

[Table of Contents](#)

SECURITIES AND EXCHANGE COMMISSION
Washington, D. C. 20549

FORM 10-Q
QUARTERLY REPORT

Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

For the quarter ended September 2, 2006

REGISTRANT: CLARCOR Inc. (Delaware)

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

FORM 10-Q

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

For the quarterly period ended September 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 1-11024

CLARCOR Inc.

(Exact name of registrant as specified in its charter)

DELAWARE

(State or other jurisdiction of incorporation or organization)

36-0922490

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

840 Crescent Centre Drive, Suite 600, Franklin, Tennessee 37067

(Address of principal executive offices)

Registrant's telephone number, including area code

615-771-3100

No Change

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

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

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

As of September 2, 2006, 51,022,996 common shares with a par value of \$1 per share were outstanding

TABLE OF CONTENTS

[Part I](#)

[Item 1](#)

[Part I](#)

[Item 2](#)

[Part I](#)

[Item 3. Quantitative and Qualitative Disclosure About Market Risk](#)

[Part I](#)

[Item 4. Controls and Procedures](#)

[Part II — Other Information](#)

[Item 1A. Risk Factors](#)

[Item 2. Unregistered Sales of Equity Securities and Use of Proceeds](#)

[Item 6 Exhibits](#)

[SIGNATURES](#)

[Section 302 Certification](#)

[Section 302 Certification](#)

[Section 906 Certification](#)

[Table of Contents](#)

Part I
Item 1

CLARCOR Inc.
CONSOLIDATED CONDENSED BALANCE SHEETS
(Dollars in thousands)

	September 2, 2006 (unaudited)	December 3, 2005
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 25,026	\$ 18,502
Short-term investments	19,500	10,400
Accounts receivable, less allowance for losses of \$12,849 for 2006 and \$9,775 for 2005	153,643	152,755
Inventories:		
Raw materials	47,091	42,205
Work in process	21,012	17,057
Finished products	60,635	58,246
Total inventories	128,738	117,508
Prepaid expenses and other current assets	7,047	7,253
Deferred income taxes	18,261	18,515
Total current assets	352,215	324,933
Plant assets at cost,	359,315	355,216
less accumulated depreciation	(213,960)	(205,711)
	145,355	149,505
Goodwill	115,691	114,278
Acquired intangibles, less accumulated amortization	53,553	53,898
Pension assets	22,567	22,069
Deferred income taxes	521	521
Other noncurrent assets	10,769	10,068
	<u>\$ 700,671</u>	<u>\$ 675,272</u>
LIABILITIES		
Current liabilities:		
Current portion of long-term debt	\$ 62	\$ 233
Accounts payable	49,353	49,239
Income taxes	11,020	12,544
Accrued employee compensation	22,496	24,281
Other accrued liabilities	34,106	35,173
Total current liabilities	117,037	121,470
Long-term debt, less current portion	15,963	16,009
Postretirement health care benefits	4,599	4,239
Long-term pension liabilities	19,998	16,287
Deferred income taxes	25,228	26,184
Other long-term liabilities	4,601	6,267
Minority interests	1,573	1,983
Contingencies		
SHAREHOLDERS' EQUITY		
Capital stock	51,023	51,595
Capital in excess of par value	1,891	21,458
Accumulated other comprehensive earnings	(1,138)	(4,637)
Retained earnings	459,896	414,417
	<u>511,672</u>	<u>482,833</u>
	<u>\$ 700,671</u>	<u>\$ 675,272</u>

See Notes to Consolidated Condensed Financial Statements

[Table of Contents](#)

CLARCOR Inc.
CONSOLIDATED CONDENSED STATEMENTS OF EARNINGS
(Dollars in thousands except per share data)
(Unaudited)

	Quarter Ended		Nine Months Ended	
	September 2, 2006	August 27, 2005	September 2, 2006	August 27, 2005
Net sales	\$ 231,510	\$ 216,403	\$ 671,769	\$ 632,450
Cost of sales	<u>159,689</u>	<u>149,003</u>	<u>469,057</u>	<u>441,945</u>
Gross profit	71,821	67,400	202,712	190,505
Selling and administrative expenses	<u>36,742</u>	<u>36,348</u>	<u>115,539</u>	<u>110,820</u>
Operating profit	<u>35,079</u>	<u>31,052</u>	<u>87,173</u>	<u>79,685</u>
Other income (expense):				
Interest expense	(174)	(164)	(564)	(460)
Interest income	468	267	1,194	556
Other, net	<u>(198)</u>	<u>175</u>	<u>(510)</u>	<u>(225)</u>
	<u>96</u>	<u>278</u>	<u>120</u>	<u>(129)</u>
Earnings before income taxes and minority interests	35,175	31,330	87,293	79,556
Provision for income taxes	<u>12,087</u>	<u>10,292</u>	<u>30,939</u>	<u>27,801</u>
Earnings before minority interests	23,088	21,038	56,354	51,755
Minority interests in earnings of subsidiaries	<u>(125)</u>	<u>(183)</u>	<u>(385)</u>	<u>(400)</u>
Net earnings	<u>\$ 22,963</u>	<u>\$ 20,855</u>	<u>\$ 55,969</u>	<u>\$ 51,355</u>
Net earnings per common share:				
Basic	<u>\$ 0.45</u>	<u>\$ 0.40</u>	<u>\$ 1.08</u>	<u>\$ 0.99</u>
Diluted	<u>\$ 0.44</u>	<u>\$ 0.40</u>	<u>\$ 1.07</u>	<u>\$ 0.98</u>
Average number of common shares outstanding:				
Basic	<u>51,414,083</u>	<u>51,866,491</u>	<u>51,691,685</u>	<u>51,650,585</u>
Diluted	<u>51,981,546</u>	<u>52,678,124</u>	<u>52,390,283</u>	<u>52,328,384</u>
Dividends paid per share	<u>\$ 0.0675</u>	<u>\$ 0.0638</u>	<u>\$ 0.2025</u>	<u>\$ 0.1913</u>

