STANDARD REGISTER CO
Form 10-Q
August 03, 2006

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended July 2, 2006

OR

[ ] TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF

THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from ________ to ________

Commission file number 0-01097

THE STANDARD REGISTER COMPANY

(Exact name of registrant as specified in its charter)

OHIO	**31-0455440**
(State or other jurisdiction of Incorporation or organization)	(I.R.S. Employer Identification No.)
600 ALBANY STREET, DAYTON OHIO	**45408**
(Address of principal executive offices)	(Zip Code)

(937) 221-1000
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is 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 [ ]

Accelerated filer [X]

Non-accelerated filer [ ]

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

Yes [ ] No [X]

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding as of July 2, 2006
Common stock, $1.00 par value	24,218,581 shares
Class A stock, $1.00 par value	4,725,000 shares

THE STANDARD REGISTER COMPANY

FORM 10-Q

For the Quarter Ended July 2, 2006

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PART I - FINANCIAL INFORMATION
THE STANDARD REGISTER COMPANY
CONSOLIDATED STATEMENTS OF INCOME AND COMPREHENSIVE INCOME
(Dollars in thousands, except per share amounts)

	13 Weeks Ended		*26Weeks Ended*	
	July 2 2006	***July 3 2005***	***July 2 2006***	***July 3 2005***
REVENUE				
Products	**$ 200,479**	$ 202,624	**$ 407,892**	$ 412,243
Services	**22,353**	19,871	**43,563**	39,628
Total revenue	**222,832**	222,495	**451,455**	451,871
COST OF SALES				
Products	**130,536**	135,821	**263,779**	272,960
Services	**14,347**	12,544	**27,858**	24,660
Total cost of sales	**144,883**	148,365	**291,637**	297,620
GROSS MARGIN	**77,949**	74,130	**159,818**	154,251
OPERATING EXPENSES				
Selling, general and administrative	**66,264**	60,808	**133,752**	125,639
Depreciation and amortization	**7,483**	9,268	**14,975**	18,194
Asset impairments	**(155)**	-	**1,539**	-
Restructuring charges	**774**	338	**1,864**	866
Total operating expenses	**74,366**	70,414	**152,130**	144,699
INCOME FROM CONTINUING OPERATIONS BEFORE CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING PRINCIPLE	**3,583**	3,716	**7,688**	9,552
OTHER INCOME (EXPENSE)				
Interest expense	**(523)**	(636)	**(1,037)**	(1,292)
Other income	**97**	(38)	**134**	49
Total other expense	**(426)**	(674)	**(903)**	(1,243)
INCOME FROM CONTINUING OPERATIONS BEFORE INCOME TAXES AND CUMULATIVE EFFECT OF A				

CHANGE IN ACCOUNTING PRINCIPLE	**3,157**	3,042	**6,785**	8,309
INCOME TAX EXPENSE	**1,228**	4,148	**2,786**	6,393
NET INCOME (LOSS) FROM CONTINUING OPERATIONS BEFORE				
CUMULATIVE EFFECT OF A CHANGE IN ACCOUNTING				
PRINCIPLE	**1,929**	(1,106)	**3,999**	1,916
DISCONTINUED OPERATIONS				
Loss from discontinued operations, net of taxes	**(1,273)**	(1,608)	**(1,923)**	(2,422)
Gain (loss) on sale of discontinued operations, net of taxes	**(9,168)**	406	**(9,168)**	552
NET (LOSS) INCOME BEFORE CUMULATIVE EFFECT OF A				
CHANGE IN ACCOUNTING PRINCIPLE	**(8,512)**	(2,308)	**(7,092)**	46
Cumulative effect of a change in accounting principle, net of taxes	**-**	-	**78**	-
NET (LOSS) INCOME	**$ (8,512)**	$ (2,308)	**$ (7,014)**	$ 46
BASIC AND DILUTED EARNINGS (LOSS) PER SHARE				
Income (loss) from continuing operations	**$ 0.07**	$ (0.04)	**$ 0.14**	$ 0.06
Loss from discontinued operations	**(0.04)**	(0.05)	**(0.06)**	(0.08)
Gain (loss) on sale of discontinued operations, net of taxes	**(0.32)**	0.01	**(0.32)**	0.02
Net loss per share	**$ (0.29)**	$ (0.08)	**$ (0.24)**	$ 0.00
Dividends Paid Per Share	**$ 0.23**	$ 0.23	**$ 0.46**	$ 0.46
NET (LOSS) INCOME	**$ (8,512)**	$ (2,308)	**$ (7,014)**	$ 46
Deferred (cost) income on forward contract	**(44)**	34	**-**	61
Foreign currency translation adjustment	**(2,234)**	(85)	**(2,288)**	(156)
COMPREHENSIVE LOSS	**$ (10,790)**	$ (2,359)	**$ (9,302)**	$ (49)

