

Edgar Filing: PERCEPTRON INC/MI - Form 10-Q

PERCEPTRON INC/MI  
Form 10-Q  
February 14, 2007

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 December 31, 2006.

Commission file number: 0-20206

PERCEPTRON, INC.  
(Exact Name of Registrant as Specified in Its Charter)

Michigan  
(State or Other Jurisdiction of  
Incorporation or Organization)

38-2381442  
(I.R.S. Employer  
Identification No.)

47827 Halyard Drive, Plymouth, Michigan  
(Address of Principal Executive Offices)

48170-2461  
(Zip Code)

(734) 414-6100  
(Registrant's Telephone Number, Including Area Code)

Not Applicable  
(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. (Check one):

Large accelerated filer ☐ Accelerated filer ☐ Non-accelerated filer ☒  
--- --- ---

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

Yes ☐ No ☒  
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The number of shares outstanding of each of the issuer's classes of common stock as of February 8, 2007, was:

Common Stock, \$0.01 par value	7,944,836	
Class	Number of shares	

### PERCEPTRON, INC. AND SUBSIDIARIES INDEX TO FORM 10-Q FOR THE QUARTER ENDED DECEMBER 31, 2006

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### PERCEPTRON, INC. AND SUBSIDIARIES CONSOLIDATED BALANCE SHEETS

	DECEMBER 31, 2006 ----- (Unaudited)	JUNE 30, 2006 -----
(In Thousands, Except Per Share Amount)		
ASSETS		
CURRENT ASSETS		
Cash and cash equivalents	\$ 19,045	\$ 25,188
Receivables:		
Billed receivables, net of allowance for doubtful accounts of \$387 and \$352, respectively	12,654	15,623

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Unbilled receivables	1,048	994
Other receivables	1,245	577
Inventories, net of reserves of \$829 and \$554, respectively	10,455	6,433
Deferred taxes	1,481	1,481
Other current assets	595	521
	-----	-----
Total current assets	46,523	50,817
PROPERTY AND EQUIPMENT		
Building and land	6,013	6,013
Machinery and equipment	12,337	11,566
Furniture and fixtures	1,098	1,093
	-----	-----
	19,448	18,672
Less - Accumulated depreciation and amortization	(12,005)	(11,264)
	-----	-----
Net property and equipment	7,443	7,408
DEFERRED TAX ASSET	4,595	4,170
	-----	-----
TOTAL ASSETS	\$ 58,561	\$ 62,395
	=====	=====
LIABILITIES AND SHAREHOLDERS' EQUITY		
CURRENT LIABILITIES		
Accounts payable	\$ 2,438	\$ 1,667
Accrued liabilities and expenses	2,258	2,277
Accrued compensation	955	1,740
Income taxes payable	107	145
Deferred revenue	2,209	2,336
	-----	-----
Total current liabilities	7,967	8,165
SHAREHOLDERS' EQUITY		
Preferred stock - no par value, authorized 1,000 shares, issued none	--	--
Common stock, \$0.01 par value, authorized 19,000 shares, issued and outstanding 8,000 and 8,352, respectively	80	84
Accumulated other comprehensive income (loss)	617	(15)
Additional paid-in capital	36,352	39,111
Retained earnings	13,545	15,050
	-----	-----
Total shareholders' equity	50,594	54,230
	-----	-----
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 58,561	\$ 62,395
	=====	=====

The notes to the consolidated financial statements are an integral part of these statements.

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(In Thousands, Except Per Share Amounts)	THREE MONTHS ENDED DECEMBER 31,		SIX MONTHS ENDED DECEMBER 31,	
	2006	2005	2006	2005
NET SALES	\$12,234	\$17,188	\$22,944	\$29,948
COST OF SALES	7,688	8,890	13,911	16,067
GROSS PROFIT	4,546	8,298	9,033	13,881
OPERATING EXPENSES				
Selling, general and administrative	4,178	3,652	8,065	6,944
Engineering, research and development	1,912	1,886	3,644	3,758
Total operating expenses	6,090	5,538	11,709	10,702
OPERATING INCOME (LOSS)	(1,544)	2,760	(2,676)	3,179
OTHER INCOME AND (EXPENSES)				
Interest income, net	265	104	579	251
Foreign currency gain (loss)	(16)	(126)	(21)	(77)
Other	--	162	5	161
Total other income (expenses)	249	140	563	335
INCOME (LOSS) BEFORE INCOME TAXES	(1,295)	2,900	(2,113)	3,514
INCOME TAX EXPENSE (BENEFIT) (NOTE 9)	(431)	706	(608)	1,051
NET INCOME (LOSS)	\$ (864)	\$ 2,194	\$ (1,505)	\$ 2,463
EARNINGS (LOSS) PER COMMON SHARE				
Basic	(\$0.11)	\$ 0.25	(\$0.18)	\$ 0.28
Diluted	(\$0.11)	\$ 0.24	(\$0.18)	\$ 0.27
WEIGHTED AVERAGE COMMON SHARES OUTSTANDING				
Basic	8,136	8,668	8,239	8,749
Dilutive effect of stock options	--	502	--	474
Diluted	8,136	9,170	8,239	9,223

The notes to the consolidated financial statements are an integral part of these statements.

