ENNIS, INC.
Form 10-Q
June 28, 2010

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

FORM 10-Q

(Mark One)

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the Quarterly Period Ended May 31, 2010

OR

o **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 þ No o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Date File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes o No o

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

Large accelerated Filer o	Accelerated filer þ	Non-accelerated filer o	Smaller reporting company o
		(Do not check if a smaller reporting company)	

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

As of June 18, 2010, there were 25,896,934 shares of the Registrant s common stock outstanding.

ENNIS, INC. AND SUBSIDIARIES
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PART I. FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

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

	May 31, 2010 *(unaudited)*	February 28, 2010
Assets		
Current assets		
Cash	$ 13,498	$ 21,063
Accounts receivable, net of allowance for doubtful receivables of $4,993 at May 31, 2010 and $4,446 at February 28, 2010	59,917	57,249
Prepaid expenses	5,942	6,867
Inventories	77,942	75,137
Deferred income taxes	5,319	5,319
Assets held for sale	804	804
Total current assets	163,422	166,439
Property, plant and equipment, at cost		
Plant, machinery and equipment	144,740	138,419
Land and buildings	61,801	55,430
Other	22,454	22,402
Total property, plant and equipment	228,995	216,251
Less accumulated depreciation	152,402	150,531
Net property, plant and equipment	76,593	65,720
Goodwill	117,341	117,341
Trademarks and tradenames, net	58,864	58,897
Customer lists, net	19,190	19,753
Deferred finance charges, net	971	1,079
Other assets	3,463	3,470
Total assets	$ 439,844	$ 432,699

See accompanying notes to consolidated financial statements.

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ENNIS, INC. AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(Dollars in thousands, except for share amounts)

	May 31, 2010 *(unaudited)*	February 28, 2010
Liabilities and Shareholders Equity		
Current liabilities		
Accounts payable	$ 19,268	$ 27,463
Accrued expenses		
Employee compensation and benefits	13,638	14,374
Taxes other than income	1,216	1,539
Federal and state income taxes payable	6,839	705
Other	6,595	5,720
Total current liabilities	47,556	49,801
Long-term debt, less current installments	41,432	41,817
Liability for pension benefits	7,624	7,132
Deferred income taxes	19,872	19,821
Other liabilities	567	868
Total liabilities	117,051	119,439
Commitments and contingencies		
Shareholders equity		
Preferred stock $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, 2010	75,134	75,134
Additional paid in capital	121,372	121,978
Retained earnings	215,096	206,062
Accumulated other comprehensive income (loss):		
Foreign currency translation, net of taxes	107	267
Unrealized loss on derivative instruments, net of taxes	(909)	(1,154)
Minimum pension liability, net of taxes	(12,376)	(12,376)
	(13,178)	(13,263)
	398,424	389,911
Treasury stock		
Cost of 4,234,944 shares at May 31, 2010 and 4,292,080 shares at February 28, 2010	(75,631)	(76,651)

Total shareholders equity	322,793	313,260
Total liabilities and shareholders equity	$ 439,844	$ 432,699

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, 2010	Three months ended May 31, 2009
Net sales	$ 140,741	$ 130,830
Cost of goods sold	98,561	99,846
Gross profit margin	42,180	30,984
Selling, general and administrative	21,247	19,459
Gain from disposal of assets		(2)
Income from operations	20,933	11,527
Other income (expense)		
Interest expense	(437)	(695)
Other, net	40	(300)
	(397)	(995)
Earnings before income taxes	20,536	10,532
Provision for income taxes	7,496	3,897
Net earnings	$ 13,040	$ 6,635
Weighted average common shares outstanding		
Basic	25,800,647	25,821,139
Diluted	25,849,937	25,836,817
Per share amounts		
Net earnings basic	$ 0.51	$ 0.26
Net earnings diluted	$ 0.50	$ 0.26
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, 2010	Three months ended May 31, 2009
Cash flows from operating activities:		
Net earnings	$ 13,040	$ 6,635
Adjustments to reconcile net earnings to net cash provided by operating activities:		
Depreciation	2,067	2,356
Amortization of deferred finance charges	108	112
Amortization of tradenames and customer lists	601	602
Gain from disposal of assets		(2)
Bad debt expense	989	539
Stock based compensation	416	246
Changes in operating assets and liabilities:		
Accounts receivable	(3,651)	(3,394)
Prepaid expenses	902	3,799
Inventories	(2,761)	13,587
Other assets	2	(8)
Accounts payable and accrued expenses	(2,253)	338
Other liabilities	(301)	(392)
Prepaid pension asset/liability for pension benefits	492	752
Net cash provided by operating activities	9,651	25,170
Cash flows from investing activities:		
Capital expenditures	(13,158)	(629)
Proceeds from disposal of plant and property		5
Net cash used in investing activities	(13,158)	(624)
Cash flows from financing activities:		
Repayment of debt		(56)
Dividends	(4,006)	(4,002)
Purchase of treasury stock	(2)	(404)
Net cash used in financing activities	(4,008)	(4,462)
Effect of exchange rate changes on cash	(50)	433
Net change in cash	(7,565)	20,517
Cash at beginning of period	21,063	9,286

Cash at end of period	$ 13,498	$ 29,803

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, 2010

1. Significant Accounting Policies and General Matters

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, 2010 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 Annual Report on Form 10-K for the year ended February 28, 2010, from which the accompanying consolidated balance sheet at February 28, 2010 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 and are of a normal recurring nature. 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, pension plan, accrued liabilities, 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.