See accompanying notes.

THE STANDARD REGISTER COMPANY

CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

A S S E T S	*July 2, 2006*	*January 1, 2006*
CURRENT ASSETS		
Cash and cash equivalents	**$ 2,426**	$ 13,609
Accounts and notes receivable, less allowance for doubtful		
accounts of $2,606 and $2,346, respectively	**121,573**	123,006
Inventories	**46,407**	47,033
Deferred income taxes	**14,937**	15,946
Prepaid expense	**15,530**	14,309
Total current assets	**200,873**	213,903
PLANT AND EQUIPMENT		
Land	**2,332**	2,473
Buildings and improvements	**66,517**	68,760
Machinery and equipment	**214,235**	219,511
Office equipment	**165,599**	166,804
Net assets held for sale	**1,200**	-
Construction in progress	**9,404**	5,625
Total	**459,287**	463,173
Less accumulated depreciation	**337,912**	333,184
Total plant and equipment, net	**121,375**	129,989
OTHER ASSETS		
Goodwill	**6,557**	6,557

Intangible assets, net	**1,367**	10,309
Deferred tax asset	**80,079**	83,937
Software development costs, net	**177**	8,468
Restricted cash	**272**	1,188
Other	**21,870**	21,561
Total other assets	**110,322**	132,020
Total assets	**$ 432,570**	$ 475,912

See accompanying notes.

THE STANDARD REGISTER COMPANY

CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

LIABILITIES AND SHAREHOLDERS' EQUITY	***July 2, 2006***	***January 1, 2006***
CURRENT LIABILITIES		
Current portion of long-term debt	**$ 619**	$ 611
Accounts payable	**32,968**	33,037
Accrued compensation	**25,886**	28,120
Deferred revenue	**1,412**	3,736
Accrued restructuring	**705**	1,829
Other current liabilities	**23,370**	32,715
Total current liabilities	**84,960**	100,048
LONG-TERM LIABILITIES		
Long-term debt	**18,068**	34,379
Pension benefit obligation	**112,267**	107,236
Retiree health care obligation	**41,994**	43,885
Deferred compensation	**16,292**	16,357
Other long-term liabilities	**75**	555
Total long-term liabilities	**188,696**	202,412
SHAREHOLDERS' EQUITY		
Common stock, $1.00 par value:		
Authorized 101,000,000 shares		
Issued 2006 - 26,142,343; 2005 - 26,032,701	**26,142**	26,033
Class A stock, $1.00 par value:		
Authorized 9,450,000 shares		
Issued - 4,725,000	**4,725**	4,725

Capital in excess of par value	**58,343**	60,223
Accumulated other comprehensive losses	**(123,849)**	(121,561)
Retained earnings	**242,904**	256,576
Treasury stock at cost:		
1,923,762 shares	**(49,351)**	(49,351)
Unearned compensation - restricted stock	**-**	(3,193)
Total shareholders' equity	**158,914**	173,452
Total liabilities and shareholders' equity	**$ 432,570**	$ 475,912

See accompanying notes.

