2,352)	(4,489)
Net earnings (loss)	6,653	(3,782)	4,029	(2,352)	(10,575)
Basic earnings (loss) per share	1.00	(0.57)	0.61	(0.35)	(1.60)
Diluted earnings (loss) per share	1.00	(0.57)	0.61	(0.35)	(1.60)
Long-term debt	8,520	13,054	2,885	2,536	2,652
Total assets	234,011	228,082	224,114	218,924	219,740
Dividends per share	0.40	0.40	0.40	0.40	0.70

Note that the significant increase in long-term debt in fiscal 2006 is related to the Tru-Stone acquisition. See Note 3 to the Consolidated Financial Statements.

Items 7 and 7A- Management's Discussion and Analysis of Financial Condition and Results of Operations and Quantitative and Qualitative Disclosure about Market Risk

RESULTS OF OPERATIONS

2007 versus 2006

Overview For fiscal 2007, the Company realized net income of $6.6 million, or $1.00 per basic and diluted share compared to a net loss of $3.8 million or $(.57) per basic and diluted share. This represents an increase in net income of $10.4 million comprised of an increase in gross margin of $19.1 million, an increase of $3.3 million in selling, general and administrative costs, an increase in other expense of $.1 million and the change in the income tax line from a $3.1 million benefit to a $2.2 million tax expense. The above items are discussed in more detail below.

Net Sales Net sales for fiscal 2007 were up $21.4 million or 11% compared to fiscal 2006. North American sales were up 9% reflecting a steady U.S. economy and the inclusion of a full year of Tru-Stone ($12.5 million), which was acquired in April 2006. This was offset by a decline in sales for the Evans Rule Division ($7.3 million decrease). Excluding the Evans Rule Division and Tru-Stone, domestic sales increased $5.8 million (6%). Foreign sales (excluding North America) were up 13% (4% increase in local currency) driven by strong European sales from the U.K. operations ($1.6 million increase), the strengthening of the Brazilian Real against the U.S. dollar, the strengthening of the British Pound against the dollar, and growing sales for the Chinese operations ($2.8 million increase).

Earnings (loss) before taxes (benefit) Pre-tax earnings for fiscal 2007 was $8.9 million compared to a pre-tax loss of $6.9 million for fiscal 2006. This represents an increase of pre-tax earnings of $15.8 million, which is effectively an increase in gross margin of $19.1 million offset by an increase in selling, general and administrative costs of $3.3 million. The gross margin percentage increased from 23.2% in fiscal 2006 to 29.6% in fiscal 2007. This was primarily driven by better overhead absorption at domestic plants (other than the Evans Rule Division) due to higher sales volumes ($9.2 million), a reduction in cost of sales at the Evans Rule Division, the impact of a full year of gross margin contribution from Tru-Stone ($4.1 million), and better overhead absorption at the U.K. and Brazilian

operations ($1.5 million). As indicated above, selling, general and administrative costs increased $3.3 million from fiscal 2006 to fiscal 2007, although the percentage of sales dropped from 26.1% in fiscal 2006 to 25.0% in fiscal 2007. The increase of $3.3 million is primarily a result of increases in professional fees ($.8 million), increases in
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marketing and advertising relating to new product introductions ($.3 million), bad debt write-offs ($.6 million) and the inclusion of a full year of Tru-Stone's selling, general and administrative costs in fiscal 2007. The full year versus the two-month period in fiscal 2006 adds $1.9 million of these costs from Tru-Stone. The increase in other expense from fiscal 2006 to fiscal 2007 of $.1 million is a net of increased interest expense and increased impairment charges on fixed assets, offset by declining exchange losses and the gain on the sale of the Alum Bank plant in fiscal 2007.