Recent Accounting Pronouncements

In January 2010, the Financial Accounting Standards Board (FASB) amended authoritative guidance for improving disclosures about fair-value measurements. The updated guidance requires new disclosures about recurring or nonrecurring fair-value measurements including significant transfers into and out of Level 1 and Level 2 fair-value measurements and information on purchases, sales, issuances, and settlements on a gross basis in the reconciliation of Level 3 fair-value measurements. The guidance also clarified existing fair-value measurement disclosure guidance about the level of disaggregation, inputs, and valuation techniques. The Company adopted this guidance on March 1, 2010 except for the disclosures requirements regarding purchases, sales, issuances and settlements on the roll-forward of activity in Level 3 fair-value measurements. Those disclosures will be effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. The Company does not expect that the adoption of this guidance will have a material impact on the consolidated financial statements.

2. Accounts Receivable and Allowance for Doubtful Receivables

Accounts receivable are reduced by an allowance for an estimate of amounts that are uncollectible. Approximately 95% of the Company s receivables are due from customers in North America. The Company extends credit to its customers based upon its evaluation of the following factors: (i) the customer s financial condition, (ii) the amount of credit the customer requests and (iii) the customer s actual payment history (which includes disputed invoice resolution). The Company does not typically require its customers to post a deposit or supply collateral. The Company s allowance for doubtful receivables is based on an analysis that estimates the amount of its total customer receivable balance that is not collectible. This analysis includes assessing a default probability to customers receivable balances, which is influenced by several factors including (i) current market conditions, (ii) periodic review of customer credit worthiness, and (iii) review of customer receivable aging and payment trends.

The Company writes off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance in the period the payment is received. Credit losses from continuing operations have consistently been within management s expectations.

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FOR THE PERIOD ENDED MAY 31, 2010

2. Accounts Receivable and Allowance for Doubtful Receivables-continued

The following table represents the activity in the Company s allowance for doubtful receivables for the three months ended (in thousands):

	Three months ended May 31,	
	2010	2009
Balance at beginning of period	$ 4,446	$ 3,561
Bad debt expense	989	539
Recoveries	12	12
Accounts written off	(454)	(547)
Foreign currency translation		28
Balance at end of period	$ 4,993	$ 3,593

3. Inventories

The Company uses the lower of last-in, first-out (LIFO) cost or market to value certain of its business forms inventories and the lower of first-in, first-out (FIFO) cost or market to value its remaining forms and apparel inventories. The Company regularly reviews inventories on hand, using specific aging categories, and writes down the carrying value of its inventories for excess and potentially obsolete inventories based on historical usage and estimated future usage. In assessing the ultimate realization of its inventories, the Company is required to make judgments as to future demand requirements. As actual future demand or market conditions may vary from those projected by the Company, adjustments to inventories may be required.

The following table summarizes the components of inventories at the different stages of production as of the dates indicated (in thousands):

	May 31, 2010	February 28, 2010
Raw material	$ 10,946	$ 11,089
Work-in-process	18,132	14,280
Finished goods	48,864	49,768
	$ 77,942	$ 75,137

4. Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of net assets of acquired businesses and is not amortized. Goodwill and indefinite-lived intangibles are evaluated for impairment on an annual basis, or more frequently if impairment indicators arise, using a fair-value-based test that compares the fair value of the asset to its carrying value. Fair values of reporting units are typically calculated using a factor of expected earnings before interest, taxes, depreciation, and amortization. Based on this evaluation, no impairment was recorded. The Company must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets in assessing the recoverability of its goodwill and other intangibles. If these estimates or the related assumptions change, the Company may be required to record impairment charges for these assets in the future.

The cost of intangible assets is based on fair values at the date of acquisition. Intangible assets with determinable lives are amortized on a straight-line basis over their estimated useful life (between 1 and 10 years). Trademarks with indefinite lives and a net book value of $58.5 million at May 31, 2010 are evaluated for impairment on an annual basis, or more frequently if impairment indicators arise. After conducting its fiscal year 2010 test, the Company determined there was no impairment. The Company assesses the recoverability of its definite-lived intangible assets primarily based on its current and anticipated future undiscounted cash flows.