THE STANDARD REGISTER COMPANY
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)

	26 Weeks Ended July 2 2006	*26 Weeks Ended July 3 2005*
CASH FLOWS FROM OPERATING ACTIVITIES		
Net (loss) income	$ (7,014)	$ 46
Cumulative effect of a change in accounting principle	(78)	-
Adjustments to reconcile net (loss) income to net		
cash provided by operating activities:		
Depreciation and amortization	17,212	20,908
Restructuring charges	1,864	2,000
Asset impairment	1,539	-
(Gain) loss on sale of discontinued operations	11,955	(552)
Pension and postretirement benefit expense	14,164	10,401
Share-based compensation	1,032	1,041
Deferred income taxes	(209)	5,404
Other	265	769
Changes in operating assets and liabilities:		
Accounts and notes receivable	(135)	7,137
Inventories	626	5,328
Income taxes	1,091	(898)
Other assets	(2,626)	(1,019)
Restructuring spending	(2,001)	(3,264)
Accounts payable and accrued expenses	(8,304)	(10,010)
Pension and postretirement obligation	(11,024)	(8,917)
Other liabilities	(100)	(1,468)
Net cash provided by operating activities	18,257	26,906

CASH FLOWS FROM INVESTING ACTIVITIES		
Additions to plant and equipment	(9,579)	(10,085)
Proceeds from sale of discontinued operations	8,925	-
Proceeds from sale of plant and equipment	312	286
Net cash used in investing activities	(342)	(9,799)
CASH FLOWS FROM FINANCING ACTIVITIES		
Net change in borrowings under revolving credit facility	(15,999)	(40,000)
Principal payments on long-term debt	(304)	(272)
Proceeds from issuance of common stock	503	1,383
Dividends paid	(13,291)	(13,170)
Debt issuance costs	-	(769)
Tax benefit from exercise of stock options	41	-
Net cash used in financing activities	(29,050)	(52,828)
Effect of exchange rate changes on cash	(48)	(139)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(11,183)	(35,860)
Cash and cash equivalents at beginning of period	13,609	44,088
CASH AND CASH EQUIVALENTS AT END OF PERIOD	$ 2,426	$ 8,228

See accompanying notes.

THE STANDARD REGISTER COMPANY

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Dollars in thousands, except per share amounts)

NOTE 1 BASIS OF PRESENTATION

The accompanying consolidated financial statements include the accounts of The Standard Register Company and its wholly-owned subsidiaries (collectively, the Company) after elimination of intercompany transactions, profits, and balances. The consolidated financial statements are unaudited and have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required for complete annual financial statements and should be read in conjunction with the Company s audited consolidated financial statements and notes for the year ended January 1, 2006 included in the Company s Annual Report on

Form 10-K.

In the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation have been included. The results for interim periods are not necessarily indicative of trends or of results to be expected for a full year.

Certain prior-year amounts have been reclassified to conform to the current-year presentation.

NOTE 2 RECENTLY ADOPTED ACCOUNTING PRONOUNCEMENTS

Effective January 2, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No.123(R), Share Based Payment (Revised 2004), which requires that compensation costs relating to share-based payment transactions be recognized in the financial statements based on estimated fair values. The Company adopted SFAS 123(R) using the modified prospective transition method. In accordance with the modified prospective transition method, the Company s Consolidated Financial Statements for prior periods have not been restated to reflect the impact of SFAS 123 (R). Incremental compensation expense recognized under SFAS No. 123(R) in 2006 is not material. The Company also recognized a $78 reduction of expense net of taxes to record the cumulative effect of a change in accounting principle as of January 2, 2006 (see Note 8).

