

FLOW INTERNATIONAL CORP
Form S-1/A
August 08, 2005
Table of Contents

As filed with the Securities and Exchange Commission on August 8, 2005

Registration No. 333-125113

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 1

to

Form S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

Flow International Corporation

(Exact name of registrant as specified in its charter)

Washington
*(State or other jurisdiction of
incorporation or organization)*

3569
*(Primary Standard Industrial
Classification Code Number)*

91-1104842
*(I.R.S. Employer
Identification Number)*

Stephen R. Light

President and Chief Executive Officer

23500 64th Avenue South

Kent, WA 98032

(253) 850-3500

(Address, including zip code and telephone number, including area code, of Registrant's principal executive offices)

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PTSGE Corp.

925 Fourth Avenue, Suite 2900

Seattle, WA 98104

(206) 623-7580

(Name, address, including zip code and telephone number, including area code, of agent for service)

Copies to:

Robert S. Jaffe

William Gleeson

Preston Gates & Ellis LLP

925 Fourth Avenue, Suite 2900

Seattle, WA 98104

(206) 623-7580

Approximate date of commencement of proposed sale to the public:

From time to time after the effective date of this registration statement,

as determined by market conditions and other factors.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box:

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering:

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering:

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering:

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box:

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to Be Registered	Amount to Be Registered(1)	Proposed Maximum Offering Price Per Security(4)	Proposed Maximum Aggregate Offering Price(4)	Amount of Registration Fee
Common Stock, \$0.01 par value.	17,473,116 Shares(2)	\$6.76	\$118,118,264.16	\$13,902.52(5)
Common Stock, \$0.01 par value.	3,219,245(3)	\$6.76	\$21,762,096	\$2,561.40(5)

- (1) In accordance with Rule 416(a), the registrant is also registering hereunder an indeterminate number of shares that may be issued and resold resulting from stock splits, stock dividends or similar transactions.
- (2) Represents shares of the registrant's common stock being registered for resale that have been issued to the selling shareholders named in this registration statement.
- (3) Represents shares of the registrant's common stock being registered for resale that have been or may be acquired upon the exercise of warrants issued to the selling shareholders named in this registration statement.
- (4) Estimated pursuant to Rule 457(c) under the Securities Act of 1933, solely for the purposes of calculating the registration fee, upon the basis of the average high and low prices of our common stock as reported on the Nasdaq National Market on May 16, 2005.
- (5) Previously paid.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

Table of Contents

PRELIMINARY PROSPECTUS

Shares

Common Stock

This prospectus relates to the offer and sale of up to 17,473,116 outstanding shares of the common stock of Flow International Corporation, a Washington corporation, and up to 3,219,245 shares that may be issued on the exercise of outstanding warrants. Such shares may be offered and sold from time to time by the persons described in this prospectus under the heading "Selling Shareholders" or by pledgees, donees, transferees, assignees or other successors-in-interest of such persons (collectively, the "Selling Shareholders"). As used in this prospectus, we, us, our and similar expressions refer to Flow International Corporation and its subsidiaries.

The Selling Shareholders may offer their shares from time to time through or to one or more underwriters, brokers or dealers, on the NASDAQ Stock National Market at market prices prevailing at the time of sale, in one or more negotiated transactions at prices acceptable to the Selling Shareholders or in private transactions. We will not receive any proceeds from the sale of shares by the Selling Shareholders. In connection with any sales, the Selling Shareholders and any underwriters, agents, brokers or dealers participating in such sales may be deemed to be underwriters within the meaning of the Securities Act.

We will pay the expenses related to the registration of the shares covered by this prospectus. The Selling Shareholders will pay commissions and selling expenses, if any, incurred by them.

Our common stock trades on the NASDAQ National Market under the symbol "FLOW". On August 4, 2005, the closing price of one share of our common stock was \$8.21.

Investing in our securities involves risks. See Risk Factors beginning on page 5 of this prospectus.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this prospectus is _____, 2005.

Table of Contents

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with different information. An offer to sell these securities is not being made in any state where the offer is not permitted. You should not assume that the information contained in this prospectus or any prospectus supplement is accurate as of any date other than the date of such documents. Our business, financial condition, results of operations and prospects may have changed since that date.