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FOR THE PERIOD ENDED MAY 31, 2010

4. Goodwill and Other Intangible Assets-continued

The carrying amount and accumulated amortization of the Company s intangible assets at each balance sheet date are as follows (in thousands):

	Gross Carrying Amount	Accumulated Amortization	Net
As of May 31, 2010			
Amortized intangible assets (in thousands)			
Tradenames	$ 1,234	$ 908	$ 326
Customer lists	29,908	10,718	19,190
Noncompete	500	488	12
	$ 31,642	$ 12,114	$ 19,528
As of February 28, 2010			
Amortized intangible assets (in thousands)			
Tradenames	$ 1,234	$ 875	$ 359
Customer lists	29,908	10,155	19,753
Noncompete	500	483	17
	$ 31,642	$ 11,513	$ 20,129

	May 31, 2010	February 28, 2010
Non-amortizing intangible assets (in thousands)		
Trademarks	$ 58,538	$ 58,538

Aggregate amortization expense for the three months ended May 31, 2010 and May 31, 2009 was $601,000 and $602,000, respectively.

The Company s estimated amortization expense for the current and next five fiscal years is as follows:

2011	$ 2,397,000
2012	2,391,000
2013	2,347,000
2014	2,254,000
2015	2,136,000
2016	2,078,000

Changes in the net carrying amount of goodwill are as follows (in thousands):

	Print Segment Total	Apparel Segment Total	Total
Balance as of March 1, 2009	$ 42,792	$ 74,549	$ 117,341

Goodwill acquired			
Goodwill impairment			
Balance as of March 1, 2010	42,792	74,549	117,341
Goodwill acquired			
Goodwill impairment			
Balance as of May 31, 2010	$ 42,792	$ 74,549	$ 117,341

During the three months ended May 31, 2010 and fiscal year ended 2009, there were no adjustments to goodwill.

ENNIS, INC. AND SUBSIDIARIES
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5. Other Accrued Expenses

The following table summarizes the components of other accrued expenses as of the dates indicated (in thousands):

	May 31, 2010	February 28, 2010
Accrued taxes	$ 286	$ 265
Accrued legal and professional fees	239	392
Accrued interest	135	114
Accrued utilities	1,354	1,322
Accrued repairs and maintenance	581	547
Accrued construction retainer	954	582
Accrued phantom stock obligation	470	422
Accrual-earn out agreements	511	594
Other accrued expenses	2,065	1,482
	$ 6,595	$ 5,720

6. Derivative Instruments and Hedging Activities

The Company uses derivative financial instruments to manage its exposure to interest rate fluctuations on its floating rate $150.0 million revolving credit facility maturing August 18, 2012. On July 7, 2008, the Company entered into a three-year Interest Rate Swap Agreement (Swap) for a notional amount of $40.0 million. The Swap effectively fixes the LIBOR rate at 3.79%.

The Swap was designated as a cash flow hedge, and the fair value at May 31, 2010 and February 28, 2010 was $(1.4) million ($(0.9) million net of deferred taxes) and $(1.8) million ($(1.2) million net of deferred taxes), respectively. The Swap has been reported on the Consolidated Balance Sheet as long-term debt with a related deferred charge recorded as a component of other comprehensive income (loss). During the three months ended May 31, 2010, there was a loss of approximately $362,000 reclassified from accumulated other comprehensive income to interest expense related to the Swap.

7. Fair Value Financial Instruments

The carrying amounts of cash, accounts receivable, accounts payable and long-term debt approximate fair value because of the short maturity and/or variable rates associated with these instruments. Derivative financial instruments are recorded at fair value.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. The Company categorizes each of its fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1 Inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access.

Level 2 Inputs utilize data points that are observable such as quoted prices, interest rates and yield curves.

Level 3 Inputs are unobservable data points for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.

Derivatives are reported at fair value utilizing Level 2 inputs. The Company utilizes valuation models with observable market data inputs to estimate the fair value of its Swap.

ENNIS, INC. AND SUBSIDIARIES
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7. Fair Value Financial Instruments-continued

The following table summarizes financial assets and financial liabilities measured at fair value on a recurring basis as of May 31, 2010 and February 28, 2010, segregated by the level of the valuation inputs within the fair value hierarchy utilized to measure fair value (in thousands):

Description	May 31, 2010	Fair Value Measurements (Level 1)	(Level 2)	(Level 3)
Derivative liability (Swap)	$ (1,432)	$	$ (1,432)	$
	$ (1,432)	$	$ (1,432)	$

Description	February 28, 2010	Fair Value Measurements (Level 1)	(Level 2)	(Level 3)
Derivative liability (Swap)	$ (1,817)	$	$ (1,817)	$
	$ (1,817)	$	$ (1,817)	$

8. Long-Term Debt

Long-term debt consisted of the following as of the dates indicated (in thousands):

	May 31, 2010	February 28, 2010
Revolving credit facility	$ 40,000	$ 40,000
Interest rate swap	1,432	1,817
Long-term debt	$ 41,432	$ 41,817