Effective January 2, 2006, the Company adopted SFAS No. 151, Inventory Costs, an amendment of ARB No. 43, Chapter 4 Inventory Pricing. SFAS No. 151 requires idle facility costs, abnormal freight, handling costs, and amounts of wasted materials (spoilage) be treated as current-period costs. Under this concept, if the costs associated with the actual level of spoilage or production defects are greater than the costs associated with the range of normal spoilage or defects, the difference would be charged to current-period expense, not included in inventory costs. SFAS No. 151 also requires the allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The adoption of this standard did not have a material effect on the Company s consolidated results of operations, financial position, or cash flows.

Effective January 2, 2006, the Company adopted SFAS No. 154, "Accounting Changes and Error Corrections - a replacement of APB Opinion No. 20 and FASB Statement No. 3". SFAS No. 154 requires, unless impracticable, retrospective application to prior periods financial statements of changes in accounting principle where transition is not specified by a new accounting pronouncement. SFAS No. 154 also requires that retrospective application of a change in accounting principle be limited to the direct effects of the change. Indirect effects of a change in accounting principle should be recognized in the period of the accounting change. The adoption of this standard did not have a material effect on the Company s consolidated results of operations, financial position, or cash flows.

NOTE 3 DISCONTINUED OPERATIONS

InSystems

On June 5, 2006, the Company sold 100% of the outstanding capital stock of InSystems Corporation (InSystems) to Whitehill Technologies, Inc. for approximately $8,500 in cash, plus the return of certain cash deposits. The transaction resulted in a loss of approximately $9,214, net of taxes, which includes a charge of $2,980 for contractual obligations to Whitehill Technologies, Inc. related to the leased facility. In conjunction with the recording of this contractual obligation, the Company reversed a restructuring liability of $1,111 to discontinued operations.

The Company made the decision to sell this business primarily because it no longer fit with the Company s future strategic direction. Revenue for InSystems included in discontinued operations was $1,862 and $2,963 for the second quarter of 2006 and 2005, respectively and $4,897 and $5,566 for the first half of 2006 and 2005, respectively. No interest expense was allocated to discontinued operations.

The sale of InSystems, a reportable segment since its acquisition in 2002, met the criteria to be accounted for as discontinued operations under SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, and the results of operations have been excluded from continuing operations in the accompanying Consolidated Statements of Operations. Cash flows related to discontinued operations are not separately disclosed in the Consolidated Statements of Cash Flows.

The Company s consolidated balance sheet at January 1, 2006 included the following assets and liabilities related to InSystems:

		January 1, 2006
Assets		
Accounts receivable	$	2,515
Deferred tax assets		4,545
Prepaid expenses		356
Property and equipment, net		1,388
Intangible and other assets		16,902
Total assets	$	25,706
Liabilities		
Accounts payable	$	267
Accrued liabilities		3,733

Other long-term liabilities		555
Total liabilities	$	4,555

Equipment Service

In December 2004, the Company sold selected assets and transferred selected liabilities of its equipment service business to Pitney Bowes. The transaction was completed on December 31, 2004 and resulted in a gain of $12,820, net of income taxes of $8,550. In the second quarter of 2005, the Company finalized the working capital adjustment with Pitney Bowes related to the sale of the service business and in the second quarter of 2006, adjusted related reserves. The net impact of these adjustments resulted in a $552 and $46 net increase in the gain on sale in 2005 and 2006, respectively.

NOTE 4 RESTRUCTURING AND IMPAIRMENT CHARGES

The Company has undertaken restructuring actions as part of an ongoing effort to improve its utilization and profitability. These restructuring plans are more fully described in Note 4 to the Consolidated Financial Statements included in the Company s Annual Report on Form 10-K for the year ended January 1, 2006.

Liabilities for costs associated with a restructuring cannot be recorded until the liability is incurred and the fair value can be estimated, except for certain one-time termination benefits. Therefore, certain restructuring costs, primarily sublease payments and the associated taxes, utilities and maintenance costs, and remaining relocation costs are expensed as incurred. All costs related to restructuring actions are included in restructuring charges in the accompanying Consolidated Statements of Income.