TABLE OF CONTENTS

	Page
<u>Prospectus Summary</u>	1
<u>The Company</u>	1
<u>The Offering</u>	2
<u>Historical Stock Price</u>	3
<u>Summary Financial Data</u>	4
<u>Risk Factors</u>	5
<u>Cautionary Note Regarding Forward-Looking Statements</u>	9
<u>Use of Proceeds</u>	10
<u>Dividend Policy</u>	10
<u>Pro-Forma Information</u>	11
<u>Selected Financial Data</u>	16
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	17
<u>Business</u>	43
<u>Information Concerning Directors and Executive Officers</u>	49
<u>Board Structure, Committees, Compensation and Composition</u>	52
<u>Executive Compensation</u>	55
<u>Market Information</u>	60
<u>Stock Ownership of Management and Principal Shareholders</u>	61
<u>Selling Shareholders</u>	64
<u>Description of Capital Stock</u>	67
<u>Plan of Distribution</u>	69
<u>Legal Matters</u>	71
<u>Experts</u>	71
<u>Where You Can Find More Information</u>	71
<u>Index to Consolidated Financial Statements</u>	72

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission using the SEC's shelf registration rules. Under the shelf registration rules, using this prospectus and, if required, one or more prospectus supplements, the Selling Shareholders may sell from time to time, in one or more offerings, the shares of common stock covered by this prospectus. The shares covered by this prospectus include 17,473,116 outstanding shares of common stock and 3,219,245 shares of common stock issuable upon the exercise of warrants.

This prospectus also covers any shares of common stock that may become issuable pursuant to anti-dilution adjustment provisions that would increase the number of shares issuable upon exercise of the warrants as a result of stock splits, stock dividends or similar transactions.

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A prospectus supplement may add, update or change information contained in this prospectus. We recommend that you read carefully this entire prospectus, especially the section entitled "Risk Factors" beginning on page 5, together with any supplements before making a decision to invest in our common stock.

Table of Contents

PROSPECTUS SUMMARY

This summary highlights key aspects of the information contained elsewhere in this prospectus. This summary does not contain all the information you should consider before investing in our common stock. You should read this entire prospectus carefully, especially the risks of investing in our common stock discussed under Risk Factors beginning on page 5, current events beginning on page 17 and our consolidated financial statements and the notes to those consolidated financial statements beginning on page F-1, before making an investment decision.

THE COMPANY

We design, develop, manufacture, market, install and service ultrahigh-pressure, or UHP, water pumps and UHP water management systems. Our core competency is the design and manufacture of UHP water pumps. Our UHP water pumps pressurize water from 40,000 to over 100,000 pounds per square inch (psi) and are integrated with water delivery systems so that water can be used to cut or clean material or pressurize food. Our products include both standard and specialized waterjet cutting and cleaning systems and the Fresher Under Pressure® food processing products. In addition to UHP water pumps and related systems, we provide non UHP automation and articulation systems, primarily to the automotive industry, and isostatic and flexform press systems which produce and strengthen advanced materials for the aerospace, automotive and medical industries.

Our UHP technology has three broad applications: cutting, cleaning and Fresher Under Pressure or food processing. In cutting and cleaning applications, the ultrahigh-pressure created by our pumps is released through a small orifice to create a jet of water. In Fresher Under Pressure, we utilize contained pressure. Food is put into a pressure vessel and UHP water is pumped into the vessel. This pressurized water is used to kill both spoilage bacteria and pathogens in the food.

The primary application of our UHP water pumps is cutting. In cutting applications, pressures from 50,000 to 87,000 psi create a thin stream of water traveling at three or more times the speed of sound which can cut both metallic and nonmetallic materials. UHP water pumps are used in aerospace, automotive, disposable products, food, glass, job shop, sign, metal cutting, marble, tile and other stone cutting, and paper slitting and trimming applications. Waterjet cutting is recognized as a more flexible alternative to traditional cutting methods such as lasers, saws or plasma. It is often faster, has greater versatility in the types of materials it can cut and eliminates the need for secondary processing operations. We also manufacture a waterjet product line used in cleaning, where pressures in the range of 40,000 to 55,000 psi are used in industrial cleaning, surface preparation, construction, and petro-chemical and oil field applications. In the food pressurization applications, pressures of between 87,000 to 100,000 psi are used for our Fresher Under Pressure food processing technology to provide food safety, quality and productivity enhancements for food producers.