On August 18, 2009, the Company entered into a Second Amended and Restated Credit Agreement (the Facility) with a group of lenders led by Bank of America, N.A. (the Lenders). The Facility provides the Company access to $150.0 million in revolving credit, which the Company may increase to $200.0 million in certain circumstances, and matures on August 18, 2012. The Facility bears interest at the London Interbank Offered Rate (LIBOR) plus a spread ranging from 2.0% to 3.5% (currently LIBOR + 2.25% or 2.6% at May 31, 2010), depending on the Company s total funded debt to EBITDA ratio, as defined. As of May 31, 2010, the Company had $40.0 million of borrowings under the revolving credit line and $2.5 million outstanding under standby letters of credit arrangements, leaving the Company availability of approximately $107.5 million. The Facility contains financial covenants, restrictions on capital expenditures, acquisitions, asset dispositions, and additional debt, as well as other customary covenants, such as total funded debt to EBITDA ratio, as defined. The Company is in compliance with these covenants as of May 31, 2010. The Facility is secured by substantially all of the Company s domestic assets as well as all capital securities of each Domestic Subsidiary and 65% of all capital securities of each direct Foreign Subsidiary.

We capitalized $292,000 of interest expense for the three months ended May 31, 2010 relating to the construction of the Agua Prieta facility. There was no interest expense capitalized for the three months ended May 31, 2009.

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ENNIS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED MAY 31, 2010

9. Shareholders Equity

Comprehensive income is defined as all changes in equity during a period, except for those resulting from investments by owners and distributions to owners. The components of comprehensive income were as follows (in thousands):

	Three months ended May 31,	
	2010	**2009**
Net earnings	$ 13,040	$ 6,635
Foreign currency translation adjustment, net of deferred taxes	(160)	1,030
Unrealized gain (loss) on derivative instruments, net of deferred taxes	245	(40)
Comprehensive income	$ 13,125	$ 7,625

Changes in shareholders equity accounts for the three months ended May 31, 2010 are as follows (in thousands):

	Common Stock		Additional Paid-in	Retained	Accumulated Other Comprehensive Income	Treasury Stock		
	Shares	**Amount**	**Capital**	**Earnings**	**(Loss)**	**Shares**	**Amount**	**Total**
Balance February 28, 2010	30,053,443	$ 75,134	$ 121,978	$ 206,062	$ (13,263)	(4,292,080)	$ (76,651)	$ 313,260
Net earnings				13,040				13,040
Foreign currency translation, net of deferred tax of $92					(160)			(160)
Unrealized gain on derivative instruments, net of deferred tax benefit of $141					245			245
Comprehensive income								13,125
Dividends declared ($.155 per share)				(4,006)				(4,006)
Stock based compensation			416					416
Exercise of stock options and restricted stock grants			(1,022)			57,227	1,022	

Stock repurchases						(91)	(2)	(2)
Balance May 31, 2010	30,053,443	$ 75,134	$ 121,372	$ 215,096	$ (13,178)	(4,234,944)	$ (75,631)	$ 322,793

On October 20, 2008, the Board of Directors authorized the repurchase of up to $5.0 million of the common stock through a stock repurchase program. Under the board-approved repurchase program, share purchases may be made from time to time in the open market or through privately negotiated transactions depending on market conditions, share price, trading volume and other factors, and such purchases, if any, will be made in accordance with applicable insider trading and other securities laws and regulations. These repurchases may be commenced or suspended at any time or from time to time without prior notice. Unrelated to the stock repurchase program, the Company purchased 91 shares of the common stock during the three months ended May 31, 2010. As of May 31, 2010, there have been 96,000 shares of the common stock that have been purchased under the repurchase program at an average price per share of $10.45.

10. Stock Option Plan and Stock Based Compensation

The Company has stock options and restricted stock granted to key executives and managerial employees and non-employee directors. At May 31, 2010, the Company has one stock option plan: the 2004 Long-Term Incentive Plan of Ennis, Inc., as amended and restated as of May 14, 2008, formerly the 1998 Option and Restricted Stock Plan amended and restated as of June 17, 2004 (Plan). The Company has 268,713 shares of unissued common stock reserved under the plan for issuance to officers and directors, and supervisory employees of the Company and its subsidiaries. The exercise price of each stock 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. Stock options and restricted stock may be granted at different times during the year and vest ratably over various periods, from grant date up to five years. The Company uses treasury stock to satisfy option exercises and restricted stock awards.

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

The Company recognizes compensation expense for stock options and restricted stock grants on a straight-line basis over the requisite service period. For the three months ended May 31, 2010 and 2009, the Company included in selling, general and administrative expenses, compensation expense related to share based compensation of $416,000 ($264,000 net of tax), and $246,000 ($155,000 net of tax), respectively.

Stock Options

The Company had the following stock option activity for the three months ended May 31, 2010:

	Number of Shares *(exact quantity)*	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (in years)	Aggregate Intrinsic Value(a) *(in thousands)*
Outstanding at February 28, 2010	250,200	$ 12.09	6.0	$ 1,003
Granted	62,500	18.46		
Terminated				
Exercised				
Outstanding at May 31, 2010	312,700	$ 13.36	6.6	$ 1,445
Exercisable at May 31, 2010	171,450	$ 13.53	4.3	$ 764

(a) Intrinsic value is measured as the excess fair market value of the Company s Common Stock as reported on the New York Stock Exchange over the applicable exercise price.