Pre-tax components of restructuring expense are as follows:

	13 Weeks Ended		*26 Weeks Ended*	
	July 2, 2006	***July 3, 2005***	***July 2, 2006***	***July 3, 2005***
2006 Restructuring Actions				
Severance and employer related costs	**$ 11**	$ -	**$ 700**	$ -
Associated costs	**668**	-	**868**	-
Total 2006	**679**	-	**1,568**	-
2005 Restructuring Actions				
Associated costs	**-**	-	**6**	-
Total 2005	**-**	-	**6**	-
2004 Restructuring Actions				
Severance and employer related costs	**-**	(26)	**-**	54
Contract exit and termination costs	**(1)**	12	**9**	21
Total 2004	**(1)**	(14)	**9**	75
2003 Restructuring Actions				
Contract exit and termination costs	**54**	47	**106**	151
Total 2003	**54**	47	**106**	151
2001 Restructuring Actions				
Contract exit and termination costs	**42**	305	**175**	640
Total 2001	**42**	305	**175**	640
Total restructuring expense	**$ 774**	$ 338	**$ 1,864**	$ 866

2006 Restructuring

Within the Document and Label Solutions (DLS) segment, the Company closed its Terre Haute, Indiana label production plant. The plant s productive capacity will be transferred to three other plants in the United States to improve overall efficiency and lower operating costs. Restructuring costs to be incurred include severance and employer related costs and other associated costs directly related to the restructuring, primarily equipment removal and relocation.

Pre-tax components of 2006 restructuring expense are as follows:

	Total Costs	***Total***	***Cumulative-***

	Expected to be Incurred	Q2 2006 Restructuring Expense	To-Date Restructuring Expense
Severance and employer related costs	$ 840	$ 11	$ 700
Associated costs	1,430	668	868
Total	$ 2,270	$ 679	$ 1,568

A summary of the 2006 restructuring accrual activity is as follows:

	Charged to Accrual	Incurred in 2006	Balance 2006
Severance and employer related costs	$ 694	$ (179)	$ 515
Total	$ 694	$ (179)	$ 515

2005 Restructuring

Within the Print on Demand (POD) Services segment, the Company closed one printing center, selling the building at a small gain. The Company moved production to other facilities and outsourced envelope production. The Company plans to open a new digital-only facility in 2006. The Company also closed a warehouse in the Document and Label Solutions segment. Costs incurred primarily related to severance and employer-related costs.

A summary of the 2005 restructuring accrual activity is as follows:

	Balance 2005	*Incurred in 2006*	*Balance 2006*
Severance and employer related costs	$ 336	$ (258)	$ 78
Total	$ 336	$ (258)	$ 78

2004, 2003, and 2001 Restructuring

All of the 2004, 2003, and 2001 restructuring actions are completed. Any restructuring expense recorded in 2006 for these actions is primarily related to vacated facilities, as the amount accrued is net of any expected sub-lease income and the Company has been unable to sublease the remaining facilities.

A summary of the 2004 restructuring accrual activity is as follows:

	Balance 2005	*Reversed in 2006*	*Incurred in 2006*	*Balance 2006*
Contract termination costs	26	(4)	(22)	-
Total	$ 26	$ (4)	$ (22)	$ -

A summary of the 2003 restructuring accrual activity is as follows:

	Balance 2005	*Incurred in 2006*	*Balance 2006*
Contract termination costs	$ 266	$ (154)	$ 112
Total	$ 266	$ (154)	$ 112

2006 Asset Impairments

In conjunction with the 2006 restructuring actions, the Company recorded $1,539 of asset impairments. Of this amount, $1,512 was related to the DLS segment, and $27 related to the International segment. Within the DLS segment, the Terre Haute building and certain pieces of equipment have been classified as assets held for sale and their carrying values were adjusted to their fair value less costs to sell, considering recent sales of similar properties and real estate valuations. Other equipment was determined to have no fair value and will be disposed of. Impairment charges are included in Asset Impairments in the accompanying Consolidated Statements of Income.