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	SIX MONTHS ENDED DECEMBER 31,	
(In Thousands)	2006	2005
CASH FLOWS FROM OPERATING ACTIVITIES		
Net income (Loss)	\$ (1,505)	\$ 2,463
Adjustments to reconcile net income (loss) to net cash provided from (used for) operating activities:		
Depreciation and amortization	685	654
Stock compensation expense	451	383
Deferred income taxes	(425)	33
Stock option income tax benefit	--	53
Other	104	(28)
Changes in assets and liabilities, exclusive of changes shown separately	(1,700)	(1,639)
Net cash provided from (used for) operating activities	(2,390)	1,919
CASH FLOWS FROM FINANCING ACTIVITIES		
Revolving credit borrowings	543	468
Revolving credit repayments	(543)	(468)
Proceeds from stock plans	487	162
Repurchase of company stock	(3,701)	(2,947)
Net cash used for financing activities	(3,214)	(2,785)
CASH FLOWS FROM INVESTING ACTIVITIES		
Capital expenditures	(791)	(591)
Net cash used for investing activities	(791)	(591)
EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS		
	252	(132)
NET DECREASE IN CASH AND CASH EQUIVALENTS	(6,143)	(1,589)
CASH AND CASH EQUIVALENTS, JULY 1	25,188	20,374
CASH AND CASH EQUIVALENTS, DECEMBER 31	\$19,045	\$18,785
CHANGES IN ASSETS AND LIABILITIES, EXCLUSIVE OF CHANGES SHOWN SEPARATELY		
Receivables, net	\$ 2,617	\$ (1,985)
Inventories	(4,021)	(644)
Accounts payable	770	972
Other current assets and liabilities	(1,066)	18
	\$ (1,700)	\$ (1,639)

The notes to the consolidated financial statements are an integral part of these statements.

PERCEPTRON, INC. AND SUBSIDIARIES  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

1. BASIS OF PRESENTATION

The accompanying consolidated financial statements should be read in conjunction with the Company's 2006 Annual Report on Form 10-K. In the opinion of management, the unaudited information furnished herein reflects all adjustments necessary, consisting of normal recurring adjustments, for a fair presentation of the financial statements for the periods presented. The results of operations for any interim period are not necessarily indicative of the results of operations for a full year.

2. INVENTORY

Inventory is stated at the lower of cost or market. The cost of inventory is determined by the first-in, first-out ("FIFO") method. The Company provides a reserve for obsolescence to recognize the effects of engineering change orders, age and use of inventory that affect the value of the inventory. When the related inventory is disposed of, the obsolescence reserve is reduced. A detailed review of the inventory is performed yearly with quarterly updates for known changes that have occurred since the annual review. Inventory, net of reserves of \$829,000 and \$554,000 at December 31, 2006 and June 30, 2006, respectively, is comprised of the following (in thousands):

	DECEMBER 31, 2006	JUNE 30, 2006
	-----	-----
Component Parts	\$ 3,311	\$3,038
Work In Process	2,642	309
Finished Goods	4,502	3,086
	-----	-----
Total	\$10,455	\$6,433
	=====	=====

3. EARNINGS PER SHARE

Basic earnings per share ("EPS") is calculated by dividing net income by the weighted average number of common shares outstanding during the period. Other obligations, such as stock options, are considered to be potentially dilutive common shares. Diluted EPS assumes the issuance of potential dilutive common shares outstanding during the period and adjusts for any changes in income and the repurchase of common shares that would have occurred from the assumed issuance, unless such effect is anti-dilutive. Effective with the adoption of Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment, ("SFAS 123R"), the calculation of diluted shares also takes into effect the average unrecognized non-cash stock-based compensation expense and additional adjustments for tax benefits related to non-cash stock-based compensation expense.

Options to purchase 944,000 and 955,000 shares of common stock outstanding in the three months ended December 31, 2006 and 2005, respectively, were not included in the computation of diluted EPS because the effect would have been

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anti-dilutive. Options to purchase 930,000 and 1,031,000 shares of common stock outstanding in the six months ended December 31, 2006 and 2005, respectively, were not included in the computation of diluted EPS because the effect would have been anti-dilutive.

### 4. FOREIGN EXCHANGE CONTRACTS

The Company may use, from time to time, a limited hedging program to minimize the impact of foreign currency fluctuations. These transactions involve the use of forward contracts, typically mature within

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one year and are designed to hedge anticipated foreign currency transactions. The Company may use forward exchange contracts to hedge the net assets of certain of its foreign subsidiaries to offset the translation and economic exposures related to the Company's investment in these subsidiaries.

At December 31, 2006, the Company had forward exchange contracts to sell 6.0 million Euros (\$7.8 million equivalent) at a weighted average settlement rate of 1.30 Euros to the United States Dollar. The contracts outstanding at December 31, 2006, mature through June 29, 2007. The objective of the hedge transactions is to protect designated portions of the Company's net investment in its foreign subsidiary against adverse changes in the Euro/U.S. Dollar exchange rate. The Company assesses hedge effectiveness based on overall changes in fair value of the forward contract. Since the critical risks of the forward contract and the net investment coincide, there was no ineffectiveness. The accounting for the hedges is consistent with translation adjustments where any gains and losses are recorded to other comprehensive income. The Company recognized a charge of approximately \$97,000 and \$24,000 in other comprehensive income (loss) for the unrealized change in value of the forward exchange contracts during the three and six months ended December 31, 2006, respectively. Offsetting this amount in other comprehensive income (loss) was the translation effect of the Company's foreign subsidiary. Because the forward contracts were effective, there was no gain or loss recognized in earnings. The Company's forward exchange contracts do not subject it to material risk due to exchange rate movements because gains and losses on these contracts offset losses and gains on the assets, liabilities, and transactions being hedged.