We analyze our business based on the utilization of UHP, either as released pressure or contained pressure, as follows: Flow Waterjet Systems, or Waterjet, for released pressure applications and Avure Technologies Incorporated, or Avure, for contained pressure applications. In addition to the cutting and cleaning operations, the Waterjet operation also includes the automotive and articulation applications while Avure includes the Fresher Under Pressure technology, and the General Press operations.

Our principal executive offices are at 23500 64th Avenue South, Kent, WA 98032 and our telephone number is (253) 850-3500. We maintain a website at www.flowcorp.com. The contents of our website are not incorporated into this prospectus.

Table of Contents

The Offering

Common Stock offered by the Selling Shareholders	20,692,359 Shares(1)
Offering	The Selling Shareholders may offer their shares from time to time through one or more underwriters, brokers or dealers, on the NASDAQ Stock National Market at market prices prevailing at the time of sale, in one or more negotiated transactions at prices acceptable to the Selling Shareholders or in private transactions.
Use of Proceeds	The proceeds from the sale of the shares covered by this prospectus will be received by the Selling Shareholders. We will not receive any of the proceeds from the sales by the Selling Shareholders of the shares covered by this prospectus.
Nasdaq National Market symbol	FLOW
Risk Factors	See Risk Factors beginning on page 5 for a discussion of factors that you should consider carefully before deciding to purchase our common stock.
Offering-related Information	<p>On March 21, 2005, in a Private Investment in Public Equity Transaction (PIPE Transaction), we sold 17,473,116 equity units at \$3.72 per unit for gross proceeds of \$65 million, and net proceeds of \$59.3 million. A unit consists of one share of our common stock and one warrant to buy 1/10th of a share of our common stock. Ten warrants give the holder the right to purchase one share of common stock for \$4.07. The closing price of our stock on Nasdaq National Market on the day before the agreement between the Company and the Selling Shareholders relating to the PIPE Transaction was entered into \$3.70 per share. On the day that the agreement was entered into, the closing price was \$4.28 per share.</p> <p>Proceeds of the PIPE were used to pay down existing debt of \$59.3 million, including all of our subordinated debt. Under the terms of warrants previously issued to our senior and subordinated lenders, we are obligated to issue additional warrants if shares of our common stock are issued for prices less than market price. Because the issuance price of the common stock of the PIPE Transaction was less than market value, we issued approximately 304,000 anti-dilution \$0.01 warrants to our lenders. These warrants had a Black-Scholes value of approximately \$1.1 million. The majority of the charges resulting from the issuance of the additional warrants, \$1.0 million, were charged to interest expense in the fourth quarter of fiscal 2005 as the underlying debt associated with these warrants was retired in the fourth quarter of fiscal 2005. The remainder, \$82,000, will be capitalized and amortized to interest expense through August 1, 2005.</p>

(1) Includes 3,219,245 shares of common stock issuable upon the exercise of outstanding warrants to purchase common stock.

Table of Contents

Under EITF 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock (EITF 00-19), the fair value of the warrants sold to the PIPE investors will be reported initially as a liability due to liquidated damages of 1% of the gross proceeds per month (\$650,000) which will be payable in the event that this Form S-1 is not be declared effective prior to September 17, 2005. Upon effectiveness of the Form S-1, the fair value of the warrants will be reclassified into Capital in Excess of Par in the Equity section of the Consolidated Balance Sheet. As of March 21, 2005, the warrants sold to the PIPE investors have been valued at \$6.4 million using the Black-Scholes method, and the shares have been recorded at \$52.9 million, or the difference between the net proceeds and the value of the warrants. The warrants sold to the PIPE investors are considered a derivative financial instrument and will be marked to fair value quarterly until this Form S-1 is declared effective. Any changes in fair value of the warrants will be recorded through the Consolidated Statement of Operations.

Historical Stock Price

Our stock is traded on the NASDAQ National Market under the symbol FLOW. The range of high and low sales prices for our common stock for the first and second quarter of fiscal 2006 through August 4, 2005 and the four quarters for fiscal 2005, 2004 and 2003 is set forth in the following table.