See Notes to Consolidated Condensed Financial Statements

[Table of Contents](#)

CLARCOR Inc.
CONSOLIDATED CONDENSED STATEMENTS OF CASH FLOWS
(Dollars in thousands)
(Unaudited)

	Nine Months Ended	
	September 2, 2006	August 27, 2005
Cash flows from operating activities:		
Net earnings	\$ 55,969	\$ 51,355
Depreciation	16,036	15,038
Amortization	1,636	944
Stock-based compensation expense	2,194	662
Tax benefits from stock-based compensation	(3,312)	—
Changes in assets and liabilities	(21,133)	(19,521)
Other, net	<u>629</u>	<u>279</u>
Net cash provided by operating activities	<u>52,019</u>	<u>48,757</u>
Cash flows from investing activities:		
Business acquisitions, net of cash acquired	(4,627)	(3,512)
Additions to plant assets	(11,416)	(16,847)
Other, net	<u>1,130</u>	<u>561</u>
Net cash used in investing activities	<u>(14,913)</u>	<u>(19,798)</u>
Cash flows from financing activities:		
Net payments under line of credit	—	(7,500)
Payments on long-term debt	(555)	(860)
Sale of capital stock under stock option and employee purchase plans	5,362	5,655
Tax benefits from stock-based compensation	3,312	—
Purchase of treasury stock	(28,909)	(1,986)
Cash dividends paid	(10,490)	(9,893)
Other, net	<u>—</u>	<u>(9,332)</u>
Net cash used in financing activities	<u>(31,280)</u>	<u>(23,916)</u>
Net effect of exchange rate changes on cash	<u>698</u>	<u>(623)</u>
Net change in cash and cash equivalents	6,524	4,420
Cash and cash equivalents, beginning of period	<u>18,502</u>	<u>17,420</u>
Cash and cash equivalents, end of period	<u>\$ 25,026</u>	<u>\$ 21,840</u>
Cash paid during the period for:		
Interest	<u>\$ 565</u>	<u>\$ 458</u>
Income taxes	<u>\$ 30,043</u>	<u>\$ 14,796</u>

See Notes to Consolidated Condensed Financial Statements

Table of Contents

CLARCOR Inc.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(Unaudited)

1. CONSOLIDATED FINANCIAL STATEMENTS

The consolidated condensed balance sheet as of September 2, 2006, the consolidated condensed statements of earnings and the consolidated condensed statements of cash flows for the periods ended September 2, 2006, and August 27, 2005, have been prepared by the Company without audit. The financial statements have been prepared on the same basis as those in the Company's December 3, 2005 annual report on Form 10-K (2005 Form 10-K). The December 3, 2005 consolidated balance sheet data was derived from CLARCOR's year-end audited financial statements as presented in the 2005 Form 10-K but does not include all disclosures required by accounting principles generally accepted in the United States of America. In the opinion of management, all adjustments (which include only normal recurring adjustments) necessary to present fairly the financial position, results of operations, and cash flows have been made. The results of operations for the period ended September 2, 2006 are not necessarily indicative of the operating results for the full year.

As discussed in the 2005 Form 10-K, at fiscal year end 2005 the Company revised its presentation of short-term investments on its Consolidated Balance Sheets and Consolidated Statements of Cash Flows, which were presented as cash and cash equivalents in previous years, to present them in accordance with their contractual maturities. The amount revised in the Consolidated Condensed Statement of Cash Flows totaled \$19,350 for the first nine months of fiscal 2005. The purchases and sales related to the investments have been presented on the Consolidated Statements of Cash Flows in the operating activities section. This revision had no impact on the Consolidated Statements of Earnings.

2. STOCK-BASED COMPENSATION

Effective December 4, 2005, the Company adopted Statement of Financial Accounting Standards No. 123R, "Share-Based Payment" (SFAS No. 123R), using the modified prospective transition method. Under this method, stock-based compensation expense is recognized using the fair-value based method for all awards granted on or after the date of adoption. Compensation expense for unvested stock options and awards that were outstanding on December 4, 2005 will be recognized over the requisite service period based on the grant-date fair value of those options and awards as previously calculated under the pro forma disclosures under SFAS No. 123. The Company determined the fair value of these awards using the Black-Scholes option pricing model. The Company also adopted the non-substantive vesting period approach for attributing stock compensation to individual periods for awards with retirement eligibility options, which requires recognition of compensation expense immediately for grants to retirement eligible employees or over the period from the grant date to the date retirement eligibility is achieved. This change will not affect the overall amount of compensation expense recognized and had an immaterial effect on the amount recorded in the quarter and nine months ended September 2, 2006. Prior to adoption, the Company used the intrinsic value method under Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations and provided the disclosure-only provisions of SFAS No. 123 applying the nominal vesting period approach. Therefore, the Company did not recognize compensation expense prior to fiscal 2006 in association with options granted.

