

ENNIS, INC.
Form 10-Q
July 10, 2006

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

FORM 10-Q

(Mark One)

**Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Quarterly Period Ended May 31, 2006**

OR

**Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the Transition Period from _____ to _____**

Commission File Number 1-5807

ENNIS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Texas

75-0256410

(State or Other Jurisdiction of Incorporation or
Organization)

(I.R.S. Employer Identification No.)

2441 Presidential Pkwy., Midlothian, Texas

76065

(Address of Principal Executive Offices)

(Zip code)

(972) 775-9801

(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 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.

Large accelerated Filer Accelerated filer Non-accelerated filer

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

Yes No

As of July 7, 2006, there were 25,540,243 shares of the Registrant's common stock outstanding.

ENNIS, INC. AND SUBSIDIARIES
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Certification of Chief Executive Officer

Certification of Chief Financial Officer

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ENNIS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

Assets	May 31, 2006 (unaudited)	February 28, 2006
Current assets:		
Cash and cash equivalents	\$ 9,322	\$ 13,860
Accounts receivables, net of allowance for doubtful receivables of \$2,957 at May 31, 2006 and \$3,001 at February 28, 2006	46,750	41,686
Prepaid expenses	6,343	4,425
Inventories	89,227	89,155
Other current assets	9,330	9,329
Total current assets	160,972	158,455
Property, plant and equipment, at cost		
Plant, machinery and equipment	124,682	120,456
Land and buildings	39,555	38,038
Other	20,478	20,292
Total property, plant and equipment	184,715	178,786
Less accumulated depreciation	118,856	114,983
Net property, plant and equipment	65,859	63,803
Goodwill	178,280	178,280
Trademarks, net	61,904	61,941
Purchased customer lists, net	21,222	21,632
Deferred finance charges, net	1,709	1,390
Prepaid pension asset	7,818	8,277
Other assets	679	623
Total assets	\$ 498,443	\$ 494,401

See accompanying notes to consolidated financial statements.

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ENNIS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands)

	May 31, 2006	February 28, 2006
	<i>(unaudited)</i>	
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable	\$ 24,485	\$ 26,589
Accrued expenses		
Employee compensation and benefits	15,722	17,250
Taxes other than income	1,538	1,488
Federal and state income taxes payable	7,828	2,490
Other	7,029	4,524
Current installments of long-term debt	11,255	11,620
 Total current liabilities	 67,857	 63,961
 Long-term debt, less current installments	 95,814	 102,916
Deferred credits, principally income taxes	29,971	30,189
 Total liabilities	 193,642	 197,066
 Shareholders equity		
Series A junior participating preferred stock of \$10 par value. Authorized 1,000,000 shares; none issued		
Common stock \$2.50 par value, authorized 40,000,000 shares; issued 30,053,443 shares at May 31 and February 28, 2006	75,134	75,134
Additional paid in capital	122,969	122,922
Retained earnings	188,804	181,423
Accumulated other comprehensive income-Foreign currency translation	472	460
	387,379	379,939
 Treasury stock:		
Cost of 4,572,837 shares at May 31, 2006 and 4,574,329 shares at February 28, 2006	(82,578)	(82,604)
 Total shareholders equity	 304,801	 297,335
 Total liabilities and shareholders equity	 \$ 498,443	 \$ 494,401

See accompanying notes to consolidated financial statements.

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ENNIS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
(Dollars in thousands except share and per share amounts)
(Unaudited)

	Three months ended	
	May 31,	
	2006	2005
Net sales	\$ 145,113	\$ 149,113
Cost of goods sold	107,298	111,635
Gross profit	37,815	37,478
Selling, general and administrative	18,078	17,837
Earnings from operations	19,737	19,641
Other income (expense)		
Interest expense	(1,792)	(2,243)
Other income, net	38	(90)
	(1,754)	(2,333)
Net income before income taxes	17,983	17,308
Provision for income taxes	6,653	6,750
Net earnings	\$ 11,330	\$ 10,558
Weighted average common shares outstanding		
Basic	25,479,722	25,426,595
Diluted	25,790,687	25,692,557
Per share amounts		
Net earnings basic	\$ 0.44	\$ 0.42
Net earnings diluted	\$ 0.44	\$ 0.41
Cash dividends per share	\$ 0.155	\$ 0.155

See accompanying notes to consolidated financial statements.