At December 31, 2005, the Company had approximately \$3.6 million of forward exchange contracts between the United States Dollar and the Euro with a weighted average settlement price of 1.20 Euros to the United States Dollar. The Company recognized income of approximately \$92,000 and \$132,000 in other comprehensive income (loss) for the unrealized change in value of the forward exchange contracts during the three and six months ended December 31, 2005.

### 5. COMPREHENSIVE INCOME

Comprehensive income is defined as the change in common shareholder's equity during a period from transactions and events from non-owner sources, including net income. Other items of comprehensive income include revenues, expenses, gains and losses that are excluded from net income. Total comprehensive income for the applicable periods is as follows (in thousands):

2006	2005
-----	-----

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THREE MONTHS ENDED DECEMBER 31,		
Net Income (Loss)	\$ (864)	\$2,194
Other Comprehensive Income (Loss):		
Foreign currency translation adjustments	506	(186)
Forward contracts	(97)	92
	-----	-----
Total Comprehensive Income (Loss)	\$ (455)	\$2,100
	=====	=====

	2006	2005
	-----	-----
SIX MONTHS ENDED DECEMBER 31,		
Net Income (Loss)	\$ (1,505)	\$2,463
Other Comprehensive Income (Loss):		
Foreign currency translation adjustments	656	(257)
Forward contracts	(24)	132
	-----	-----
Total Comprehensive Income (Loss)	\$ (873)	\$2,338
	=====	=====

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### 6. CREDIT FACILITIES

The Company had no debt outstanding at December 31, 2006.

The Company has a \$7.5 million secured Credit Agreement with Comerica Bank, which expires on November 1, 2008. Proceeds under the Credit Agreement may be used for working capital and capital expenditures. The security for the loan is substantially all assets of the Company held in the United States. Borrowings are designated as a Prime-based Advance or as a Eurodollar-based Advance. Interest on Prime-based Advances is payable on the last day of each month and is calculated daily at a rate that ranges from a 1/2% below to a 1/4% above the bank's prime rate (8.25% as of December 31, 2006) dependent upon the Company's ratio of funded debt to earnings before interest, taxes, depreciation and amortization ("EBITDA"). Interest on Eurodollar-based Advances is calculated at a specific margin above the Eurodollar Rate offered at the time and for the period chosen (approximately 7.24% as of December 31, 2006) dependent upon the Company's ratio of funded debt to EBITDA and is payable on the last day of the applicable period. Quarterly, the Company pays a commitment fee on the daily unused portion of the Credit Agreement based on a percentage dependent upon the Company's ratio of funded debt to EBITDA. The Credit Agreement prohibits the Company from paying dividends. In addition, the Credit Agreement requires the Company to maintain a Tangible Net Worth, as defined in the Credit Agreement, of not less than \$36.0 million as of December 31, 2006 and to have no advances outstanding for 30 consecutive days each calendar year.

At December 31, 2006, the Company's German subsidiary (GmbH) had an unsecured credit facility totaling 500,000 Euros (equivalent to approximately \$660,000 at December 31, 2006). The facility may be used to finance working capital needs and equipment purchases or capital leases. Any borrowings for working capital needs will bear interest at 9.0% on the first 100,000 Euros of borrowings and 2.0% for borrowings over 100,000 Euros. The German credit facility is cancelable at any time by either GmbH or the bank and any amounts then outstanding would



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become immediately due and payable. At December 31, 2006, GmbH had no borrowings outstanding. At December 31, 2006, the facility supported outstanding letters of credit totaling 82,700 Euros (equivalent to approximately \$109,000).

### 7. STOCK-BASED COMPENSATION

The Company adopted SFAS 123R, effective July 1, 2005. SFAS 123R requires the recognition of the fair value of stock-based compensation in the Company's financial statements. Prior to July 1, 2005, the Company applied the requirements of APB Opinion No. 25 ("APB 25"), "Accounting for Stock Issued to Employees," and related interpretations in accounting for its stock-based plans. Under APB 25, generally no compensation expense was recognized for the Company's stock-based plans since the exercise price of granted employee stock options was greater than or equal to the market value of the underlying common stock on the date of grant.

The Company elected the modified prospective transition method for adopting SFAS 123R. Under this method, the provisions of SFAS 123R apply to all awards granted or modified after the date of adoption. The Company continues to use the Black Scholes model for determining stock option valuations. The provisions of SFAS 123R also apply to awards granted prior to July 1, 2005 that did not vest before July 1, 2005 (transition awards). The compensation cost for the portion of the transition awards that had not vested by July 1, 2005 is based on the grant-date fair value of these transition awards as calculated for pro forma disclosures under the provisions of SFAS 123. Compensation cost for these transition awards are attributed to periods beginning July 1, 2005 and use the Black Scholes method used under SFAS 123, except that an estimate of expected forfeitures is used rather than actual forfeitures.

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The Company recognized as an operating expense non-cash stock-based compensation cost in the amount of \$176,000 and \$451,000 in the three and six months ended December 31, 2006, respectively. This had the effect of decreasing net income by \$137,000, or \$0.02 per diluted share, and \$356,000, or \$0.04 per diluted share, for the three and six months ended December 31, 2006, respectively. The Company recognized as an operating expense non-cash stock-based compensation cost in the amount of \$198,000 and \$383,000 in the three and six months ended December 31, 2005, respectively. This had the effect of decreasing net income by \$161,000, or \$0.02 per diluted share, and \$311,000, or \$0.03 per diluted share, for the three and six months ended December 31, 2005, respectively. As of December 31, 2006, the total remaining unrecognized compensation cost related to non-vested stock options amounted to \$1.0 million. The Company expects to recognize this cost over a weighted average vesting period of 1.31 years.