As a result of adopting the standard, the Company recorded pretax compensation expense related to stock options of \$611 and \$1,628 and related tax benefits of \$217 and \$578 for the

[Table of Contents](#)

CLARCOR Inc.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(Unaudited) Continued

2. STOCK-BASED COMPENSATION (Continued)

quarter and nine months ended September 2, 2006, respectively. This reduced net earnings by \$394 and \$1,050 and diluted earnings per share (EPS) by less than \$0.01 and by approximately \$0.02 for the quarter and for the nine months ended September 2, 2006, respectively. The Company also recorded \$161 and \$566 in pretax compensation expense related to its restricted share units for the quarter and nine months ended September 2, 2006. The tax benefits associated with tax deductions that exceed the amount of compensation expense recognized in the financial statements related to stock option exercises was \$320 and \$3,312 for the quarter and nine months ended September 2, 2006, respectively. This reduced cash flows from operating activities and increased cash flows from financing activities compared to amounts that would have been reported if the standard had not been adopted.

On November 18, 2005, the Board of Directors approved a grant of 386,375 options that were fully vested on the date of grant. Approximately \$3,000 of pretax compensation expense was included in the determination of pro forma earnings during 2005 that otherwise would have been recorded as stock option expense in accordance with SFAS No. 123R over future years had the options been granted with a four-year vesting period similar to prior grants. On March 22, 2005, the Compensation Committee of the Board of Directors approved accelerating the vesting of nonqualified stock options granted on December 12, 2004 to current employees, including executive officers. All of these options had an exercise price greater than the then-market price per share and provided for vesting at the rate of 25% per year beginning on the first anniversary of the date of grant. Approximately \$3,000 of pretax compensation expense was included in the determination of pro forma earnings during 2005 that otherwise would have been recorded as stock option expense in accordance with SFAS No. 123R over future years. Together these events reduced the amount of pre-tax compensation that would have been recorded related to these two grants in the quarter and nine months ended September 2, 2006 by approximately \$375 and \$1,125, respectively.

If the Company had determined compensation expense for its stock-based compensation plans based on the fair value at the grant dates for the prior fiscal year, the Company's pro forma net earnings and basic and diluted EPS would have been as follows:

	Quarter Ended August 27, 2005	Nine Months Ended August 27, 2005
Net earnings, as reported	\$ 20,855	\$ 51,355
Add stock-based compensation expense, net of tax, included in net earnings	137	420
Less total stock-based compensation expense under the fair value-based method, net of tax	<u>(2,308)</u>	<u>(6,020)</u>
Pro forma net earnings	<u>\$ 18,684</u>	<u>\$ 45,755</u>
Basic EPS, as reported	\$ 0.40	\$ 0.99
Pro forma basic EPS	\$ 0.36	\$ 0.89
Diluted EPS, as reported	\$ 0.40	\$ 0.98
Pro forma diluted EPS	\$ 0.35	\$ 0.87

The following is a description and summary of the key provisions of the stock-based compensation plans.

[Table of Contents](#)

CLARCOR Inc.
 NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
 (Dollars in thousands, except per share data)
 (Unaudited) Continued

2. STOCK-BASED COMPENSATION (Continued)

On March 24, 2003, the shareholders of CLARCOR approved the 2004 Incentive Plan, which replaced the 1994 Incentive Plan on its termination date of December 14, 2003. The 2004 Incentive Plan allows the Company to grant stock options, restricted stock and performance awards to officers, directors and key employees of up to 3,000,000 shares. Upon share option exercise or restricted share unit conversion, the Company issues new shares unless treasury shares are available.

Stock Options

Under the 2004 Incentive Plan, nonqualified stock options may only be granted at the fair market value at the date of grant. All outstanding stock options have been granted at the fair market value on the date of grant, which is the date the Board of Directors approves the grant and the participants receive it. The Company's Board of Directors determines the vesting requirements for stock options at the time of grant and may accelerate vesting as occurred during 2005. Excluding the grants awarded in fiscal 2005, options granted to key employees vest 25% per year beginning at the end of the first year; therefore, they become fully exercisable at the end of four years. Vesting may be accelerated in the event of retirement, disability or death of a participant or change in control of the Company. Options granted to non-employee directors vest immediately. All options expire ten years from the date of grant unless otherwise terminated. The options granted in fiscal 2005 are fully vested as discussed above.

The following table summarizes the activity for the nine months ended September 2, 2006 under the nonqualified stock option plans and includes options granted under both the 1994 Incentive Plan and the 2004 Incentive Plan.

	Shares Granted under Incentive Plans	Weighted Average Exercise Price
Outstanding at beginning of year	3,885,915	\$20.63
Granted	61,550	35.08
Exercised	(572,117)	16.72
Surrendered	(41,875)	20.60
Outstanding at September 2, 2006	<u>3,333,473</u>	<u>\$21.56</u>
Options exercisable at September 2, 2006	<u>3,009,561</u>	<u>\$21.63</u>

At September 2, 2006, there was \$1,220 of unrecognized compensation cost related to nonvested option awards which the Company expects to recognize over a weighted-average period of 1.2 years.

	Quarter Ended		Nine Months Ended	
	September 2, 2006	August 27, 2005	September 2, 2006	August 27, 2005
Fair value of options exercised	\$ 339	\$ 2,381	\$2,377	\$ 3,392
Total intrinsic value of options exercised	1,035	12,346	9,923	17,802
Cash received upon exercise of options	515	948	3,529	3,493
Tax benefit realized from exercise of options	367	4,658	3,365	6,727

[Table of Contents](#)

CLARCOR Inc.
 NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
 (Dollars in thousands, except per share data)
 (Unaudited) Continued

2. STOCK-BASED COMPENSATION (Continued)

The following table summarizes information about the options at September 2, 2006.