Significant Fourth Quarter Activity As shown in Footnote 12 to the consolidated financial statements, $3.9 million of the $6.6 million of net income realized during fiscal 2007 was earned in the fourth quarter. This is primarily a result of higher operating income levels for the fourth quarter for most divisions compared to the average quarterly earnings for the first nine months of fiscal 2007 ($.7 million). Also, because of the Company's 52/53 week year convention, fiscal 2007 included an extra week of sales and related earnings ($.2 million). Also, certain adjustments were made to capitalize variances into inventory amounting to $.6 million. Finally, as discussed under Income Taxes below, tax reserves were released and return to provision adjustments were made netting to $.3 million. Also, valuation allowances of $.9 million were eliminated in the fourth quarter for certain state and foreign NOL's as a strong earnings trend evidenced in recent periods increased the likelihood of realizing the benefits of those NOL's.

Income Taxes The effective tax rate for fiscal 2007 was 25%, reflecting the benefits of a release of tax reserves, the elimination of the valuation allowances for certain state and foreign NOL's and the benefit of the tax treatment of the Brazilian dividend. A net reduction resulted from a release of tax reserves, resulting from the close out of certain examination years and additional analysis of transfer pricing exposure and return to provision adjustments resulting from the preparation of the fiscal 2006 tax returns. Valuation allowances were eliminated for certain state and foreign NOL's as strong earnings in fiscal 2007 increased the likelihood of realizing the benefits of those NOL's. The effective rate for fiscal 2006 was 45% reflecting the benefits of a release of tax reserves and return to provision adjustments, offset by increases in valuation allowances for state NOL's, foreign NOL's and foreign tax credits. The release of tax reserves is a result of the close out of certain examination years and the reduced likelihood of future assessment due to change in circumstances. The increases in valuation allowances reflected the uncertainty caused by fiscal 2006 losses.

RESULTS OF OPERATIONS
2006 versus 2005

Overview For fiscal 2006, the Company incurred a net loss of $3.8 million or ($.57) per basic and diluted share compared to a realization of net income of $4.0 million, or $.61 per basic and diluted share in fiscal 2005. This represents a decline in pre-tax earnings of $12.1 million. The reduction in pre-tax earnings occurred primarily at the gross margin line, with increases in selling, general and administrative expenses and gains on real estate and asset sales in fiscal 2005, which did not reoccur in fiscal 2006, accounting for the remaining pre-tax decline in operating income. As discussed below, lower pricing and lower volume at the Evans Rule Division and increases in medical and pension costs caused lower margins. Also, certain items relating to the purchase accounting for the Tru-Stone acquisition and to the shutdown of the Evans Rule Division Charleston plant were recorded in the fourth quarter. The above items are discussed in more detail below.

Net Sales Net sales for fiscal 2006 were up $5.0 million or 3% compared to fiscal 2005. Domestic sales were down 1% reflecting lower pricing due to pressure from foreign competitors on certain product categories. Much of the domestic sales decline was related to the Evans Rule Division ($5.8 million). Excluding the Evans Rule Division, domestic sales increased $5.0 million (5%). Foreign sales were up 5% (4% decrease in local currency) driven by the strengthening of the Brazilian Real against the U.S. dollar and strong export sales from the Brazilian operations ($8.9 million) and growing sales for the Chinese operations ($.9 million).

Earnings (loss) before taxes (benefit) The pretax loss for fiscal 2006 was $6.9 million compared to $5.2 million of pretax earnings for fiscal 2005. This represents a decrease of pretax earnings of $12.1 million. Approximately $7.1 million of this decrease is at the gross margin line. The gross margin percentage