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, 2010 and 2009:

	May 31, 2010	May 31, 2009
Expected volatility	34.63%	32.35%
Expected term (years)	3	4
Risk free interest rate	1.58%	2.01%
Dividend yield	4.24%	4.74%

Weighted average grant-date fair value	$ 3.348	$ 1.583

There were no stock options exercised during either the three months ended May 31, 2010 or May 31, 2009.

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10. Stock Option Plan and Stock Based Compensation-continued

A summary of the status of the Company s unvested stock options at February 28, 2010, and changes during the three months ended May 31, 2010 is presented below:

	Number of Options	Weighted Average Grant Date Fair Value
Unvested at February 28, 2010	110,000	$ 1.64
New grants	62,500	3.35
Vested	(31,250)	1.79
Forfeited		
Unvested at May 31, 2010	141,250	$ 2.36

As of May 31, 2010, there was $315,000 of unrecognized compensation cost related to unvested stock options granted under the Plan. The weighted average remaining requisite service period of the unvested stock options was 2.9 years. The total fair value of shares underlying the options vested during the three months ended May 31, 2010 was $550,000.

Restricted Stock

The Company had the following restricted stock grant activity for the three months ended May 31, 2010:

	Number of Shares	Weighted Average Grant Date Fair Value
Outstanding at February 28, 2010	91,470	$ 15.38
Granted	39,000	18.46
Terminated		
Vested	(57,227)	16.23
Outstanding at May 31, 2010	73,243	$ 16.36

As of May 31, 2010, the total remaining unrecognized compensation cost related to unvested restricted stock was approximately $927,000. The weighted average remaining requisite service period of the unvested restricted stock awards was 1.8 years.

11. Employee Benefit Plans

The Company and certain subsidiaries have a noncontributory defined benefit retirement plan covering approximately 14% 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 cost of good sold and selling, general and administrative expenses in the Company s consolidated statements of earnings (in thousands):

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ENNIS, INC. AND SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
FOR THE PERIOD ENDED MAY 31, 2010

11. Employee Benefit Plans-continued

	Three months ended May 31, 2010	Three months ended May 31, 2009
Components of net periodic benefit cost		
Service cost	$ 303	$ 285
Interest cost	654	685
Expected return on plan assets	(765)	(606)
Amortization of:		
Prior service cost	(36)	(36)
Unrecognized net loss	336	424
Net periodic benefit cost	$ 492	$ 752

The Company is required to make contributions to its defined benefit pension plan. These contributions are required under the minimum funding requirements of ERISA. For the current fiscal year ending February 28, 2011, there is not a minimum contribution requirement and no pension payments have been made so far this fiscal year; however, the Company expects to contribute from $2.0 million to $3.0 million in the fourth quarter of fiscal year 2011. The Company contributed $3.0 million to its pension plan during fiscal year 2010.

12. Earnings per share

Basic earnings per share have been computed by dividing net earnings by the weighted average number of common shares outstanding during the applicable period. Diluted earnings per share reflect the potential dilution that could occur if stock options or other contracts to issue common shares were exercised or converted into common stock.

At May 31, 2010, 95,000 shares related to stock options 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. At February 28, 2010, 98,950 shares related to stock options 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 following table sets forth the computation for basic and diluted earnings per share for the periods indicated:

	Three months ended May 31, 2010	Three months ended May 31, 2009
Basic weighted average common shares outstanding	25,800,647	25,821,139
Effect of dilutive options	49,290	15,678
Diluted weighted average common shares outstanding	25,849,937	25,836,817
Per share amounts:		
Net earnings basic	$ 0.51	$ 0.26
Net earnings diluted	$ 0.50	$ 0.26
Cash dividends	$ 0.155	$ 0.155

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13. Segment Information and Geographic Information

The Company operates in two segments the Print Segment and the Apparel Segment.

The Print Segment, which represented 48% of the Company s consolidated net sales for the three months ended May 31, 2010, is in the business of manufacturing, designing, and selling business forms and other printed business products primarily to distributors located in the United States. The Print Segment operates 37 manufacturing locations throughout the United States in 16 strategically located domestic states. Approximately 96% of the business products manufactured by the Print Segment are custom and semi-custom, constructed in a wide variety of sizes, colors, number of parts and quantities on an individual job basis depending upon the customers specifications.

The products sold include snap sets, continuous forms, laser cut sheets, tags, labels, envelopes, integrated products, jumbo rolls and pressure sensitive products in short, medium and long runs under the following labels: Ennis®, Royal Business Forms®, Block Graphics®, Specialized Printed Forms℠, 360º Custom Labels℠, Enfusion®, Uncompromised Check Solutions®, Witt Printing℠, B&D Litho of Arizona℠, Genforms® and Calibrated Forms®. The Print Segment also sells the Adams-McClure® brand (which provides Point of Purchase advertising for large franchise and fast food chains as well as kitting and fulfillment); the Admore® brand (which provides presentation folders and document folders); Ennis Tag & Label℠ (which provides tags and labels, promotional products and advertising concept products); Trade Envelopes® and Block Graphics® (which provide custom and imprinted envelopes) and Northstar® and GFS® (which provide financial and security documents).