Range of Exercise Prices	Options Outstanding			Options Exercisable	
	Number	Weighted Average Exercise Price	Weighted Average Remaining Life in Years	Number	Weighted Average Exercise Price
\$ 7.21 — \$ 9.79	356,626	\$ 9.15	3.26	356,626	\$ 9.15
\$10.53 — \$15.15	267,263	\$13.22	4.97	267,263	\$13.22
\$16.01 — \$22.80	1,409,443	\$20.37	5.53	1,093,331	\$20.27
\$25.89 — \$35.66	1,300,141	\$27.97	7.77	1,292,341	\$27.95
	<u>3,333,473</u>	<u>\$21.56</u>	<u>6.11</u>	<u>3,009,561</u>	<u>\$21.63</u>

At September 2, 2006, the aggregate intrinsic value of options outstanding and exercisable was \$27,623 and \$24,751, respectively.

The weighted average fair value per option at the date of grant for options granted during the nine-month periods of 2006 and 2005 was \$10.53 and \$7.13, respectively. The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions. The expected life selected for options granted during the nine-month periods represents the period of time that the options are expected to be outstanding based on historical data of option holder exercise and termination behavior. Expected volatilities are based upon historical volatility of the Company's monthly stock closing prices over a period equal to the expected life of each option grant. The risk-free interest rate was selected based on yields from U.S. Treasury zero-coupon issues with a remaining term approximately equal to the expected term of the options being valued.

	Nine Months Ended September 2, 2006	Year Ended December 3, 2005
Risk-free interest rate	4.74%	4.05%
Expected dividend yield	0.96%	1.06%
Expected volatility factor	20.72%	21.48%
Expected option term (in years):		
Original grants without reloads	6.9	6.4
Original grants with reloads	n/a	5.0

Restricted Share Unit Awards

The Company's restricted share unit awards are considered nonvested share awards as defined under SFAS No. 123R. No restricted share units were granted during the nine months ended September 2, 2006. During the nine months ended August 27, 2005, the Company granted 32,144 restricted units of Company common stock with a fair value of \$26.08 per unit, the market price of the stock at the date granted. The restricted share units require no payment from the employee and compensation cost is recorded based on the market price on the

[Table of Contents](#)

CLARCOR Inc.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(Unaudited) Continued

2. STOCK-BASED COMPENSATION (Continued)

grant date and is recorded equally over the vesting period of four years. During the vesting period, officers and key employees receive compensation equal to dividends declared on common shares. Upon vesting, the employee may elect to defer receipt of their shares. Compensation expense related to vesting of restricted stock awards totaled \$161 and \$566 for the quarter and nine months ended September 2, 2006, respectively, and \$217 and \$662 for the quarter and nine months ended August 27, 2005, respectively. The following table summarizes the restricted share unit awards.

	Units	Weighted Average Grant Date Fair Value
Nonvested at beginning of year	110,441	\$23.32
Granted	—	—
Vested	(37,158)	19.56
Surrendered	(3,382)	24.56
Nonvested at September 2, 2006	<u>69,901</u>	<u>\$25.25</u>

The total fair value of shares vested during the nine months ended September 2, 2006 and August 27, 2005 was \$566 and \$689, respectively. As of September 2, 2006, there was \$1,046 of total unrecognized compensation cost related to nonvested share-based compensation arrangements. Of this nonvested cost, \$171 is expected to be recognized during the remainder of fiscal 2006 and the remaining \$875 during fiscal years 2007, 2008 and 2009.

Employee Stock Purchase Plan

The Company sponsors an employee stock purchase plan which allows employees to purchase stock at a discount. Effective January 1, 2006, the plan was amended to be in compliance with the safe harbor rules of SFAS No. 123R so that the plan is not compensatory under the new standard and no expense will be recognized. The Company issued stock under this plan for \$364 and \$1,833 during third quarter and nine months of 2006, respectively, and \$1,054 and \$2,162, during third quarter and nine months of 2005, respectively.

3. EARNINGS PER SHARE AND TREASURY STOCK TRANSACTIONS

Diluted earnings per share reflects the impact of outstanding stock options and restricted share units as if exercised during the periods presented using the treasury stock method. The following table provides a reconciliation of the numerators and denominators utilized in the calculation of basic and diluted earnings per share:

[Table of Contents](#)

CLARCOR Inc.
 NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
 (Dollars in thousands, except per share data)
 (Unaudited) Continued

3. EARNINGS PER SHARE AND TREASURY STOCK TRANSACTIONS (Continued)

	Quarter Ended		Nine Months Ended	
	September 2, 2006	August 27, 2005	September 2, 2006	August 27, 2005
Basic weighted average number of common shares outstanding	51,414,083	51,866,491	51,691,685	51,650,585
Dilutive effect of stock options and restricted stock	567,463	811,633	698,598	677,799
Diluted weighted average number of common shares outstanding	<u>51,981,546</u>	<u>52,678,124</u>	<u>52,390,283</u>	<u>52,328,384</u>
Net earnings	\$ 22,963	\$ 20,855	\$ 55,969	\$ 51,355
Basic earnings per share amount	\$ 0.45	\$ 0.40	\$ 1.08	\$ 0.99
Diluted earnings per share amount	\$ 0.44	\$ 0.40	\$ 1.07	\$ 0.98

Options with exercise prices greater than the average market price of the common shares during the respective quarter were not included in the computation of diluted earnings per share. For the quarter and nine months ended September 2, 2006, 57,550 options with a weighted average exercise price of \$35.53 were excluded from the computation. For the quarter and nine months ended August 27, 2005, 321,038 and 358,490 options with a weighted average price of \$29.04 and \$29.00, respectively, were excluded from the computation.