dropped from 27.4% in the prior year to 23.2% in the current year. This was primarily driven by the Evans Rule Division as a result of the combination of lower pricing ($3.0 million) and unit volume ($.1 million) primarily from its largest customer, Sears. In addition, this division has only been able to pass along a portion of its higher material costs to its customers. Also, an inventory adjustment recorded at the Suzhou, China plant during fiscal 2006 ($1.0 million) created a drop in margin compared to fiscal 2005. Domestic gross margins were reduced during fiscal 2006, as the Company experienced a $1.3 million increase in medical costs and a $1.8 million increase in pension costs for its domestic businesses. The majority of these increases ($2.3 million) impacted the gross margin line with the remaining impact on selling, general and administrative costs. Therefore, these impacts and those discussed above (i.e. Evans and Suzhou adjustments) explain the vast majority of the $7.1 million decrease in gross margin. As the Dominican Republic moving costs continued to decline from levels experienced in fiscal 2006 and the full impact of Tru-Stone's higher gross margins were experienced, the Company has seen improvement in the gross margin percentage over the course of fiscal 2007. Selling, general and administrative expense increased $1.4 million from fiscal 2005 to fiscal 2006. This is primarily a result of increases in employee benefit costs, relating to health insurance and pension costs as discussed above, of which $.8 million impacted selling, general and administrative expenses. In addition, there was a $.6 million increase relating to computer maintenance and support. Included in Other Income for fiscal 2005 is the pretax gains on the sales of the Elmhurst, IL facility, the CMM division assets and the Skipton plant, amounting to $1.5 million, $.7 million and $.7 million, respectively.

Significant Fourth Quarter Activity During May and June of fiscal 2006, a charge to cost of sales was recorded for the flow-through of a portion of the purchase accounting adjustment to fair value for the work-in-process and finished goods inventory of Tru-Stone as of the acquisition date. The impact amounted to $.3 million (pre-tax). Also during the fourth quarter, charges were recorded under SFAS 146, Costs Associated with Exit Activities, for retention bonuses and reserves for inventory and fixed assets relating to the shutdown of the Evans Rule Division Charleston plant, amounting to $.8 million (pre-tax). The Company intends to vacate and sell the building in the near future.

Income Taxes The effective tax rate for fiscal 2006 was 45%, relating to the benefit of a release of tax reserves and return to provision adjustments offset by increases in valuation allowances for state NOL's, foreign NOL's and foreign tax credits. The release of tax reserves is a result of the close out of certain examination years and the reduced likelihood of future assessment due to changes in circumstances. The effective tax rate was 23% for fiscal 2005. The fiscal 2005 rate was impacted by an adjustment to the net deferred tax balances, resulting from a revision to the estimated combined state rate, an increase in the valuation allowance for certain foreign loss carryforwards which are not likely to be realized. This was offset by a reduction in the tax reserves as a result of the close out of certain examination years.

Net Income (Loss) per Share For purposes of better understanding the results from the Company's manufacturing and distribution operations, management reviews results excluding certain items.

	2006		2005	
	$000	Per Share	$000	Per Share
Net income (loss) as reported	$ (3,782)	$ (0.57)	$ 4,029	$ 0.61
Remove certain items:				
Tru-Stone purchase accounting - inventory charge	206	0.03		
Evans retention bonuses	60	0.01		
Evans shutdown reserves	470	0.07		
Sales of Elmhurst, IL facility			(1,047)	(0.16)
Sale of CMM division assets			(453)	(0.07)
Sale of Skipton plant			(662)	(0.10)
Net income (loss) (non-GAAP)	$ (3,046)	$ (0.46)	$ 1,867	$ 0.28

The above table is designed to provide the reader a better understanding of certain items which are not necessarily part of the Company’s core business. It should be noted that the Net Income (Loss) excluding

certain items (non-GAAP) amount is not intended to be in accordance with generally accepted accounting principles.

Management believes it is useful to exclude the items in the above table because these items represent changes and income that disappear in the near-term finite period. The Company is in a period of transition as it seeks to achieve and maintain consistent profitability. Although the impact of these items is immediate, both from a GAAP basis and cash flow basis, management considers them to be specific longer term investments the Company is making to achieve this consistent profitability.

Management acknowledges that there are material limitations using such non-GAAP measures. The most significant of these limitations compared to the GAAP measure is that the non-GAAP measure does not include all charges or gains recognized for the period. However, management compensates for such limitations by fully evaluating the Company's performance using both the GAAP and non-GAAP measures.