NOTE 5 INVENTORIES

The components of inventories are as follows:

	July 2, 2006	***January 1, 2006***
Finished products	**$ 39,847**	$ 39,019
Jobs in process	**2,248**	3,442
Materials and supplies	**4,312**	4,572
Total	**$ 46,407**	$ 47,033

NOTE 6 GOODWILL AND INTANGIBLE ASSETS

Identifiable intangible assets consist of the following:

	July 2, 2006		*January 1, 2006*	
	Gross Carrying Amount	***Accumulated Amortization***	***Gross Carrying Amount***	***Accumulated Amortization***
Intangible Assets with Determinable Lives				
Service Relationships	**$ -**	**$ -**	$ 16,048	$ (7,297)
Patents	**650**	**(511)**	650	(487)
Customer contracts	**303**	**(259)**	303	(214)
Professional services backlog	**735**	**(551)**	1,770	(1,464)
	1,688	**(1,321)**	18,771	(9,462)
Intangible Assets with Indefinite Lives				
Trademark	**1,000**	**-**	1,000	-
	1,000	**-**	1,000	-
Total	**$ 2,688**	**$ (1,321)**	$ 19,771	$ (9,462)

Amortization expense for intangible assets was $95 for each of the second quarters of 2006 and 2005 and $190 for the year-to-date periods of 2006 and 2005. Estimated amortization expense for the remainder of 2006 is $190. Estimated amortization expense for the next three years is as follows: 2007-$108; 2008-$46; and 2009-$23.

During the second quarter of 2006, the Company performed the annual impairment test for goodwill related to the PlanetPrint acquisition. The test was performed at the reporting unit level using a fair-value-based test that compares the fair value of the asset to its carrying value. Fair values are calculated using discounted expected future cash flows, using a risk-adjusted discount rate. Based upon the test results, the Company determined that the discounted sum of the expected future cash flows from the assets exceeded the carrying value of those assets; therefore, no impairment of goodwill was recognized.

NOTE 7 EARNINGS PER SHARE

The number of shares outstanding for calculation of earnings per share (EPS) is as follows:

	13 Weeks Ended		*26 Weeks Ended*	
	July 2,	***July 3,***	***July 2,***	***July 3,***

(Shares in thousands)	*2006*	*2005*	*2006*	*2005*
Weighted average shares outstanding - basic	**28,934**	28,771	**28,907**	28,657
Dilutive effect of stock options	**18**	-	**63**	11
Weighted average shares outstanding - diluted	**28,952**	28,771	**28,970**	28,668

The effects of stock options on diluted EPS are reflected through the application of the treasury stock method. Under this method, proceeds received by the Company, based on assumed exercise, are hypothetically used to repurchase the Company s shares at the average market price for the period. Outstanding options to purchase approximately 2,226,000 and 2,202,000 shares for the three-and six month periods ended July 2, 2006 and approximately 2,052,000 shares for the six month period ended July 2, 2005 were not included in the computation of diluted EPS because the exercise prices of the options were greater than the average market price of the shares; therefore, the effect would be anti-dilutive. Due to the loss from continuing operations incurred in the second quarter of 2005, no outstanding options were included in the EPS computation because they would automatically result in anti-dilution.

NOTE 8 SHARE BASED COMPENSATION

The Company has one plan under which share-based awards may currently be granted to officers and key employees. The 2002 Equity Incentive Plan (2002 Plan) provides for the granting of a maximum of 3,500,000 shares. The 2002 Plan permits the grant of incentive or non-qualified stock options, restricted stock grants, and stock appreciation rights. A committee of the Board of Directors (Committee) administers the Company s stock incentive plan. The Committee has the authority to determine the employees to whom awards will be made, the amount of the awards, and the other terms and conditions of the awards. Non-employee directors are also eligible to receive stock incentives under the 2002 Plan.