For the nine months ended September 2, 2006, exercises of stock options added \$4,609 to capital in excess of par value.

During the quarter and nine months ended September 2, 2006, the Company purchased and retired 1,000,000 shares of common stock for \$28,909. During the quarter and nine months ended August 27, 2005, the Company purchased and retired 68,200 shares of common stock. The number of issued shares was reduced as a result of the retirement of these shares.

4. COMPREHENSIVE EARNINGS

The Company's total comprehensive earnings and its components are as follows:

	Quarter Ended		Nine Months Ended	
	September 2, 2006	August 27, 2005	September 2, 2006	August 27, 2005
Net earnings	\$ 22,963	\$ 20,855	\$ 55,969	\$ 51,355
Other comprehensive earnings, net of tax:				
Foreign currency translation adjustments	(61)	(1,620)	3,499	(2,624)
Total comprehensive earnings	<u>\$ 22,902</u>	<u>\$ 19,235</u>	<u>\$ 59,468</u>	<u>\$ 48,731</u>

[Table of Contents](#)

CLARCOR Inc.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(Unaudited) Continued

4. COMPREHENSIVE EARNINGS (Continued)

The components of the ending balances of accumulated other comprehensive earnings are as follows:

	September 2, 2006	December 3, 2005
Minimum pension liability, net of \$2,373 tax	\$ (3,944)	\$ (3,944)
Translation adjustments, net of \$155 tax	2,806	(693)
Accumulated other comprehensive loss	<u>\$ (1,138)</u>	<u>\$ (4,637)</u>

5. ACQUISITIONS, PURCHASE OF MINORITY INTERESTS

In April 2006, the Company acquired two small businesses for approximately \$2,843 in cash, net of cash received. One was a filter distributorship based in Minnesota which became a wholly-owned subsidiary of the Company and was included in the Industrial/ Environmental Filtration segment beginning in the second quarter of 2006. In the other transaction, the Company acquired certain assets of a manufacturer and distributor of heavy-duty air filters based in Oklahoma. These assets were combined into an existing subsidiary of the Company within the Engine/Mobile Filtration segment and the results were included in the Company's consolidated results of operations from the date of acquisition.

A preliminary allocation of the purchase prices for these two acquisitions has been made to major categories of assets and liabilities. The \$498 excess of the purchase price over the preliminary estimated fair value of the net tangible and identifiable intangible assets acquired was recorded as goodwill. Other acquired intangibles included noncompete agreements valued at \$91 and customer relationships valued at \$1,195, which will be amortized on a straight-line basis over three years and ten to twenty years, respectively. The acquisitions are not material to the results of the Company. The Company expects to make additional adjustments for the valuation of assets and deferred taxes during the fourth quarter of 2006.

On June 1, 2006, the Company purchased the minority owners' interest in a consolidated affiliate in South Africa for approximately \$2,200 of which \$1,644 was paid and the remainder will be paid in 2007 based on fiscal 2006 results. In addition, there will be a payment estimated to be approximately \$225 to be paid in 2008 based on fiscal 2007 results.

As discussed in the 2005 Form 10-K, on November 1, 2005, the Company acquired Martin Kurz & Co., Inc. (MKI), a privately-owned Mineola, New York manufacturer of sintered porous metal laminates used in screening and filtration products for a wide array of industries, including pharmaceutical, petrochemical, aerospace, paper and chemical process industries, for approximately \$24,761 net of cash received, including acquisition expenses. During the nine months of 2006, the Company paid an additional \$140 related to a working capital adjustment and final settlement with the sellers and acquisition expenses. This payment, along with a revised estimate of liabilities assumed and finalization of the appraisal, increased goodwill by \$117. The purchase price was paid in cash with available funds. MKI's sales for the most recent twelve months prior to acquisition were approximately \$12,000. The acquisition is expected to be accretive to earnings per share in fiscal year 2006. MKI was included in the Industrial/Environmental Filtration segment from the date of acquisition.

[Table of Contents](#)

CLARCOR Inc.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(Unaudited) Continued

5. ACQUISITIONS, PURCHASE OF MINORITY INTERESTS (Continued)

The excess of the purchase price over the estimated fair value of the net tangible and identifiable intangible assets acquired was recorded as goodwill. The initial purchase price was based on the net assets of the business acquired as shown on an October 31, 2005, balance sheet which was subject to a final adjustment. The allocation of the purchase price over the estimated fair value of the tangible and identifiable intangible assets acquired for MKI resulted in \$9,231 recorded as goodwill. In addition based on an independent appraisal, the Company recognized \$8,600 for customer relationships that will be amortized over twelve years, \$267 for trademarks that will be amortized over twenty years and \$1,700 as other acquired intangibles which will be amortized over five to ten years. Following is a condensed balance sheet based on fair values of the assets acquired and liabilities assumed.