For fiscal 2006, the Tru-Stone purchase accounting inventory change occurs for only a finite period subsequent to date of acquisition based upon highly predictable inventory turns. Similarly, the Evans Rule retention bonus and shutdown reserves relate to a non-recurring move of operations from South Carolina to the Dominican Republic. Although the Company acknowledges that there is no assurance that such items will not occur in the future, the Company believes that the retention bonuses and shutdown reserves for Evans are unusual within the normal context of the Company's operations and showing their impact provides the reader with additional information to understand the Company's results.

The fiscal 2005 items represent various sales of assets. The gains realized on the sale of these assets are not considered by the Company to be part of the Company's core business or operations; accordingly, the Company believes it is important for the reader to understand the impact of these items on the Company's net income as reported under GAAP. Additionally, management considers this information related to non-core activities in evaluating the economic substance derived from non-core activities and the impact of such activities on the Company's strategic plan..

Financial Instrument Market Risk Market risk is the potential change in a financial instrument's value caused by fluctuations in interest and currency exchange rates, and equity and commodity prices. The Company's operating activities expose it to risks that are continually monitored, evaluated, and managed. Proper management of these risks helps reduce the likelihood of earnings volatility. At June 30, 2007, the Company was party to an interest swap arrangement more fully described in Note 9 to the Consolidated Financial Statements. The Company does not engage in tracking, market-making, or other speculative activities in derivatives markets. The Company does not enter into long-term supply contracts with either fixed prices or quantities. The Company does not engage in regular hedging activities to minimize the impact of foreign currency fluctuations. Net foreign monetary assets are approximately $4 million.

A 10% change in interest rates would not have a significant impact on the aggregate net fair value of the Company's interest rate sensitive financial instruments (primarily variable rate investments of $20.0 million) or the cash flows or future earnings associated with those financial instruments. A 10% change in interest rates would impact the fair value of the Company's fixed rate investments of approximately $2.2 million by $19,000. See Note 9 to the Consolidated Financial Statements for details concerning the Company's long-term debt outstanding of $8.5 million.

LIQUIDITY AND CAPITAL RESOURCES

	Years ended in June ($000)		
	2007	**2006**	**2005**
Cash provided by operations	$ 12,849	$ 8,456	$ 2,548
Cash provided by (used in) investing activities	(852)	(17,538)	1,403
Cash provided by (used in) financing activities	(8,652)	8,406	(2,043)

The significant increase in cash provided by operations from fiscal 2006 to fiscal 2007 is primarily driven by the $10.5 million improvement in net income offset by various working capital changes.

Despite the operating loss in fiscal 2006, cash provided by operations has been positive in all periods presented. During fiscal 2006, receivables increased as a result of higher overall sales and a change in the process in which the Brazilian receivables are collected. During fiscal 2005 inventories increased as a result of plant start-ups in the Dominican Republic and additional Brazilian capacity, and as a hedge against raw material price increases. This is the primary cause of the lower level cash provided by operations in fiscal 2005. This was partially offset by a reduction in receivables during that period.

"Retirement benefits" under noncash expenses in the detailed cash flow statement shows the effect on operating cash flow of the Company's pension and retiree medical plans. Primarily because the Company's domestic defined benefit plan is overfunded, retirement benefits in total are currently generating approximately $1.1 million, $.7 million and $1.4 million of noncash income in fiscal 2007, 2006 and 2005, respectively. Consolidated retirement benefit expense (income) was approximately $.1 million in 2007, $1.2 million in 2006, and $(.6) million in 2005.

At the start of fiscal 2007, the Company switched from self-funding to a fixed monthly premium for both its domestic employee health care plans and its domestic worker's compensation plan. This has reduced the cash flow uncertainty related to these Company expenses.