The Print Segment sells predominantly through private printers and independent distributors. Northstar and GFS also sell to a small number of direct customers. Northstar has continued its focus with large banking organizations on a direct basis (where a distributor is not acceptable or available to the end-user) and has acquired several of the top 25 banks in the United States as customers and is actively working on other large banks within the top 25 tier of banks in the United States. Adams-McClure sales are generally provided through advertising agencies.

The second segment, the Apparel Segment, which accounted for 52% of the Company s consolidated net sales for the three months ended May 31, 2010, consists of Alstyle Apparel. This group is primarily engaged in the production and sale of activewear including t-shirts, fleece goods, and other wearables. Alstyle sales are seasonal, with sales in the first and second quarters generally being the highest. Substantially all of the Apparel Segment sales are to customers in the United States.

Corporate information is included to reconcile segment data to the consolidated financial statements and includes assets and expenses related to the Company s corporate headquarters and other administrative costs.

Segment data for the three months ended May 31, 2010 and 2009 were as follows (in thousands):

	Print Segment	Apparel Segment	Corporate	Consolidated Totals
Three months ended May 31, 2010:				
Net sales	$ 67,790	$ 72,951	$	$ 140,741
Depreciation	1,376	501	190	2,067
Amortization of identifiable intangibles	234	367		601
Segment earnings (loss) before income tax	12,502	12,502	(4,468)	20,536
Segment assets	138,896	285,413	15,535	439,844
Capital expenditures	621	12,534	3	13,158

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13. Segment Information and Geographic Information-continued

	Print Segment	Apparel Segment	Corporate	Consolidated Totals
Three months ended May 31, 2009:				
Net sales	$ 71,710	$ 59,120	$	$ 130,830
Depreciation	1,554	584	218	2,356
Amortization of identifiable intangibles	235	367		602
Segment earnings (loss) before income tax	10,810	3,399	(3,677)	10,532
Segment assets	146,276	261,756	33,266	441,298
Capital expenditures	207	353	69	629

Identifiable long-lived assets by country include property, plant, and equipment, net of accumulated depreciation. The Company attributes revenues from external customers to individual geographic areas based on the country where the sale originated. Information about the Company s operations in different geographic areas as of and for the three months ended is as follows (in thousands):

	United States	Canada	Mexico	Total
Three months ended May 31, 2010:				
Net sales to unaffiliated customers				
Print Segment	$ 67,790	$	$	$ 67,790
Apparel Segment	66,942	5,320	689	72,951
	$ 134,732	$ 5,320	$ 689	$ 140,741
Identifiable long-lived assets				
Print Segment	$ 37,228	$	$	37,228
Apparel Segment	15,100	32	19,826	34,958
Corporate	4,407			4,407
	$ 56,735	$ 32	$ 19,826	$ 76,593
Three months ended May 31, 2009:				
Net sales to unaffiliated customers				
Print Segment	$ 71,710	$	$	$ 71,710
Apparel Segment	54,699	3,395	1,026	59,120
	$ 126,409	$ 3,395	$ 1,026	$ 130,830
Identifiable long-lived assets				
Print Segment	$ 40,923	$	$	40,923
Apparel Segment	5,648	41	1,308	6,997
Corporate	5,184			5,184

$ 51,755	$ 41	$ 1,308	$ 53,104

14. Supplemental Cash Flow Information

Net cash flows from operating activities reflect cash payments for interest and income taxes as follows (in thousands):

	Three months ended May 31,	
	2010	**2009**
Interest paid	$ 417	$ 688
Income taxes paid	$ 1,392	$ 467

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15. Concentrations of Risk

Financial instruments that potentially subject the Company to a concentration of credit risk principally consist of cash and trade receivables. Cash is placed with high-credit quality financial institutions. The Company s credit risk with respect to trade receivables is limited in management s opinion due to industry and geographic diversification. As disclosed on the Consolidated Balance Sheets, the Company maintains an allowance for doubtful receivables to cover estimated credit losses associated with accounts receivable.

The Company, for quality and pricing reasons, purchases its paper, cotton and yarn products from a limited number of suppliers. To maintain its high standard of color control associated with its apparel products, the Company purchases its dyeing chemicals from limited sources. While other sources may be available to the Company to purchase these products, they may not be available at the cost or at the quality the Company has come to expect.

For the purposes of the consolidated statements of cash flows, the Company considers cash to include cash on hand and in bank accounts. The Federal Deposit Insurance Corporation (FDIC) insures accounts up to $250,000. At May 31, 2010, cash balances included $10.1 million that was not federally insured because it represented amounts in individual accounts above the federally insured limit for each such account. This at-risk amount is subject to fluctuation on a daily basis. While management does not believe there is significant risk with respect to such deposits, we cannot be assured that we will not experience losses on our deposits. At May 31, 2010, the Company had $538,000 in Canadian and $2.2 million in Mexican bank accounts.