The Company maintains a 1992 Stock Option Plan ("1992 Plan") and a 1998 Global Team Member Stock Option Plan ("1998 Plan") covering substantially all company employees and certain other key persons and a Directors Stock Option Plan ("Directors Plan") covering all non-employee directors. During fiscal 2005, shareholders approved a new 2004 Stock Incentive Plan that replaced the 1992 and Directors Stock Option Plans as to future grants. Options previously granted under the 1992 and Directors Stock Option Plans will continue to be maintained until all options are executed, cancelled or expire. The 2004, 1992 and Directors Plans are administered by a committee of the Board of Directors, the Management Development Compensation and Stock Option Committee (the "Management Development Committee"). The 1998 Plan is administered by the President of the Company.

Awards under the 2004 Stock Incentive Plan may be in the form of stock options,

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stock appreciation rights, restricted stock or restricted stock units, performance share awards, director stock purchase rights and deferred stock units; or any combination thereof. The terms of the awards will be determined by the Management Development Committee, unless specified in the 2004 Stock Incentive Plan. As of December 31, 2006, the Company has only issued awards in the form of stock options. Options outstanding under the 2004 Stock Incentive Plan and 1992 and 1998 Stock Option Plans generally become exercisable at 25% per year beginning one year after the date of grant and expire ten years after the date of grant. Options outstanding under the Directors Stock Option Plan are either an initial option or an annual option. Prior to December 7, 2004, initial options of 15,000 shares were granted as of the date the non-employee director was first elected to the Board of Directors and became exercisable in full on the first anniversary of the date of grant. Prior to December 7, 2004, annual options of 3,000 shares were granted as of the date of the respective annual meeting to each non-employee director serving at least six months prior to the annual meeting and become exercisable in three annual increments of 33 1/3% after the date of grant. Options under the Directors Stock Option Plan expire ten years from the date of grant. Option prices for options granted under these plans must not be less than fair market value of the Company's stock on the date of grant.

The Company did not grant any options during the quarter ended December 31, 2006. The estimated fair value as of the date options were granted during the periods presented, using the Black-Scholes option-pricing model, was as follows:

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	THREE MONTHS ENDED 12/31/2006 -----	THREE MONTHS ENDED 12/31/2005 -----	SIX MONTHS ENDED 12/31/2006 -----	SIX MONTHS ENDED 12/31/2005 -----
Weighted Average Estimated Fair Value Per Share Of Options Granted During The Period	--	\$ 2.23	\$ 3.03	\$ 2.23
Assumptions:				
Amortized Dividend Yield	--	--	--	--
Common Stock Price Volatility	--	30.57%	32.78%	30.57%
Risk Free Rate Of Return	--	3.88%	5.13%	3.88%
Expected Option Term (in years)	--	5	5	5

The Company received \$101,000 and \$330,000 in cash from option exercises under all share-based payment arrangements during the three and six months ended December 31, 2006, respectively.

### 8. COMMITMENTS AND CONTINGENCIES

Management is currently unaware of any significant pending litigation affecting the Company, other than the matters set forth below.

The Company is a party to a suit filed by Industries GDS, Inc., Bois Granval GDS Inc., and Centre de Preparation GDS, Inc. (collectively, "GDS") on or about November 21, 2002 in the Superior Court of the Judicial District of Quebec, Canada against the Company, Carbotech, Inc. ("Carbotech"), and U.S. Natural Resources, Inc. ("USNR"), among others. The suit alleges that the Company breached its contractual and warranty obligations as a manufacturer in

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connection with the sale and installation of three systems for trimming and edging wood products. The suit also alleges that Carbotech breached its contractual obligations in connection with the sale of equipment and the installation of two trimmer lines, of which the Company's systems were a part, and that USNR, which acquired substantially all of the assets of the Forest Products business unit from the Company, was liable for GDS' damages. USNR has sought indemnification from the Company under the terms of existing contracts between the Company and USNR. GDS seeks compensatory damages against the Company, Carbotech and USNR of approximately \$5.7 million using a December 31, 2006 exchange rate. GDS and Carbotech have filed for bankruptcy protection in Canada. The Company intends to vigorously defend GDS' claims.

The Company has been informed that certain of its customers have received allegations of possible patent infringement involving processes and methods used in the Company's products. Certain of these customers, including one customer who was a party to a patent infringement suit relating to this matter, have settled such claims. Management believes that the processes used in the Company's products were independently developed without utilizing any previously patented process or technology. Because of the uncertainty surrounding the nature of any possible infringement and the validity of any such claim or any possible customer claim for indemnity relating to claims against the Company's customers, it is not possible to estimate the ultimate effect, if any, of this matter on the Company's financial statements.

Based upon a recent review by the Company of a third party licensing agreement under which the Company licenses certain software included in its products, the Company has begun discussions with the third party licensor to resolve potential instances of non-compliance by the Company with the terms of the licensing agreement. The Company anticipates that it will incur additional royalty costs for prior periods and has recorded a reserve for the amount it believes will be required to resolve the matter. The final resolution may be different from the estimate recorded.

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The Company may, from time to time, be subject to other claims and suits in the ordinary course of its business.