Stock options granted under the 2002 Plan have terms that range from five to ten years and the exercise price per share may not be less than the fair market value on the grant date. The options vest over periods determined when granted, generally one to four years and are exercisable until the term expires. Stock options granted under a previous plan had a maximum term of ten years and the exercise price per share was not less than the fair market value on the grant date. The remaining options outstanding under this plan vest over one to four years.

Under the 2002 Plan, shares subject to restricted stock award may be issued when the award is granted or at a later date, with or without dividend rights. The stock awards are subject to terms determined by the Committee, and may include specified performance objectives. In 2004, as part of an acquisition agreement, the Company s Board of Directors also approved restricted stock awards to one individual not to exceed an aggregate dollar amount of $1,750.

Prior to the adoption of SFAS 123 (R)

Prior to January 2, 2006, the Company accounted for share-based compensation using the intrinsic value method in accordance with Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations, as permitted by SFAS No. 123, Accounting for Stock-Based Compensation. As permitted, no share-based compensation cost was recognized for stock options in the consolidated financial statements for 2005, as all options granted had an exercise price equal to the market value of the underlying common stock on the date of grant. Effective January 2, 2006, the Company adopted SFAS No. 123(R) using the modified prospective transition method. Under that transition method, compensation cost recognized in 2006 includes compensation cost for all share-based payments granted prior to, but not yet vested as of January 2, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and compensation cost for all share-based payments granted on or after January 2, 2006, based on the grant date fair value estimated in accordance with the provision of SFAS No. 123(R). In accordance with the modified prospective transition method, results for prior periods have not been restated.

The following table illustrates the effect on net income and earnings per share from continuing operations as if the Company had determined compensation expense for all awards granted under the Company s share-based compensation plans under the provisions of SFAS No. 123, prior to the adoption of SFAS No. 123(R). For purposes of this pro forma disclosure, the fair value of stock options was estimated using a Black-Scholes option-pricing model and amortized on a straight-line basis over the options vesting periods.

	13 Weeks Ended July 3, 2005	***26 Weeks Ended July 3, 2005***
Net (loss) income from continuing operations	**$ (1,106)**	**$ 1,916**

Add: share-based employee compensation expense included in reported net income, net of related tax effects		**412**		**632**
Less: share-based employee compensation expense determined under fair-value-based method for all awards, net of related tax effects		**(461)**		**(714)**
Proforma net (loss) income from continuing operations	**$**	**(1,155)**	**$**	**1,834**
Basic and diluted (loss) earnings per share from continuing operations				
As reported	**$**	**(0.04)**	**$**	**0.06**
Proforma	**$**	**(0.04)**	**$**	**0.06**

When recognizing compensation cost for restricted stock awards under APB Opinion No. 25, the Company was required to recognize compensation cost assuming all awards would vest and to reverse recognized compensation cost for forfeited awards only when the awards were actually forfeited. SFAS No. 123(R) requires the Company to estimate the number of share-based compensation awards that ultimately will be forfeited when recognizing compensation cost and to reevaluate this estimate each reporting period.

An estimate of forfeitures was required related to the unvested awards outstanding as of the adoption of SFAS No. 123(R) for which expense has been recognized in the Consolidated Statements of Income. The adjustment related to this estimate of forfeitures for compensation cost that would not have been recognized in prior periods had forfeitures been estimated during those periods was $78, net of $51 of tax, and is recorded as a cumulative effect of a change in accounting principle in the accompanying Consolidated Statement of Income.

Adoption of SFAS 123 (R)

The following table illustrates the effect of adoption of SFAS No. 123(R) on 2006 second quarter and year-to-date results of operations.