Cash	\$ 244
Accounts receivable, less allowance for losses	1,312
Inventory, net	468
Prepaid assets	59
Plant assets	3,493
Goodwill	9,231
Other acquired intangibles	10,567
Total assets acquired	25,374
Accounts payable and accrued liabilities	(369)
Net assets acquired	<u>\$25,005</u>

6. RESTRUCTURING CHARGES

As announced in July 2006, the Company began a restructuring program focused on the heating, ventilating and air conditioning (HVAC) filter manufacturing operations within its Industrial/Environmental filtration segment. The goal of the program is to pursue the Company's goal of an overall 10% segment operating margin from its current margins of mid-single digits. As a part of this program, the Company will discontinue production at an HVAC filter manufacturing plant in Kenly, North Carolina effective November 6, 2006. Severance costs of \$195 were accrued during the third quarter and included in cost of sales in the Industrial/Environmental segment. No amounts were paid. Minimal additional charges related to contract termination costs and facilities consolidation costs will be recognized when the Company exits a lease related to that facility.

At the end of the second quarter 2006, the Company announced a plan to merge two of its manufacturing facilities in order to realize cost savings and efficiency benefits. At the end of August 2006, the Company terminated manufacturing at one of its European facilities. The Company recorded a \$416 severance charge which it expects to pay as one-time termination benefits to employees who were involuntarily terminated in the third quarter of fiscal 2006. The Company had paid \$304 as of the end of the third quarter 2006. This charge is included in cost of sales in the Industrial/Environmental filtration segment. Additional charges related to contract termination costs and facilities consolidation costs, estimated to be less than \$500, will be recognized when the Company exits leases related to that facility, which it expects will occur during fourth quarter 2006.

[Table of Contents](#)

CLARCOR Inc.
 NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
 (Dollars in thousands, except per share data)
 (Unaudited) Continued

6. RESTRUCTURING CHARGES (Continued)

Following is a summary of the related liability accounts:

	Employee Termination Benefits	Contract Termination Costs	Facilities Consolidation Costs	Total
Balance at December 3, 2005	\$ —	\$—	\$—	\$ —
Additional expense incurred	611	—	—	611
Amounts paid	(304)	—	—	(304)
Balance at September 2, 2006	\$ 307	\$—	\$—	\$ 307

7. GAIN ON INSURANCE SETTLEMENT

In April 2006, the Company's warehouse in Goodlettsville, Tennessee was damaged by a tornado. In accordance with Financial Accounting Standards Board Interpretation No. 30, "Accounting for Involuntary Conversions of Non-Monetary Assets to Monetary Assets," (FIN No. 30) the Company has recognized a \$790 gain in management and selling expenses on the excess of insurance proceeds over the net book value of the property offset by \$250 of expenses subject to a deductible paid by the Company. As of September 2, 2006, the Company has collected \$500. The remaining insurance receivable, estimated to approximate \$500, is recorded in current assets and is expected to be received during fourth quarter 2006 when repairs to the building are complete.

8. ACQUIRED INTANGIBLES

The following table reconciles the activity for goodwill by reporting unit for the nine months ended September 2, 2006.

	Engine/ Mobile Filtration	Industrial/ Environmental Filtration	Packaging	Total Goodwill
Balance at December 3, 2005	\$15,678	\$ 98,600	\$ —	\$114,278
Acquisitions	190	425	—	615
Currency translation adjustments	639	159	—	798
Balance at September 2, 2006	\$16,507	\$ 99,184	\$ —	\$115,691

The following table summarizes acquired intangibles by reporting unit. Other acquired intangibles include parts manufacturer regulatory approvals, patents and noncompete agreements.

	Engine/ Mobile Filtration	Industrial/ Environmental Filtration	Packaging	Total
Balance at September 2, 2006:				
Trademarks, gross	\$ 603	\$ 29,157	\$ —	\$29,760
Less accumulated amortization	—	8	—	8
Trademarks, net	\$ 603	\$ 29,149	\$ —	\$29,752
Customer relationships, gross	\$1,970	\$ 16,672	\$ —	\$18,642
Less accumulated amortization	371	2,060	—	2,431
Customer relationships, net	\$1,599	\$ 14,612	\$ —	\$16,211

[Table of Contents](#)

CLARCOR Inc.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(Unaudited) Continued

8. ACQUIRED INTANGIBLES (Continued)

	Engine/ Mobile Filtration	Industrial/ Environmental Filtration	Packaging	Total
Balance at September 2, 2006:				
Other acquired intangibles	\$ 241	\$ 12,682	\$ —	\$12,923
Less accumulated amortization	<u>212</u>	<u>5,121</u>	<u>—</u>	<u>5,333</u>
Other acquired intangibles, net	<u>\$ 29</u>	<u>\$ 7,561</u>	<u>\$ —</u>	<u>\$ 7,590</u>

Amortization expense is estimated to be \$2,192 in 2006, \$2,117 in 2007, \$1,944 in 2008, \$1,918 in 2009 and \$1,909 in 2010.

9. GUARANTEES AND WARRANTIES

The Company has provided letters of credit totaling approximately \$29,463 to various government agencies, primarily related to industrial revenue bonds, and to insurance companies and other entities in support of its obligations. The Company believes that no payments will be required resulting from these accommodation obligations.

In the ordinary course of business, the Company also provides routine indemnifications and other guarantees whose terms range in duration and often are not explicitly defined. The Company does not believe these will have a material impact on the results of operations or financial condition of the Company.

Warranties are recorded as a liability on the balance sheet and as charges to current expense for estimated normal warranty costs and, if applicable, for specific performance issues known to exist on products already sold. The expenses estimated to be incurred are provided at the time of sale and adjusted as needed, based primarily upon experience.