To estimate whether a loss contingency should be accrued by a charge to income, the Company evaluates, among other factors, the degree of probability of an unfavorable outcome and the ability to make a reasonable estimate of the amount of the loss. Since the outcome of claims and litigation is subject to significant uncertainty, changes in these factors could materially impact the Company's financial position or results of operations.

### 9. INCOME TAXES

During the second quarter of fiscal 2006, the Company recognized a \$725,000 tax benefit associated with reversing the valuation allowance related to net operating losses in the United States. The Company continues to have a valuation allowance for tax credit carryforwards that it still expects will more likely than not expire prior to the tax benefit being realized.

During the second quarter of fiscal 2006, the Company recorded a \$290,000 tax expense related to the repatriation of \$6.3 million of unremitted earnings of certain of the Company's European subsidiaries under the provisions of The American Jobs Creation Act of 2004.

### 10. NEW ACCOUNTING PRONOUNCEMENTS

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In September 2006, the Securities and Exchange Commission issued Staff Accounting Bulletin ("SAB") No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Current Year Misstatement." This bulletin requires analysis of misstatements using both an income statement (rollover) approach and a balance sheet (iron curtain) approach in assessing materiality and provides for a one-time cumulative effect transition adjustment. This bulletin is effective for the Company's 2007 fiscal year annual financial statements. The Company is currently assessing the potential impact that the adoption of this bulletin will have on the Company's financial statements although the impact is not expected to be material.

In September 2006, the Financial Accounting Standards Board ("FASB") issued Statement of Financial Accounting Standards ("SFAS") No. 157, "Fair Value Measurements". This statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles (GAAP), and expands disclosures about fair value measurements. This statement does not require any new fair value measurements, but does provide guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. This statement is effective for fiscal years beginning after November 15, 2007. The impact of adopting this statement on the Company's financial statements has not yet been evaluated.

In June 2006, the Financial Accounting Standards Board ("FASB") issued FASB Interpretation No. 48, "Accounting for Uncertainty in Income Taxes - an interpretation of FASB Statement No. 109". This interpretation prescribes a recognition threshold and a measurement attribute for the financial statement reporting of tax positions taken in tax returns. The interpretation is effective for fiscal years beginning after December 15, 2006. The impact of adopting this statement on the Company's financial statements has not yet been evaluated.

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### ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

#### OVERVIEW

Perceptron, Inc. ("Perceptron" or the "Company") designs, develops, manufactures and markets non-contact metrology solutions for manufacturing process control as well as sensor and software technologies for non-contact measurement and inspection applications. Perceptron's product offerings are designed to improve quality, increase productivity and decrease costs in manufacturing and product development. Perceptron also produces innovative technology products for trade professionals and consumers. The solutions offered by the Company are divided into four groups: 1) The Automated Systems Group made up of AutoGauge(R), AutoFit(R), AutoScan(R), AutoSpect(R) and AutoGuide(R) products; 2) The Technology Components Group made up of ScanWorks(R), Non-Contact Wheel Alignment and TriCam(R) sensors for the forest products industry; 3) The Value Added Services Group providing consulting, training and non-warranty support services, and 4) The Commercial Products Group providing electronic inspection products for trade professionals and consumers. The Company services multiple markets, with the largest being the automotive industry. The Company's primary operations are in North America, Europe and Asia.

The Company's financial base remained strong, with no debt and approximately \$19.0 million of cash at December 31, 2006 available to support its growth plans. Near-term the Company will focus on the successful production and release of its recently announced new line of electronic inspection products and its previously announced growth strategy in untapped geographic markets, principally

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in Asia.

The Company's growth strategies in Asia are generating customer interest in this region. This region represents approximately one-third of global light vehicle production and sales and with the development of China's light vehicle market will become more important to the Company. As a result, the Company will continue to hire sales and technical personnel during fiscal 2007 to support its long term growth opportunities in Asia.

The Company's sales are principally derived from the sale of products for use in the automotive industry. New vehicle tooling programs are the most important selling opportunity for the Company's Automated Systems Group. The number and timing of new vehicle tooling programs can be influenced by economic conditions. Therefore, the Company continues to assess the global economy and its likely effect on the Company's automotive customers and markets served to determine if actions are required. The Company views the automotive industry's focus on introducing new vehicles more frequently to satisfy their customers' changing requirements, as well as their continuing focus on improved quality, as positive indicators for its automotive Automated Systems Group business. The Company is continuing its efforts to identify opportunities outside the automotive industry, principally through its Technology Components Group and Commercial Products Group.

The foregoing statements in this "Overview" section are "forward-looking statements" within the meaning of the Securities Exchange Act of 1934, as amended. See Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Safe Harbor Statement" for a discussion of a number of uncertainties which could cause actual results to differ materially from those set forth in the forward-looking statements.

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### RESULTS OF OPERATIONS

THREE MONTHS ENDED DECEMBER 31, 2006 COMPARED TO THREE MONTHS ENDED DECEMBER 31, 2005

For the second quarter of fiscal 2007, the Company reported a net loss of \$864,000, or \$0.11 per diluted share, compared to net income of \$2.2 million or \$0.24 per diluted share, for the second quarter of fiscal 2006. Specific line item results are described below.

SALES - Net sales of \$12.2 million for the second quarter of fiscal 2007 were \$5.0 million lower than the same period one year ago. The following tables set forth comparison data for the Company's net sales by product groups and geographic location.