16. Assets Held for Sale

As of May 31, 2010, the Company had land, building and equipment of approximately $0.8 million classified as assets held for sale on the consolidated balance sheet. This balance is comprised of land and building with a net book value of $0.7 million and equipment with a net book value of $0.1 million.

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Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Overview

Ennis, Inc. (formerly Ennis Business Forms, Inc.) was organized under the laws of Texas in 1909. Ennis, Inc. and its subsidiaries (collectively known as the Company, Registrant, Ennis, or we, us, or our) print and manufactu broad line of business forms and other business products and also manufacture a line of activewear for distribution throughout North America. Distribution of business products and forms throughout the United States, Canada, and Mexico is primarily through independent dealers, and with respect to our activewear products, through sales representatives. This distributor channel encompasses print distributors, stationers, quick printers, computer software developers, activewear wholesalers, screen printers and advertising agencies, among others. The Apparel Segment produces and sells activewear, including t-shirts, fleece goods and other wearables. We offer a great selection of high-quality activewear apparel and hats with a wide variety of styles and colors in sizes ranging from toddler to 6XL. The apparel line features a wide variety of tees, fleece, shorts and yoga pants, and two headwear brands.

Business Segment Overview

We are one of the largest providers of business forms to independent distributors in the United States and are also one of the largest providers of blank t-shirts in North America to the active-wear market. We operate in two reportable segments Print and Apparel. For additional financial information concerning segment reporting, please see Note 13 of the Notes to the Consolidated Financial Statements beginning on page 16 included elsewhere herein, which information is incorporated herein by reference.

Print Segment

The Print Segment, which represented 48% of our consolidated net sales for the three months ended May 31, 2010, is in the business of manufacturing, designing and selling business forms and other printed business products primarily to distributors located in the United States. The Print Segment operates 37 manufacturing locations throughout the United States in 16 strategically located domestic states. Approximately 96% of the business products manufactured by the Print Segment are custom and semi-custom products, constructed in a wide variety of sizes, colors, and quantities on an individual job basis depending upon the customers specifications.

The products sold include snap sets, continuous forms, laser cut sheets, tags, labels, envelopes, integrated products, jumbo rolls and pressure sensitive products in short, medium and long runs under the following labels: Ennis®, Royal Business Forms®, Block Graphics®, Specialized Printed Forms℠, 360º Custom Labels℠, Enfusion®, Uncompromised Check Solutions®, Witt Printing℠, B&D Litho of Arizona℠, Genforms® and Calibrated Forms®. The Print Segment also sells the Adams-McClure® brand (which provides Point of Purchase advertising for large franchise and fast food chains as well as kitting and fulfillment); the Admore® brand (which provides presentation folders and document folders); Ennis Tag & Label℠ (which provides tags and labels, promotional products and advertising concept products); Trade Envelopes®, and Block Graphics® (which provide custom and imprinted envelopes) and Northstar® and GFS® (which provide financial and security documents).

The Print Segment sells predominantly through private printers and independent distributors. Northstar and GFS also sell to a small number of direct customers. Northstar has continued its focus with large banking organizations on a direct basis (where a distributor is not acceptable or available to the end-user) and has acquired several of the top 25 banks in the United States as customers and is actively working on other large banks within the top 25 tier of banks in the United States. Adams-McClure sales are generally through advertising agencies.

The printing industry generally sells its products in two ways. One market direction is to sell predominately to end users, and is dominated by a few large manufacturers, such as Moore Wallace (a subsidiary of R.R. Donnelly), Standard Register, and Cenveo. The other market direction, which the Company primarily serves, sells forms and other business products through a variety of independent distributors and distributor groups. While it is not possible, because of the lack of adequate statistical information, to determine Ennis share of the total business products

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market, management believes Ennis is one of the largest producers of business forms in the United States distributing primarily through independent dealers and that its business forms offering is more diversified than that of most companies in the business forms industry.

There are a number of competitors that operate in this segment, ranging in size from single employee-owner operations to multi-plant organizations, such as Cenveo and their resale brand known as: PrintXcel, Discount Label, and Printegra. We believe our strategic locations and buying power permit us to compete on a favorable basis within the distributor market on competitive factors, such as service, quality, and price.

Distribution of business forms and other business products throughout the United States is primarily done through independent dealers; including business forms distributors, stationers, printers, computer software developers, and advertising agencies.

Raw materials of the Print Segment principally consist of a wide variety of weights, widths, colors, sizes, and qualities of paper for business products purchased from a number of major suppliers at prevailing market prices.

Business products usage in the printing industry is generally not seasonal. General economic conditions and contraction of the traditional business forms industry are the predominant factor in quarterly volume fluctuations.