Changes in the Company's warranty accrual during the nine months ended September 2, 2006 are as follows:

Balance at December 3, 2005	\$ 1,122
Accruals for warranties issued during the period	942
Accruals related to pre-existing warranties	(62)
Settlements made during the period	(606)
Other adjustments, including currency translation	<u>151</u>
Balance at September 2, 2006, included in other current liabilities	<u>\$ 1,547</u>

[Table of Contents](#)

CLARCOR Inc.
 NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
 (Dollars in thousands, except per share data)
 (Unaudited) Continued

10. RETIREMENT BENEFITS

The Company provides various retirement benefits, including defined benefit plans and postretirement health care plans covering certain current and retired employees in the U.S. and abroad. Components of net periodic benefit cost and company contributions for these plans were as follows:

	Quarter Ended		Nine Months Ended	
	September 2, 2006	August 27, 2005	September 2, 2006	August 27, 2005
Pension Benefits				
Components of net periodic benefit cost:				
Service cost	\$ 848	\$ 944	\$ 2,541	\$ 2,837
Interest cost	1,689	1,561	5,057	4,696
Expected return on plan assets	(1,964)	(1,874)	(5,874)	(5,634)
Amortization of unrecognized:				
Prior service cost	42	40	129	120
Net actuarial loss	502	523	1,505	1,570
Net periodic benefit cost	<u>\$ 1,117</u>	<u>\$ 1,194</u>	<u>\$ 3,358</u>	<u>\$ 3,589</u>
Cash Contributions	<u>\$ 127</u>	<u>\$ 160</u>	<u>\$ 376</u>	<u>\$ 401</u>
Postretirement Healthcare Benefits				
Components of net periodic benefit cost:				
Service cost	\$ 4	\$ 8	\$ 15	\$ 24
Interest cost	22	26	63	78
Amortization of unrecognized:				
Prior service cost	(31)	(31)	(93)	(93)
Net actuarial gain	(27)	(19)	(78)	(57)
Net periodic benefit income	<u>\$ (32)</u>	<u>\$ (16)</u>	<u>\$ (93)</u>	<u>\$ (48)</u>
Cash Contributions	<u>\$ 70</u>	<u>\$ 66</u>	<u>\$ 210</u>	<u>\$ 198</u>

The Company's policy is to contribute to the qualified U.S. and non-U.S. pension plans at least the minimum amount required by applicable laws and regulations, to contribute to the nonqualified plan when required for benefit payments, and to contribute to the postretirement benefit plan an amount equal to the benefit payments. There is no minimum required contribution for the U.S. pension plans for 2006. The Company from time to time makes contributions in excess of the minimum amount required as economic conditions warrant. The Company has not determined whether it will make a voluntary contribution to the U.S. qualified plan in 2006; however it does expect to fund \$280 for the U.S. nonqualified plan, \$210 for the non-U.S. plan and \$280 for the postretirement benefit plan to pay benefits during 2006.

Table of Contents

CLARCOR Inc.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(Unaudited) Continued

11. CONTINGENCIES

The Company is involved in legal actions arising in the normal course of business. Additionally, the Company is party to various proceedings relating to environmental issues. The U.S. Environmental Protection Agency (EPA) and/or other responsible state agencies have designated the Company as a potentially responsible party (PRP), along with other companies, in remedial activities for the cleanup of waste sites under the federal Superfund statute.

Although it is not certain what future environmental claims, if any, may be asserted, the Company currently believes that its potential liability for known environmental matters does not exceed its present accrual of \$50. However, environmental and related remediation costs are difficult to quantify for a number of reasons, including the number of parties involved, the difficulty in determining the extent of the contamination at issue, the difficulty in determining the nature and extent of contamination attributable to each PRP, the length of time remediation may require, the complexity of the environmental regulation and the continuing advancement of remediation technology. Applicable federal law may impose joint and several liability on each PRP for the cleanup.

It is the opinion of management, after consultation with legal counsel that additional liabilities, if any, resulting from these legal or environmental issues, are not expected to have a material adverse effect on the Company's financial condition or consolidated results of operations.

In the event of a change in control of the Company, termination benefits may be required for certain executive officers and other key employees.

12. SEGMENT DATA

The Company operates in three principal product segments: Engine/Mobile Filtration, Industrial/Environmental Filtration and Packaging. The segment data for the third quarter and nine months ended September 2, 2006 and August 27, 2005, respectively, are shown below. Net sales represent sales to unaffiliated customers as reported in the consolidated condensed statements of earnings. Intersegment sales were not material.

	Quarter Ended		Nine Months Ended	
	September 2, 2006	August 27, 2005	September 2, 2006	August 27, 2005
Net sales:				
Engine/Mobile Filtration	\$ 103,358	\$ 90,686	\$ 295,819	\$267,537
Industrial/Environmental Filtration	106,263	105,153	312,785	309,019
Packaging	21,889	20,564	63,165	55,894
	<u>\$ 231,510</u>	<u>\$216,403</u>	<u>\$ 671,769</u>	<u>\$632,450</u>

[Table of Contents](#)

CLARCOR Inc.
NOTES TO CONSOLIDATED CONDENSED FINANCIAL STATEMENTS
(Dollars in thousands, except per share data)
(Unaudited) Continued