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ENNIS, INC. AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Three months ended	
	May 31,	
	2006	2005
Cash flows from operating activities:		
Net earnings	\$ 11,330	\$ 10,558
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	3,894	3,908
Amortization of deferred financing charges	92	242
Amortization of trademarks and customer lists	497	479
Loss (Gain) on the sale of equipment	3	(2)
Bad debt expense		369
Stock based compensation	59	
Changes in operating assets and liabilities, net of the effects of acquisitions:		
Accounts receivables	(4,150)	976
Prepaid expenses	(2,011)	(448)
Inventories	675	4,261
Other current assets	(1)	(19)
Accounts payable and accrued expenses	2,352	(2,431)
Prepaid pension assets	459	501
Other assets	(1,018)	381
Excess tax benefits from stock-based payment arrangements	(3)	
Net cash provided by operating activities	12,178	18,775
Cash flows from investing activities:		
Capital expenditures	(636)	(4,521)
Purchase of operating assets, net of cash acquired	(4,627)	(366)
Proceeds from disposal of property	3	7
Net cash used in investing activities	(5,260)	(4,880)
Cash flows from financing activities:		
Debt issued		5,000
Repayment of debt	(7,473)	(19,035)
Dividends	(3,949)	(3,940)
Purchase of treasury stock		301
Proceeds from exercise of stock options	14	
Excess tax benefits from stock-based payment arrangements	3	
Net cash used in financing activities	(11,405)	(17,674)
Effect of exchange rate changes on cash	(51)	(21)

Net change in cash and cash equivalents	(4,538)	(3,800)
Cash and cash equivalents at beginning of year	13,860	10,694
Cash and cash equivalents at end of year	\$ 9,322	\$ 6,894

See accompanying notes to consolidated financial statements.

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**ENNIS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED MAY 31, 2006**

1. Basis of Presentation

These unaudited consolidated financial statements of Ennis, Inc. and its subsidiaries (collectively the Company or Ennis), for the quarter ended May 31, 2006 have been prepared in accordance with generally accepted accounting principles for interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company's Form 10-K for the year ended February 28, 2006, from which the accompanying consolidated balance sheet at February 28, 2006 was derived. All significant intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, all adjustments considered necessary for a fair presentation of the interim financial information have been included. In preparing the financial statements, the Company is required to make estimates and assumptions that affect the disclosure and reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company evaluates these estimates and judgments on an ongoing basis, including those related to bad debts, inventory valuations, property, plant and equipment, intangible assets and income taxes. The Company bases estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. The results of operations for any interim period are not necessarily indicative of the results of operations for a full year.

2. Stock Option Plans and Stock Based Compensation

The Company has stock options granted to key executives and managerial employees and non-employee directors. The Company has two stock option plans: the 1998 Option and Restricted Stock Plan amended and restated as of June 17, 2004 and the 1991 Incentive Stock Option Plan. The Company has 398,208 shares available for grant under the stock option plans for issuance to officers and directors and supervisory employees of the Company and its subsidiaries. The exercise price of each option granted equals the quoted market price of the Company's common stock on the date of grant, and an option's maximum term is ten years. Options may be granted at different times during the year and vest over a period of immediate to a five-year period. For the three-month periods ended May 31, 2006 and 2005, 37,700 and 35,000 of options, respectively, were not included in the diluted earnings per share computation because their exercise price exceeded the average fair market value of the Company's stock for the period. The fair value of the restricted stock awards is based upon the market price of the underlying common stock as of the date of the grant and is amortized over the applicable vesting period using the straight-line method. The Company currently uses treasury stock to satisfy option exercises and restricted stock awards. The Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (SFAS 123R), effective March 1, 2006. SFAS 123R requires the recognition of the fair value of stock-based compensation in net earnings. The Company recognizes stock-based compensation expense net of estimated forfeitures (estimated at 1.1%) over the requisite service period of the individual grants, which generally equals the vesting period. For the three months ended May 31, 2006, in accordance with SFAS 123R, we recorded stock based compensation expense of approximately \$59,000 and related tax benefit of \$3,000 related to stock options and restricted stock units.

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ENNIS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED MAY 31, 2006

2. Stock Option Plans and Stock Based Compensation-continued

Prior to March 1, 2006, the company applied the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation, (FAS 123). In accordance with the provisions of FAS 123, the Company accounted for stock options granted to its employees and Board of Directors using the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and its related interpretations, (APB 25) and accordingly did not recognize compensation expense for stock options issued to employees and board members. For disclosure purposes, the Company used the Black-Scholes option pricing model to calculate the related compensation expense for stock options granted, as if it had applied the fair value recognition provisions of FAS 123. The Company has elected to utilize the modified prospective transition method for adopting SFAS 123R. Under this method, the provisions of SFAS 123R apply to all awards granted or modified after the date of adoption. If the Company had applied the fair value recognition provisions of SFAS 123 stock-based employee compensation for the quarter ended May 31, 2005, net earnings and earnings per share would have been as follows (in thousands except per share amounts):

	For the three months ended May 31, 2005
Net earnings:	
As reported	\$ 10,558
Deduct: Stock-based Employee compensation expense not included in reported earnings, net of related tax effects \$7.	(12)
Pro forma	\$ 10,546

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ENNIS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED MAY 31, 2006

2. Stock Option Plans and Stock Based Compensation-continued

	For the three months ended May 31, 2005
Net earnings per share:	
Basic as reported	\$ 0.42
Basic pro forma	\$ 0.41
Diluted as reported	\$ 0.41
Diluted pro forma	\$ 0.41