	13 Weeks Ended July 2, 2006	*26 Weeks Ended July 2, 2006*
Increase to income from continuing operations before cumulative effect of a change in accounting principle	**$ 27**	**$ 5**
Increase to income from continuing operations before income taxes and cumulative effect of a change in accounting principle	**$ 27**	**$ 5**
Increase to net income	**$ 17**	**$ 82**
Effect on basic and diluted earnings per share	**$ -**	**$ -**

Total share-based compensation expense by type of award is as follows:

	13 Weeks Ended		*26 Weeks Ended*	
	July 2, 2006	*July 3, 2005*	*July 2, 2006*	*July 3, 2005*
Restricted stock awards, service based	**$ 154**	**$ 485**	**$ 520**	**$ 727**
Restricted stock awards, performance based	**171**	**194**	**339**	**314**
Stock options	**104**	**-**	**177**	**-**
Total share-based compensation expense	**429**	**679**	**1,036**	**1,041**
Tax effect on share-based compensation expense	**170**	**267**	**408**	**409**
Net effect on income from continuing operations	**$ 259**	**$ 412**	**$ 628**	**$ 632**
Effect on basic and diluted earnings per share	**$ 0.01**	**$ 0.01**	**$ 0.02**	**$ 0.02**

Stock Options

The weighted average fair value of stock options granted in 2006 and 2005 was estimated at $3.31 and $2.18 per share, respectively, using the Black-Scholes option-pricing model based on the following assumptions. Assumptions used in the model for prior year grants are described in the Company s Annual Report on Form 10-K for the year ended January 1, 2006.

Expected Term: The Company s expected term represents the period that the Company s share-based awards are expected to be outstanding and was determined based on historical experience of similar awards, giving consideration to the contractual terms of the share-based awards and vesting schedules.

Expected Volatility: The fair value of share based payments were valued using the Black-Scholes Model with a volatility factor based on the Company s historical stock prices.

Expected Dividend: The Black-Scholes Model requires a single expected dividend yield as an input. The Company calculates an expected dividend yield based on the quarter-end stock price and dividends paid per share.

Risk-Free Interest Rate: The Company bases the risk-free interest rate used in the Black-Scholes Model on the implied yield currently available on U.S. Treasury zero-coupon issues with a remaining term equivalent to the expected remaining term of the options being valued.

Estimated Pre-vesting Forfeitures: When estimating forfeitures, the Company considers historical rates of forfeitures adjusted for known anomalies such as restructuring actions taken in the past by the Company.

The weighted average of significant assumptions used to estimate the fair value of options granted in 2006 are as follows:

	2006
Risk-free interest rate	**4.5%**
Dividend yield	**5.9%**
Expected life	**4 years**
Expected volatility	**34.2%**

A summary of the Company s stock option activity and related information for year-to-date period of fiscal 2006 is as follows:

	26 Weeks Ended July 2, 2006	
	Number of Shares	***Weighted Average Exercise Price***
Outstanding at January 1, 2006	**2,391,626**	**$ 20.31**
Granted	**307,214**	**16.89**
Exercised	**(24,501)**	**12.63**
Forfeited/Canceled	**(199,456)**	**21.64**
Outstanding at July 2, 2006	**2,474,883**	**$ 19.86**
Exercisable at July 2, 2006	**1,953,562**	**$ 21.11**

The aggregate intrinsic value of options exercised during the first six months of fiscal 2006 and fiscal 2005 were $71 and $99, respectively.

Following is a summary of the status of stock options outstanding at July 2, 2006 which are fully vested or are expected to ultimately vest. The share amounts presented below have been reduced to reflect estimated forfeitures.

Options Outstanding ***Options Exercisable***

Number of Shares	*Weighted-Average Remaining Contractual Life*	*Weighted-Average Exercise Price*	*Aggregate Intrinsic Value*	*Number of Shares*	*Weighted-Average Exercise Price*	*Aggregate Intrinsic Value*
2,426,649	**5 years**	**$ 19.95**	**$ 18**	**1,953,562**	**$ 21.11**	**$ 15**