SALES (BY GROUP) (in millions)	SECOND QUARTER 2007		SECOND QUARTER 2006		INCREASE/ (DECREASE)	
-----	-----	-----	-----	-----	-----	-----
Automated Systems	\$ 8.0	65.6%	\$13.2	76.7%	\$ (5.2)	(39.4)%
Technology Components	3.1	25.4%	3.0	17.5%	0.1	3.3%
Value Added Services	1.1	9.0%	1.0	5.8%	0.1	10.0%
	-----	-----	-----	-----	-----	-----
Totals	\$12.2	100.0%	\$17.2	100.0%	\$ (5.0)	(29.1)%
	=====	=====	=====	=====	=====	=====

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SALES (BY LOCATION) (in millions)	SECOND QUARTER 2007		SECOND QUARTER 2006		INCREASE/ (DECREASE)	
-----	-----	-----	-----	-----	-----	-----
North America	\$ 6.9	56.6%	\$12.0	69.8%	\$ (5.1)	(42.5)%
Europe	4.8	39.3%	4.9	28.5%	(0.1)	(2.0)%
Asia	0.5	4.1%	0.3	1.7%	0.2	66.7%
	-----	-----	-----	-----	-----	-----
Totals	\$12.2	100.0%	\$17.2	100.0%	\$ (5.0)	(29.1)%
	=====	=====	=====	=====	=====	=====

Automated Systems sales in the second quarter of fiscal 2007 were lower than the second quarter of fiscal 2006 primarily for AutoGauge(R) systems. AutoGauge(R) systems sales in the second quarter of fiscal 2006 were unusually high reflecting the strong backlog at the beginning of that quarter and the high rate of new orders received during that quarter. Sales of Technology Components and Value Added Services were comparable from quarter to quarter. The sales decline in the second quarter reflected customer delays in both North America and Europe, as customers in both of these regions delayed some of their tooling programs as a result of restructuring efforts and as programs were reassessed in response to demand for more fuel efficient models. Some existing orders in Europe that were expected to be shipped during the second quarter were delayed, however, the Company expects that these orders will be shipped during the remainder of the fiscal year and during the first part of fiscal 2008. The sales decrease in Europe was mitigated by the strengthening Euro that, based on conversion rates in effect this quarter, resulted in \$440,000 more in sales than the comparable rates in the second quarter of fiscal 2006 would have yielded.

BOOKINGS - The Company had new order bookings during the quarter of \$17.2 million compared with new order bookings of \$9.6 million in the first quarter of fiscal 2007 and \$18.9 million for the quarter ended December 31, 2005. The amount of new order bookings during any particular period is not necessarily indicative of the future operating performance of the Company. The following tables set forth comparison data for the Company's bookings by product groups and geographic location.

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BOOKINGS (BY GROUP) (in millions)	SECOND QUARTER 2007		SECOND QUARTER 2006		INCREASE/ (DECREASE)	
-----	-----	-----	-----	-----	-----	-----
Automated Systems	\$11.2	65.1%	\$15.5	82.0%	\$ (4.3)	(27.7)%
Technology Components	3.9	22.7%	1.9	10.1%	2.0	105.3%
Value Added Services	1.2	7.0%	1.5	7.9%	(0.3)	(20.0)%
Commercial Products	0.9	5.2%	--	--	0.9	100.0%
	-----	-----	-----	-----	-----	-----
TOTALS	\$17.2	100.0%	\$18.9	100.0%	\$ (1.7)	(9.0)%
	=====	=====	=====	=====	=====	=====

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BOOKINGS (BY LOCATION) (in millions)	SECOND QUARTER 2007		SECOND QUARTER 2006		INCREASE/ (DECREASE)	
-----	-----	-----	-----	-----	-----	-----
North America	\$ 7.1	41.3%	\$14.9	78.8%	\$ (7.8)	(52.3)%
Europe	9.2	53.5%	3.8	20.1%	5.4	142.1%
Asia	0.9	5.2%	0.2	1.1%	0.7	350.0%
	-----	-----	-----	-----	-----	-----
TOTALS	\$17.2	100.0%	\$18.9	100.0%	\$ (1.7)	(9.0)%
	=====	=====	=====	=====	=====	=====

Both Automated Systems and North American new order bookings were lower in the second quarter of fiscal 2007 compared to the same quarter of fiscal 2006 when new order bookings included several large orders for AutoGauge(R) systems to support a customer's new vehicle platform at several assembly plants in North America. New order bookings for Technology Components increased for all products compared to the second quarter of fiscal 2006. The Company received its first order of \$900,000 in the second quarter of fiscal 2007 for its new commercial product and began shipments of this product during the third quarter of fiscal 2007. North American new order bookings were also negatively impacted by customer delays as a result of customer restructuring efforts and as programs were reassessed by customers in response to demand for more fuel efficient models. European new order bookings were strong in the second quarter of fiscal 2007. Additionally, European bookings during the second quarter of fiscal 2006 reflected the generally weak state of many European economies. Historically, the Company's rate of new orders has varied from quarter to quarter. Based on the timing of current customer programs that the Company is quoting, the Company expects new automotive order bookings for the third and fourth quarters of fiscal 2007 to be comparable to the level of new automotive orders received in the second quarter of fiscal 2007. The foregoing statements are "forward-looking statements" within the meaning of the Securities Exchange Act of 1934, as amended. See Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Safe Harbor Statement" for a discussion of a number of uncertainties which could cause actual results to differ materially from those set forth in the forward-looking statements.