The Company's investing activities consisted of the acquisition of Tru-Stone in fiscal 2006, expenditures for plant and equipment, the investment of cash not immediately needed for operations and the proceeds from the sale of Company assets. Expenditures for plant and equipment have been relatively stable over each of the three years, although they are less than depreciation expense in each of those years. The fiscal 2005 proceeds from the sale of real estate and CMM business relate to the three asset sales discussed in Results of Operations above. Details of the Tru-Stone acquisition are disclosed in Note 3 to the Consolidated Financial Statements.

Cash flows from financing activities are primarily the payment of dividends. The proceeds from the sale of stock under the various stock plans has historically been used to purchase treasury shares, although in recent years such purchases have been curtailed. Overall debt has decreased by $4.9 million at the end of 2006 to $11.4 million at the end of 2007, primarily due to the reduction of capitalized lease obligations in Brazil and the first principal payment of $2.4 million on the Company's Reducing Revolver Credit Facility.

Liquidity and credit arrangements

The Company believes it maintains sufficient liquidity and has the resources to fund its operations in the near term. If the Company is unable to return to consistent profitability, additional steps will have to be taken in order to maintain liquidity, including plant consolidations and further workforce reductions (see Reorganization Plans below). The Company maintains a $10 million line of credit, of which, as of June 30, 2007, $1,000,000 was utilized in the form of standby letters of credit for insurance purposes. Although the credit line is not currently collateralized, it is possible, based on the Company's financial performance, that in the future the Company will have to provide collateral in order to maintain the credit agreement. The Company has a working capital ratio of 4.0 to one as of June 30, 2007 and 3.8 to one as of June 24, 2006.

REORGANIZATION PLANS

The continued migration of manufacturing to low cost countries has adversely affected the Company's customer base and competitive position, particularly in North America. As a result, the Company has been rethinking almost all aspects of its business and is implementing plans to lower wage costs, consolidate operations, move its strategic focus from manufacturing location to product group and distribution channel, as well as to achieving the goals of enhanced marketing focus and global procurement.

The Company consolidated its Gardner, Massachusetts product development facility into the Company's Athol, Massachusetts facility during fiscal 2005. The Company also sold the assets of its CMM division to a third party in fiscal 2005.

On September 21, 2006, the Company sold its Alum Bank, Pennsylvania level manufacturing plant and has relocated the manufacturing to the Dominican Republic, where production began in fiscal 2005. The tape measure production of the Evans Rule Division facilities in Puerto Rico and Charleston, South Carolina have been transferred to the Dominican Republic at an adjacent site. The Company plans to vacate and sell its Evans Rule facility in North Charleston, South Carolina during fiscal 2008. The Company's goal is to achieve labor savings and maintain margins while satisfying the demands of its customers for lower prices. The Company has closed three warehouses, the most recent being the Glendale, Arizona facility, which is expected to be sold in fiscal 2008. Also during fiscal 2006, the Company began a lean manufacturing initiative in its Athol, Massachusetts facility, which is expected to reduce costs over time. This initiative has continued through fiscal 2007 and will continue into fiscal 2008.

As discussed under Item 1, the Tru-Stone acquisition in April 2006 represents a strategic acquisition for the Company in that it provides an enhancement of the Company's granite surface plate capabilities. Profit margins for the Company's standard plate business have improved as the Company's existing granite surface plate facility was consolidated into Tru-Stone, where average gross margins have been higher. Along the same lines, the Kinemetric Engineering acquisition in July 2007 represents another strategic acquisition in the field of precision video-based metrology which, when combined with the Company's existing optical projection line, will provide a very comprehensive product offering.

OFF-BALANCE SHEET ARRANGEMENTS

The Company does not have any material off-balance sheet arrangements as defined under the Securities and Exchange Commission rules.

CRITICAL ACCOUNTING POLICIES

The preparation of financial statements and related disclosures in conformity with accounting principles generally accepted in the United States of America requires management to make judgments, assumptions and estimates that affect the amounts reported in the consolidated financial statements and accompanying notes. The first footnote to the Company's Consolidated Financial Statements describes the significant accounting policies and methods used in the preparation of the consolidated financial statements.