Results for prior periods have not been restated and do not reflect the recognition of stock-based compensation. A summary of the option activity under the plans for the three months ended May 31, 2006 is as follows:

	Number of Shares (exact quantity)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value (in thousands)(a)
Outstanding at February 28, 2006	687,600	\$ 10.94		
Granted				
Terminated				
Exercised	(1,500)	10.25		
Outstanding at May 31, 2006	686,100	\$ 10.63	4.4	\$ 6,100
Exercisable at May 31, 2006	581,150	\$ 9.81	3.7	\$ 5,643

(a) Value is calculated on the basis of the difference between the market value of the Company's Common Stock as reported on the New York Stock Exchange on May 31, 2006 (\$19.52) and the weighted average exercise price, multiplied by the number of shares indicated.

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ENNIS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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2. Stock Option Plans and Stock Based Compensation-continued

The Company did not grant any stock options during the three months ended May 31, 2006. The following is a summary of the assumptions used and the weighted average grant-date fair value of the stock options granted during the three months ended May 31, 2005:

	Three months ended May 31, 2005
Expected volatility	23.89%
Expected term (years)	5
Risk free interest rate	3.85%
Dividend yield	3.81%
 Weighted average grant-date fair value	 \$ 2.85

A summary of the stock options exercised during the three months ended May 31, 2006 and 2005 is presented below (in thousands):

	Three months ended May 31,	
	2006	2005
Total Cash Received	\$ 15	\$ 300
Income tax benefits	\$ 3	\$ 72
Total grant-date fair value	\$ 2	\$ 34
Intrinsic value	\$ 14	\$ 40

A summary of the status of the company's unvested stock options at May 31, 2006, and changes during the three months ended May 31, 2006 is presented below:

	Three months May 31, 2006	
	No of Options	Weighted Average Grant Date Fair Value
Unvested at February 28, 2006	143,700	\$ 2.28
New Grants		\$
Vested	(38,750)	\$ 1.66
Forfeited		\$
Unvested at May 31, 2006	104,950	\$ 2.51

As of May 31, 2006, there was \$198,000 of unrecognized compensation cost related to nonvested share based compensation arrangements granted under the Plan. The cost is expected to be recognized over a weighted-average period of 2 years. The total fair value of shares vested during the three months ended May 31, 2006 was \$756,000.

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ENNIS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
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2. Stock Option Plans and Stock Based Compensation-continued

A summary of restricted stock award activity under the plans for the three months ended May 31, 2006 is as follows:

	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at February 28, 2006	23,919	\$ 19.69
Granted		
Forfeited		
Outstanding at May 31, 2006	23,919	\$ 19.69
Vested at May 31, 2006		

As of May 31, 2006, the total remaining unrecognized compensation cost related to unvested restricted stock was approximately \$432,000. The weighted average remaining requisite service period of the unvested stock options was 1.8 years.

3. Employee Benefit Plans

The Company and certain subsidiaries have a noncontributory defined benefit retirement plan covering approximately 15% of their employees. Benefits are based on years of service and the employee's average compensation for the highest five compensation years preceding retirement or termination. The Company's funding policy is to contribute annually an amount in accordance with the requirements of the Employee Retirement Income Security Act of 1974 (ERISA).

Pension expense is composed of the following components included in our consolidated statement of earnings for the three months ended (in thousands):

	Three months ended May 31,	
	2006	2005
Components of net periodic benefit cost		
Service cost	\$ 360	\$ 356
Interest cost	610	611
Expected return on plan assets	(712)	(693)
Amortization of:		
Prior service cost	(36)	(36)
Unrecognized net loss	239	264
Net periodic benefit cost	\$ 461	\$ 502

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**ENNIS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED MAY 31, 2006**

3. Employee Benefit Plans (continued)

The Company is required to make contributions to its defined benefit pension plan. These contributions are required under the minimum funding requirements of the Employee Retirement Pension Plan Income Security Act (ERISA). For the current fiscal year ending February 28, 2007, there is not a minimum contribution requirement and no pension payments have been made; however, the Company expects to contribute from \$2.0 million to \$3.0 million in the fourth quarter of fiscal year 2007. The Company contributed \$2,000,000 to its pension plan during fiscal year 2006.

4. Due From Factors

Pursuant to terms of an agreement between the Company and various factors, the Company sells a majority of the trade accounts receivable of the Apparel Segment to the factors on a non-recourse basis. The price at which the accounts are sold is the invoice amount reduced by the factor commission of between 0.25% and 1.50%. Additionally, some trade accounts receivable are sold to the factors on a recourse basis.

Trade accounts receivable not sold to the factor remain in the custody and control of the Company and the Company maintains all credit risk on those accounts as well as accounts which are sold to the factor with recourse. The Company accounts for receivables sold to the factors with recourse as accrued borrowings.

The Company may request payment