BACKLOG - The Company's backlog was \$22.6 million as of December 31, 2006 compared with \$17.7 million as of September 30, 2006 and \$22.0 million as of December 31, 2005. The following tables set forth comparison data for the Company's backlog by product groups and geographic location.

BACKLOG (BY GROUP) (in millions)	SECOND QUARTER 2007		SECOND QUARTER 2006		INCREASE/ (DECREASE)	
-----	-----	-----	-----	-----	-----	-----
Automated Systems	\$16.8	74.3%	\$19.1	86.8%	\$ (2.3)	(12.0)%
Technology Components	2.7	12.0%	1.2	5.5%	1.5	125.0%
Value Added Services	2.2	9.7%	1.7	7.7%	0.5	29.4%
Commercial Products	0.9	4.0%	--	--	0.9	100.0%
	-----	-----	-----	-----	-----	-----
TOTALS	\$22.6	100.0%	\$22.0	100.0%	\$ 0.6	2.7%
	=====	=====	=====	=====	=====	=====

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BACKLOG (BY LOCATION) (in millions)	SECOND QUARTER 2007		SECOND QUARTER 2006		INCREASE/ (DECREASE)	
-----	-----	-----	-----	-----	-----	-----
North America	\$10.1	44.7%	\$15.6	70.9%	\$ (5.5)	(35.3)%
Europe	11.9	52.6%	6.2	28.1%	5.7	91.9%
Asia	0.6	2.7%	0.2	1.0%	0.4	200.0%
	-----	-----	-----	-----	-----	-----
TOTALS	\$22.6	100.0%	\$22.0	100.0%	\$ 0.6	2.7%
	=====	=====	=====	=====	=====	=====

The Company expects to be able to fill substantially all of the orders in backlog during the next twelve months. The level of backlog during any particular period is not necessarily indicative of the future operating performance of the Company. Most of the backlog is subject to cancellation by the customer.

GROSS PROFIT - Gross profit was \$4.5 million, or 37.2% of sales, in the second quarter of fiscal year 2007, as compared to \$8.3 million, or 48.3% of sales, in the second quarter of fiscal year 2006. The gross profit margin reduction was primarily due to under absorbed fixed installation labor and manufacturing cost as a percent of sales at the relatively low level of sales for the second quarter of fiscal 2007. The reduction was mitigated in part by the benefit from the strengthening Euro exchange rate this quarter and a favorable product mix compared with the second quarter of fiscal 2006.

SELLING, GENERAL AND ADMINISTRATIVE (SG&A) EXPENSES - SG&A expenses were \$4.2 million in the quarter ended December 31, 2006 compared to \$3.7 million in the second quarter a year ago. SG&A expenses were higher primarily due to salary and benefit increases, recruiting and relocation costs and travel of approximately \$470,000. These increases primarily related to the Company's new sales growth opportunities in Asia and to support the new commercial products business initiatives. The increase was also due to higher costs for various expenses including the unfavorable effect of the strengthening Euro on expenses that were partially offset by lower Michigan Single Business Taxes and commission expense.

ENGINEERING, RESEARCH AND DEVELOPMENT (R&D) EXPENSES - Engineering and R&D expenses were \$1.9 million in both quarters ended December 31, 2006 and 2005 as salary and benefit increases were offset by decreased spending on engineering materials.

INTEREST INCOME, NET - Net interest income was \$265,000 in the second quarter of fiscal 2007 compared with net interest income of \$104,000 in the second quarter of fiscal 2006. The increase was primarily due to higher interest rates on cash invested in short term securities compared to one year ago. Additionally, the second quarter of fiscal 2006 had interest expense of approximately \$53,000 on additional taxes related to a tax audit in Germany for fiscal years 2001 through 2003.

FOREIGN CURRENCY - There was a net foreign currency transaction loss of \$16,000 this quarter compared to a net foreign currency loss of \$126,000 last year due to foreign currency changes, particularly the Euro and Yen, within the respective quarters.

OTHER - Other income of \$162,000 in the second quarter of fiscal 2006 primarily reflected the value of stock received by the Company when a mutual life insurance company was demutualized.



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INCOME TAXES - The effective tax rate for the second quarter of fiscal 2007 was 33.3% and reflected the effect of the mix of operating profit and loss among the Company's various operating entities and their countries' respective tax rates. The second quarter of fiscal 2006 included the recognition of a \$725,000 tax benefit associated with reversing a valuation allowance related to net operating losses in North America that the Company determined would be utilized, and a \$290,000 tax expense related to the repatriation of \$6.3 million of unremitted earnings of certain of the Company's European subsidiaries

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under the provisions of the American Jobs Creation Act of 2004. The effective tax rate excluding these two items was 39.3% for the second quarter of fiscal 2006.

OUTLOOK - The Company expects total revenues for fiscal year 2007, including anticipated sales of the Company's new commercial product, to be at least comparable to fiscal year 2006. Any revenue increase for fiscal 2007 over fiscal 2006 will depend on how rapidly sales increase for the new commercial product over anticipated levels. As customers in North America firm up their plans with respect to new vehicle models, the Company expects a higher rate of new orders in North America for the second half of fiscal 2007 but does not expect new orders in Europe to continue at the level achieved in the second quarter of fiscal 2007. As a result, based on business currently being quoted, the Company expects new automotive order bookings for the third and fourth quarter of fiscal 2007 to be comparable to the level of new orders received in the second quarter of fiscal 2007. To fuel long-term growth, the Company intends to continue to make investments in Asia and to support its new commercial products. See Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Safe Harbor Statement" for a discussion of the uncertainties regarding the expansion into new markets and the development and introduction of new products.