	Fiscal Year 2006		Fiscal Year 2005		Fiscal Year 2004		Fiscal Year 2003	
	High	Low	High	Low	High	Low	High	Low
First Quarter	\$ 7.83	\$ 5.87	\$ 3.66	\$ 1.90	\$ 1.94	\$ 1.13	\$ 10.90	\$ 5.05
Second Quarter	8.21	7.74	3.75	2.54	3.11	1.36	5.60	2.12
Third Quarter			3.20	2.57	4.11	2.40	3.80	2.13
Fourth Quarter			6.90	2.85	3.74	2.20	3.28	1.08

We have not paid dividends to common shareholders in the past. Our Board of Directors intends to retain future earnings, if any, to finance development and expansion of our business and reduce debt and does not expect to declare dividends to common shareholders in the near future. The credit agreement entered into on July 11, 2005 does permit us to pay dividends however. Prior to this date however, our credit agreements contained restrictions on our ability to pay dividends to our shareholders.

Table of Contents**Summary Financial Data**

The following table provides summary historical financial data for the periods indicated. You should read this information in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and the related notes included elsewhere in this prospectus.

The summary statement of operations data for each of the fiscal years ended April 30, 2003, 2004 and 2005 and the summary balance sheet data as of April 30, 2004 and 2005 are derived from our audited financial statements, which are included elsewhere in this prospectus. The summary statement of operation data for the fiscal year ended April 30, 2002 and the summary balance sheet data as of April 30, 2003 are derived from our audited financial statements which are not included in this prospectus. The summary statement of operation data for the fiscal year ended April 30, 2001 and the summary balance sheet data as of April 30, 2001 and 2002 are derived from our unaudited financial statements which are not included in this prospectus.

	Year Ended April 30,				
	2005	2004	2003(3)	2002(2)	2001(1)
(In thousands, except per share amounts)					(unaudited)
Statement of Operations Data:					
Sales	\$ 219,365	\$ 177,609	\$ 144,115	\$ 176,890	\$ 204,854
(Loss) Income Before Cumulative Effect of Change in Accounting Principles and Discontinued Operations	(10,797)	(12,048)	(69,464)	(8,244)	4,038
Net (Loss) Income	(10,797)	(11,522)	(69,987)	(7,853)	1,630
Basic (Loss) Income Per Share Before Cumulative Effect of Change in Accounting Principles and Discontinued Operations	(0.61)	(0.78)	(4.53)	(0.54)	0.27
Diluted (Loss) Income Per Share Before Cumulative Effect of Change in Accounting Principles and Discontinued Operations	(0.61)	(0.78)	(4.53)	(0.54)	0.27
Basic (Loss) Income Per Share	(0.61)	(0.75)	(4.56)	(0.52)	0.11
Diluted (Loss) Income Per Share	(0.61)	(0.75)	(4.56)	(0.52)	0.11
April 30,					
	2005	2004	2003	2002	2001
					(unaudited)
Balance Sheet Data:					
Working Capital	\$ 8,013	\$ (9,060)	\$ (6,709)	\$ 84,532	\$ 91,750
Total Assets	131,334	135,071	147,701	208,674	209,309
Short-Term Debt	13,443	48,727	61,056	5,237	8,464
Long-Term Obligations, net	5,704	38,081	29,023	83,453	85,652
Shareholders' Equity (Deficit)	37,732	(9,552)	4,872	71,054	68,755

- (1) The Statement of Operations for fiscal 2001 includes the adoption of SEC Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements, as amended by SAB101A and 101B. We reflected this change in policy as a Cumulative Effect of Change in Accounting Principle.
- (2) The Statement of Operations for fiscal 2002 includes the adoption of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (FAS 142). See Note 1 to the Consolidated Financial Statements for the year ended April 30, 2005 for further discussion of the impact of this adoption.
- (3)

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The Statement of Operations for fiscal 2003 includes the impact of management's launch of its restructuring program and resulting focus on cash generation. See the Fiscal 2003 Comprehensive Financial Review at the end of the Fiscal 2004 Compared to Fiscal 2003 financial analysis in the Management's Discussion and Analysis section for further discussion of the impact on our financial results.

Table of Contents

RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the risks described below, together with the financial and other information contained in this prospectus, before making a decision to buy our common stock from the Selling Shareholder. If any of the following risks actually occur, our business, financial condition and results of operations could suffer. In these circumstances, the market price of our common stock could decline, and you may lose all or part of your investment in our common stock.

We have incurred losses in recent years and we may be unable to achieve profitability.

Our net losses for each of the fiscal years ended April 30, 2003, 2004 and 2005 were \$70.0 million, \$11.5 million and \$10.8 million, respectively. We believe our recently completed restructuring and related cost-cutting initiatives will reduce overall spending. If our restructuring efforts fail to adequately reduce costs, or if our sales are less than we project, we will continue to incur losses in future periods. Economic weakness in our served markets may adversely affect our ability to meet our sales projections.