Our Print Business Challenges In our Print segment, we are engaged in an industry undergoing significant changes. Technology advances have made electronic distribution of documents, internet hosting, digital printing and print on demand valid, cost-effective alternatives to traditional custom printed documents and customer communications. In addition, the downturn in the economy and turmoil in the credit markets in 2009 and 2010 have created highly competitive conditions in an already over-supplied, price-competitive industry. Thus, we believe we are facing the following challenges in the Print Segment of our business:

- Transformation of our portfolio of products
- Excess production capacity and price competition within our industry
- Economic uncertainties

The following is a discussion of these business challenges and our strategy for managing their effect on our print business.

Transformation of our portfolio of products Traditional business documents are essential in order to conduct business. However, many are being replaced or devalued with advances in digital technologies, causing steady declines in demand for a large portion of our current product line. The same digital advances also introduce potential new opportunities for growth for us, such as print-on-demand services and product offerings that assist customers in their transition to digital business environments. We currently have many innovative products, such as our recently introduced healthcare wristbands, secure document solutions, and innovative in-mold label offerings, which address important business needs, and we feel are positioned for growth. In addition, we will continue to look for new market opportunities and niches, such as our addition of our envelope offerings that provide us with an opportunity for growth and differentiate us from our competition. Transforming our product offerings to continue to provide innovative, valuable solutions to our customers on a proactive basis will require us to make investments in new and existing technology and to develop key strategic business relationships.

Excess production capacity and price competition within our industry Paper mills continue to adjust production capacity through downtime and closures to attempt to keep projected customer demand in line with the available supply. Due to the limited number of paper mills, paper prices have been and are expected to remain fairly volatile. In 2010, we saw our material prices stabilize due to the depressed economic conditions. However, we would expect paper mills to continue to increase paper prices, especially as the economy strengthens, and have already experienced paper price increases during the first quarter of fiscal 2011.

Despite a competitive marketplace, we have generally been able to pass through increased paper costs, although it can often take several quarters to push these through due to the custom nature of our products and/or contractual relationships with some of our customers. We expect this trend to continue; however, weak economic conditions

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may limit our ability to recover all these costs. In addition, poor economic conditions have also resulted in increased price competition, due to an already over-supplied market, which continues to put pressure on selling prices. We attempt to effectively manage and control our product costs to minimize the effects of the foregoing on our operational results, primarily through the use of forecasting models, and production and costing models. However, an inherent risk in this process is that our assumptions are inaccurate, which could have a negative impact on our reported profit margins.

Economic uncertainties As a result of the recessionary conditions of 2009 and 2010, the economic climate has been volatile and challenging. Decreased demand and intense price competition resulted in significant declines in our revenue during the past fiscal year. Although, we have seen slight improvements in some economic indicators within our markets, unemployment rates and other leading indicators continue to be strained. A weak job market may continue to present a challenging environment for substantial revenue growth next fiscal year. As we cannot predict the pace of the economic recovery, we will be highly focused on customer retention, expanding our growth targeted products and continuing to develop our new market niches. In addition, we have proven a history of managing our costs and wouldn t expect this trend to change in the future.

Apparel Segment

The Apparel Segment represented 52% of our consolidated net sales for the three months ended May 31, 2010, and operates under the name of Alstyle Apparel (Alstyle). Alstyle markets high quality knit basic activewear (t-shirts, tank tops, and fleece) across all market segments. The products of Alstyle are standardized shirts manufactured in a variety of sizes and colors. Approximately 99% of Alstyle s revenues are derived from t-shirt sales, and 92% of those are domestic sales. Alstyle s branded product lines are sold under the AAA label, Murina® and Hyland® Headwear brands.

The Apparel Segment operates six manufacturing facilities, one in California, and five in Mexico. Alstyle is headquartered in Anaheim, California, where it knits domestic cotton yarn and some polyester fibers into tubular material. The material is dyed at that facility and then shipped to its plants in Ensenada or Hermosillo, Mexico, where it is cut and sewn into finished goods. Alstyle also ships their dyed fabric to outsourced manufacturers in El Salvador for sewing. After sewing and packaging is completed, the product is shipped to one of Alstyle s eight distribution centers located across the United States, Canada, and Mexico.

Alstyle utilizes a customer-focused internal sales team comprised of 23 sales representatives assigned to specific geographic territories in the United States, Canada, and Mexico. Sales representatives are allocated performance objectives for their respective territories and are provided financial incentives for achievement of their target objectives. Sales representatives are responsible for developing business with large accounts and spend approximately 60% of their time in the field.

Alstyle employs a staff of customer service representatives that handle call-in orders from smaller customers. Sales personnel sell directly to Alstyle s customer base, which consists primarily of screen printers, embellishers, retailers, and mass marketers.

A majority of Alstyle s sales are branded products, with the remainder customer private label products. Generally, sales to screen printers and mass marketers are driven by price and the availability of products, which directly impacts inventory level requirements. Sales in the private label business are characterized by slightly higher customer loyalty.

Alstyle s most popular styles are produced based on demand management forecasts to