Judgments, assumptions, and estimates are used for, but not limited to, the allowance for doubtful accounts receivable and returned goods; inventory allowances; income tax reserves; employee turnover, discount, and return rates used to calculate pension obligations.

Future events and their effects cannot be determined with absolute certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results inevitably will differ from those estimates, and such differences may be material to the Company's Consolidated Financial Statements. The following sections describe the Company's critical accounting policies.

Sales of merchandise and freight billed to customers are recognized when title passes and all substantial risks of ownership change, which generally occurs either upon shipment or upon delivery based upon contractual terms. Sales are net of provisions for cash discounts, returns, customer discounts (such as volume or trade discounts), cooperative advertising and other sales related discounts.

The allowance for doubtful accounts and sales returns of $1.6 million and $1.4 million at the end of fiscal 2007 and 2006, respectively, is based on our assessment of the collectibility of specific customer accounts, the aging of our accounts receivable and trends in product returns. While the Company believes that the allowance for doubtful accounts and sales returns is adequate, if there is a deterioration of a major customer's credit worthiness, actual defaults are higher than our previous experience, or actual future returns do not reflect historical trends, the estimates of the recoverability of the amounts due the Company and sales could be adversely affected.

Inventory purchases and commitments are based upon future demand forecasts. If there is a sudden and significant decrease in demand for our products or there is a higher risk of inventory obsolescence because of rapidly changing technology and requirements, the Company may be required to increase the inventory reserve and, as a result, gross profit margin could be adversely affected.

The Company generally values property, plant and equipment (PP&E) at historical cost less accumulated depreciation. Impairment losses are recorded when indicators of impairment, such as plant closures, are present and the undiscounted cash flows estimated to be generated by those assets are less than the carrying amount. The Company continually reviews for such impairment and believes that PP&E is being carried at its appropriate value.

The Company assesses the fair value of its goodwill, generally based upon a discounted cash flow methodology. The discounted cash flows are estimated utilizing various assumptions regarding future revenue and expenses, working capital, terminal value, and market discount rates. If the carrying amount of the goodwill is greater than the fair value, goodwill impairment may be present. An impairment charge is recognized to the extent the recorded goodwill exceeds the implied fair value of goodwill.

Accounting for income taxes requires estimates of future benefits and tax liabilities. Due to temporary differences in the timing of recognition of items included in income for accounting and tax purposes, deferred tax assets or liabilities are recorded to reflect the impact arising from these differences on future tax payments. With respect to recorded tax assets, the Company assesses the likelihood that the asset will be realized. If realization is in doubt because of uncertainty regarding future profitability or enacted tax rates, the Company provides a valuation allowance related to the asset. Should any significant changes in the tax law or the estimate of the necessary valuation allowance occur, the Company would record the impact of the change, which could have a material effect on our financial position or results of operations.

Pension and postretirement medical costs and obligations are dependent on assumptions used by actuaries in calculating such amounts. These assumptions include discount rates, healthcare cost trends, inflation, salary growth, long-term return on plan assets, employee turnover rates, retirement rates, mortality and other factors. These assumptions are made based on a combination of external market factors, actual historical experience, long-term trend analysis, and an analysis of the assumptions being used by other companies with similar plans. Actual results that differ from assumptions are accumulated and amortized over future periods. Significant differences in actual experience or significant changes in assumptions would affect pension and other postretirement benefit costs and obligations. See also Employee Benefit Plans (Note 8 to the Consolidated Financial Statements).

CONTRACTUAL OBLIGATIONS

The following table summarizes future estimated payment obligations by period. The majority of the obligations represent commitments for production needs in the normal course of business.

		Payments due by period (in millions)			
	Total	**<1yr.**	**1-3yrs.**	**3-5yrs.**	**>5yrs.**