12. SEGMENT DATA (Continued)

	Quarter Ended		Nine Months Ended	
	September 2, 2006	August 27, 2005	September 2, 2006	August 27, 2005
Operating profit:				
Engine/Mobile Filtration	\$ 25,147	\$ 20,500	\$ 66,666	\$ 56,907
Industrial/Environmental Filtration	7,965	8,544	15,044	18,747
Packaging	1,967	2,008	5,463	4,031
	<u>35,079</u>	<u>31,052</u>	<u>87,173</u>	<u>79,685</u>
Other income (expense)	96	278	120	(129)
Earnings before income taxes and minority earnings	<u>\$ 35,175</u>	<u>\$ 31,330</u>	<u>\$ 87,293</u>	<u>\$ 79,556</u>
Identifiable assets:				
Engine/Mobile Filtration			\$ 208,364	\$191,891
Industrial/Environmental Filtration			375,299	349,089
Packaging			42,756	43,054
Corporate			<u>74,252</u>	<u>81,427</u>
			<u>\$ 700,671</u>	<u>\$665,461</u>

During the second quarter the Company recognized a pretax charge to earnings of approximately \$3,000 in the Industrial/Environmental segment's operating profit arising from the refusal of a customer to pay for products it had ordered and used. The charge represents unpaid invoices and certain inventories and is included in selling and administrative expenses. The Company has initiated legal proceedings against the customer to recover this amount. The Industrial/Environmental operating profit for the nine months ended September 2, 2006 also includes the \$611 charge related to restructuring of a European manufacturing facility and closing of a North Carolina operation and the \$540 gain related to insurance proceeds.

13. RECENT ACCOUNTING PRONOUNCEMENT

In June 2006, the Financial Accounting Standards Board issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," (FIN No. 48). The Interpretation clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statement of Financial Accounting Standard No. 109, "Accounting for Income Taxes," and will be effective for the Company's fiscal year 2008 although earlier application is encouraged. FIN No. 48 prescribes guidance for recognizing, measuring, reporting and disclosing a tax position taken or expected to be taken in a tax return. The Company is currently evaluating the effects FIN No. 48 will have on its financial statements.

[Table of Contents](#)

Part I
Item 2

MANAGEMENT'S DISCUSSION AND ANALYSIS
OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RESULTS OF OPERATIONS: THIRD QUARTER OF 2006 COMPARED WITH THIRD QUARTER OF 2005.

CLARCOR reported increased sales, operating profit, net earnings and diluted earnings per share for the third quarter of 2006 compared to the same quarter in 2005. Sales increased 7.0%, operating profit increased 13.0% and net earnings increased 10.1% over the same quarter in 2005. Sales and administrative expenses for the third quarter included stock option expense of \$611,000 that reduced net earnings by \$394,000 and diluted earnings per share by approximately \$0.01. Diluted earnings per share increased to \$0.44 for the 2006 quarter from \$0.40 in the 2005 quarter.

The 2006 third quarter results were impacted by a pre-tax gain of \$790,000 (\$518,000 after-tax), or \$0.01 per diluted share, from insurance proceeds received due to tornado damage at the Company's warehouse in Goodlettsville, Tennessee, recorded in the Company's Industrial/ Environmental filtration segment in the third quarter of 2006. Additionally in the third quarter of 2006, the Company recognized a pre-tax gain of \$800,000 (\$525,000 after-tax), or \$0.01 per diluted share, from the elimination of a reserve that was no longer necessary related to an overseas subsidiary included in the Engine/Mobile filtration segment. In the 2005 third quarter, the Company realized a benefit of \$1,235,000, or \$0.02 per diluted share, due to the favorable settlement of a tax position related to a foreign subsidiary.

Net sales of \$231,510,000 increased from \$216,403,000 reported for third quarter of 2005. Acquisitions made during the fourth quarter of 2005 and in the second quarter 2006 increased sales in the third quarter of 2006 by approximately \$6 million. Fluctuations in foreign currencies did not have a material impact on sales in either the 2006 or the 2005 quarter.

The Engine/Mobile Filtration segment reported increased sales of 14.0% to \$103,358,000 from \$90,686,000 in the third quarter of 2005. This increase was primarily due to additional sales of heavy-duty filters through domestic and international aftermarket distribution, OEM dealers and national accounts and sales to railroads and railroad equipment maintenance companies. The international engine filter businesses, led by over 20% sales increases in China, Europe and Mexico, posted solid gains. Price increases, which averaged 1% to 2%, also contributed to sales increases for the quarter.

The Company's Industrial/Environmental Filtration segment recorded a 1.1% increase in sales to \$106,263,000 for the 2006 quarter from \$105,153,000 for the 2005 third quarter. Acquisitions made during the fourth quarter of 2005 and second quarter of 2006 increased third quarter sales in 2006 by approximately \$6 million. Sales grew strongly in several specialty filtration markets, including aviation fuel filtration systems, aerospace filters, dust collector cartridges, increased oil and gas filter products and rainwater run-off systems. Sales levels in the 2006 quarter were lower for plastic and polymer applications, environmental filtration equipment and HVAC filters used in industrial, commercial and residential applications. Lower HVAC sales were due in part to lower filter usage in automotive and automotive parts manufacturing plants.

Additionally, this segment has had to absorb the loss of \$11 million in annual sales to a customer who decided late in 2005 to begin manufacturing certain HVAC filter products at its manufacturing plants outside the United States. On March 30, 2006, the Company terminated a \$10 million annual sales contract with Electronic Data Systems Corporation (EDS) who had refused to pay amounts owed to CLARCOR, which also negatively impacted third quarter 2006 sales. The