Economic weakness in our served markets may adversely affect our financial results.

The products we sell are capital goods with individual system prices ranging from \$150,000 to several million dollars. Many of our customers depend on long term financing from a financial institution to purchase our equipment. Economic weakness in the capital goods market and or a credit tightening by the banking industry would reduce our sales and accordingly affect our financial results.

If we fail to comply with our financing arrangements, our ability to continue operations would be impaired.

Under the Current Senior Credit Agreement (entered into on July 11, 2005), we are operating under a credit agreement with our senior lenders which expires July 8, 2008 and sets forth specific financial covenants to be attained on a quarterly basis. In addition, our agreement includes subjective acceleration clauses which permit the lenders to demand payment on the determination of a material adverse change in the business. In the event of default, the senior lenders may limit our access to borrow funds as needed. Our ability to continue operating is dependent on the senior lenders' willingness to grant access to funds. If we are unable to obtain the necessary funds, our ability to continue operations would be seriously impaired unless we are able to obtain alternative financing from another source. In the event of a default, obtaining alternative financing may be difficult and may be at less favorable terms. We may be unable to achieve our projected operating results and maintain compliance with the loan covenants which would trigger an event of default with our Lenders. In an event of default, the Lenders would be in the position to exercise default remedies which include applying a default interest rate and acceleration of payment schedules for our outstanding debt. Our Lenders may pursue any number of plans to reduce the outstanding debt, including, in certain circumstances, a liquidation of some or all of our assets.

If the registration statement of which this prospectus is a part becomes ineffective for more than 40 days, after having gone effective, we may be subject to significant financial penalties.

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Under terms of the Registration Rights Agreement with the purchasers in the PIPE Transaction, if the registration statement of which this prospectus is a part becomes ineffective for more than 40 days (not necessarily consecutive) then we will be subject to a cash penalty of up to \$650,000 per month for each month the registration statement is not effective. Certain factors that could cause the registration statement to become or remain ineffective are not within our control.

If we are unable to retain the current members of our senior management team and other key personnel, and to quickly replace our Chief Financial Officer, our future success may be negatively impacted.

Effective August 8, 2005, our Chief Financial Officer resigned to take a position with another company. We have retained Spencer Stuart, an international executive search firm, to assist in filling our Chief Financial

Table of Contents

Officer position. In addition to the departure of our Chief Financial Officer, we may lose key management personnel and encounter difficulties replacing these positions. We may have to incur greater costs to attract replacement personnel.

Our inability to protect our intellectual property rights, or our possible infringement on the proprietary rights of others, and related litigation could be time consuming and costly.

We defend our intellectual property rights because unauthorized copying and sale of our proprietary equipment and consumables represents a loss of revenue to us. From time to time we also receive notices from others claiming we infringe their intellectual property rights. The number of these claims may grow in the future, and responding to these claims may require us to stop selling or to redesign affected products, or to pay damages. On November 18, 2004, Omax Corporation (Omax) filed suit against us alleging that our products infringe on Omax 's patents. The suit also seeks to have a specific patent we hold declared invalid. Although the suit seeks damages of over \$100 million, we believe Omax 's claims are without merit and we intend not only to contest Omax 's allegations of infringement but also to vigorously pursue our claims against Omax with regard to our own patent. See Note 14 to Consolidated Financial Statements for further discussion of contingencies.

Fluctuations in our quarterly operating results may cause our stock price to decline and limit our shareholders ' ability to sell our common stock in the public market.

In the past, our operating results have fluctuated significantly from quarter to quarter and we expect them to continue to do so in the future due to a variety of factors, many of which are outside of our control. Our operating results may in some future quarter fall below the expectations of securities analysts and investors. In this event, the trading price of our common stock could decline significantly. In addition to the risks disclosed elsewhere in this prospectus, factors outside of our control that have caused our quarterly operating results to fluctuate in the past and that may affect us in the future include:

fluctuations in general economic conditions;

demand for UHP pumps and UHP water management systems generally;

fluctuations in the capital budgets of customers; and

development of superior products and services by our competitors.

In addition, factors within our control, such as our ability to deliver equipment in a timely fashion, have caused our operating results to fluctuate in the past and may affect us similarly in the future.

The factors listed above may affect both our quarter-to-quarter operating results as well as our long-term success. Given the fluctuations in our operating results, you should not rely on quarter-to-quarter comparisons of our results of operations as an indication of our future performance or to determine any trend in our performance. Fluctuations in our quarterly operating results could cause the market price of and demand for our common stock to fluctuate substantially, which may limit your ability to sell our common stock on the public market.

We do business in industries that are cyclical, which may result in weakness in demand for our products.

Our products are sold in many industries, including machine tool, automotive and aerospace, that are highly cyclical. The machine tool industry, in particular from 1998 through 2003, experienced a significant decline in global demand. Cyclical weaknesses in the industries that we serve could lead to a reduced demand for our products.

We may be affected by rising costs or lack of availability of materials, which could negatively impact our operations.

We have experienced and may continue to experience significant increases in the costs of materials we use in the manufacture of our products, such as steel, and we may not be able to either achieve corresponding

Table of Contents

increases in the prices of our products or reduce manufacturing costs to offset these increases, or if we do increase prices, we may experience lower sales. Any of the foregoing may adversely affect our financial results.

If we cannot develop technological improvements to our products through continued research and engineering, our financial results may be adversely affected.

In order to maintain our position in the market, we need to continue to invest in research and engineering to improve our products and technologies and introduce new products and technologies. If we are unable to make such investment, if our research and development does not lead to new and/or improved products or technologies, or if we experience delays in the development or acceptance of new and/or improved products, our financial results will be adversely affected.

We have received notice of material weaknesses in internal controls. Consequently, there is more than a remote likelihood that a material misstatement of our financial statements will not be prevented or detected in the current or any future period. Additionally we may conclude that our system of internal controls under Section 404 of Sarbanes-Oxley is not effective.

In December 2004, in connection with the restatement of our fiscal 2002, 2003 and 2004 financial statements, our independent registered public accounting firm reported to our Audit Committee two matters involving internal controls which our independent registered public accounting firm considered to be material weaknesses in our financial reporting process, as defined by the Public Company Accounting Oversight Board (PCAOB) in Auditing Standard No. 2. As defined by the PCAOB, a material weakness is a significant deficiency, or a combination of significant deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Management agrees and has responded to the Audit Committee and our independent registered public accounting firm and has addressed each matter raised in our independent registered public accounting firm's report. As of April 30, 2005, we had begun but had not yet completed the remediation of these material weaknesses.

The material weaknesses identified by our independent registered public accounting firm were as follows:

Insufficient analysis, a documentation and review of the consolidation of the financial statements of subsidiaries. Inadequate processes to ensure the accuracy of the reconciliation of inter-company accounts. Also, we must improve the consolidation process and controls surrounding adequate monitoring and oversight of the work performed by accounting and financial reporting personnel.

Insufficient staffing of the accounting and financial reporting function. The financial and accounting function requires additional personnel with appropriate skills and training to identify and address the application of technical accounting literature of our transactions and activities.

An in-depth review of the remediation process to date, as well as the steps remaining, can be found under "Controls and Procedures" in this Form S-1.

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to assess the design and effectiveness of our internal control systems effective April 30, 2006. Our independent registered public accounting firm is required to render an attestation report on management's assessment and the effectiveness of our system of internal control over financial reporting. We must complete the documentation, evaluation and remediation of our

systems of internal control. The costs associated with such compliance are likely to be substantial and will negatively impact our financial results. In addition, there is no assurance that we will be able to conclude that our systems are appropriately designed or effective, which could result in a material misstatement of the financial statements in the future and a decline in the stock price.

We have outstanding options and warrants that have the potential to dilute the return of our existing common shareholders and cause the price of our common stock to decline.

We grant stock options to our employees and other individuals. At April 30, 2005, we had options outstanding to purchase 2,030,221 shares of our common stock, at exercise prices ranging from \$2.00 to \$12.25

Table of Contents

per share. In addition, we currently have outstanding 3,219,245 warrants, for which we are registering the resale of the underlying shares hereby. The exercise price of the warrants range from \$.008 to \$4.07 per share.

As a result of accounting regulations, which become applicable to us on May 1, 2006, requiring companies to expense stock options, our expenses will increase and our stock price may decline.

A number of publicly traded companies have recently announced that they will begin expensing stock option grants to employees. In addition, the Financial Accounting Standards Board (FASB) has adopted rule changes with an effective date as of the beginning of fiscal years beginning after June 15, 2005 requiring expensing of stock options. Currently we include such expenses on a pro forma basis in the notes to our financial statements in accordance with accounting principles generally accepted in the United States, but do not include stock option expense for employee options in our reported financial statements. This change in accounting standards will require us to expense stock options, and as a result our reported expenses may increase significantly.

Washington law and our charter documents may make an acquisition of us more difficult.

Provisions in Washington law and in our articles of incorporation, bylaws, and rights plan could make it more difficult for a third-party to acquire us, even if doing so would benefit our shareholders. These provisions:

Establish a classified board of directors so that not all members of our board are elected at one time;

Authorize the issuance of blank check preferred stock that could be issued by our board of directors (without shareholder approval) to increase the number of outstanding shares (including shares with special voting rights), each of which could hinder a takeover attempt;

Provide for a Preferred Share Rights Purchase Plan or poison pill;

Impose restrictions on certain transactions between a corporation and certain significant shareholders.

Provide that directors may be removed only at a special meeting of shareholders and provide that only directors may call a special meeting;

Require the affirmative approval of a merger, share exchange or sale of substantially all of the Corporation's assets by 2/3 of the Corporation's shares entitled to vote; and

Provide for 60 day advance notification for shareholder proposals and nominations at shareholder meetings.

Market risk exists in our operations from potential adverse changes in foreign exchange rates relative to the U.S. dollar in our foreign operations.

A significant portion of our sales take place outside of the United States, and we transact business in various foreign currencies, primarily the Canadian dollar, the Eurodollar, the Japanese yen, the New Taiwan dollar, and the Swedish Krona. In addition, our foreign divisions may have customer receivables and vendor obligations in currencies other than their local currency which exposes us to near-term and longer term currency fluctuation risks. The assets and liabilities of our foreign operations, with functional currencies other than the U.S. dollar, are translated into U.S. dollars at exchange rates in effect at the balance sheet date. Income and expense items are translated at the average exchange rates prevailing during the period. Aggregate net foreign exchange gains included in the determination of net loss amounted to \$531,000 for the year ended April 30, 2005. Based on our results for the year ended April 30, 2005 for our foreign subsidiaries, and based on the net position of foreign assets less liabilities, a near-term 10% appreciation or depreciation of the U.S. dollar in all currencies we operate could impact operating income by \$1.2 million and other income (expense) by \$3.7 million. Our financial position and cash flows could be similarly impacted.

Table of Contents

Current year foreign sales have benefited from a weak U.S. dollar. If the dollar were to strengthen against certain foreign currencies, such as the euro and yen, our margins may be negatively affected.

A significant portion of our products sold outside the United States are manufactured domestically. The weaker U.S. dollar, relative to the local currency of many of the countries we sell into, has made our products less expensive, on a relative basis, when compared to locally manufactured products and products manufactured in certain other countries. As the U.S. dollar gains in value relative to these foreign currencies, our products will increase in cost to the customer relative to locally produced product and products manufactured in certain other countries, which could negatively impact sales.

Sales of registered stock could exert downward pressure on the market price of our stock and could encourage short selling that could exert further downward pressure

To the extent the Selling Stockholders acquired their shares (whether such shares were acquired in the PIPE transaction or on the exercise of warrants, which are exercisable at \$.01 per share) at prices less than the then current trading price of our common stock, they may have an incentive to immediately resell material amounts of such shares in the market which may, in turn, cause the trading price of our common stock to decline. Significant downward pressure on our stock price caused by the sale of stock registered in this offering could encourage short sales by the Selling Stockholders (and in particular short sales by warrant holders in anticipation of exercising their warrants) or third parties that would place further downward pressure on our stock price. In an ordinary or uncovered short sale, a seller causes his or her executing broker to borrow the shares to be delivered at the completion of the sale from another broker, subject to an agreement to return them upon request, thereby avoiding the need to deliver any shares actually owned by the seller stockholder on the settlement date for the sale. Since the seller does not own the shares that are sold, the seller must subsequently purchase an equivalent number of shares in the market to complete or cover the transaction. The seller stockholder will realize a profit if the market price of the shares declines after the time of the short sale, but will incur a loss if the market price rises and he or she is forced to buy the replacement shares at a higher price. Accordingly, a declining trend in the market price of our common stock may stimulate short sales.

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

SAFE HARBOR STATEMENT:

Statements made in t