The Company's new order bookings and sales forecast for its products sold to the automotive industry is based on a thorough assessment of the probable size, system content, and timing of each of the programs being considered by its automotive customers. These factors are difficult to quantify accurately because over time the Company's customers weigh changes in the economy and the probable effect of these changes on their business, and on occasion adjust the number and timing of their new vehicle programs to reflect changing business conditions. The Company continues to view the automotive industry's focus on introducing new vehicles more frequently to satisfy their customers' changing requirements, as well as their continuing focus on improved quality, as positive indicators for new business. The Company's new order bookings and sales forecast relating to its new electronic inspection products is based upon preliminary customer and internal forecasts. The actual level of orders will depend on the market reaction after the product is introduced.

The foregoing statements in this "Outlook" section are "forward-looking statements" within the meaning of the Securities Exchange Act of 1934, as amended. See Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Safe Harbor Statement" for a discussion of a number of uncertainties which could cause actual results to differ materially from those set forth in the forward-looking statements.

SIX MONTHS ENDED DECEMBER 31, 2006 COMPARED TO SIX MONTHS ENDED DECEMBER 31,  
2005

The Company reported a net loss of \$1.5 million, or \$0.18 per diluted share, for

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the first half of fiscal 2007, compared with net income of \$2.5 million, or \$0.27 per diluted share for the six months ended December 31, 2005.

SALES - Net sales in the first six months of fiscal 2007 were \$22.9 million, compared to \$29.9 million for the six months ended December 31, 2005. The following tables set forth comparison data for the Company's net sales by product groups and geographic location.

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SALES (BY GROUP) (in millions)	SIX MONTHS ENDED 12/31/06		SIX MONTHS ENDED 12/31/05		INCREASE/ (DECREASE)	
Automated Systems	\$14.7	64.2%	\$22.3	74.6%	\$ (7.6)	(34.1)%
Technology Components	6.0	26.2%	5.9	19.7%	0.1	1.7%
Value Added Services	2.2	9.6%	1.7	5.7%	0.5	29.4%
Totals	\$22.9	100.0%	\$29.9	100.0%	\$ (7.0)	(23.4)%

SALES (BY LOCATION) (in millions)	SIX MONTHS ENDED 12/31/06		SIX MONTHS ENDED 12/31/05		INCREASE/ (DECREASE)	
North America	\$11.4	49.8%	\$18.3	61.2%	\$ (6.9)	(37.7)%
Europe	10.4	45.4%	10.8	36.1%	(0.4)	(3.7)%
Asia	1.1	4.8%	0.8	2.7%	0.3	37.5%
Totals	\$22.9	100.0%	\$29.9	100.0%	\$ (7.0)	(23.4)%

Sales of Automated Systems products during the first half of fiscal 2007 reflected changes in original delivery schedules made by the Company's customers that both accelerated delivery of several orders into the fourth quarter of fiscal 2006 and delayed delivery of orders originally scheduled to ship during the second quarter of fiscal 2007. The sales increase in the Technology Components Group was primarily due to higher sales of the Company's ScanWorks(R) products. Sales of other products within the Technology Components Group were down compared to last year due to lower customer demand. The Company has focused resources on the sale of Value Added Services and believes that the sales improvement for this group is beginning to reflect the results from this effort. The sales decline in the first half of fiscal 2007 reflected customer delays in both North America and Europe, as customers in both of these regions delayed some of their tooling programs as a result of restructuring efforts and as programs were reassessed in response to demand for more fuel efficient models. Some existing orders in Europe that were expected to be shipped during the second quarter were delayed, however, the Company expects that these orders will be shipped during the remainder of the fiscal year and during the first part of fiscal 2008. The sales decrease in Europe was mitigated by a favorable strengthening of the Euro during the first half of fiscal 2007 that based on conversion rates in effect during the six-month period, resulted in approximately \$710,000 of higher sales than rates in effect in the corresponding

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period of fiscal 2006 would have yielded.

BOOKINGS - New order bookings for the six months ended December 31, 2006 were \$26.7 million compared to \$33.9 million for the same period one year ago. The amount of new order bookings during any particular period is not necessarily indicative of the future operating performance of the Company. The following tables set forth comparison data for the Company's bookings by product groups and geographic location.

BOOKINGS (BY GROUP) (in millions)	SIX MONTHS ENDED 12/31/06		SIX MONTHS ENDED 12/31/05		INCREASE/ (DECREASE)	
-----	-----	-----	-----	-----	-----	-----
Automated Systems	\$16.3	61.1%	\$27.1	80.0%	\$ (10.8)	(39.9)%
Technology Components	6.9	25.8%	4.5	13.3%	2.4	53.3%
Value Added Services	2.6	9.7%	2.3	6.7%	0.3	13.0%
Commercial Products	0.9	3.4%	--	--	0.9	100.0%
	-----	-----	-----	-----	-----	-----
TOTALS	\$26.7	100.0%	\$33.9	100.0%	\$ (7.2)	(21.2)%
	=====	=====	=====	=====	=====	=====

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BOOKINGS (BY LOCATION) (in millions)	SIX MONTHS ENDED 12/31/06		SIX MONTHS ENDED 12/31/05		INCREASE/ (DECREASE)	
-----	-----	-----	-----	-----	-----	-----
North America	\$13.3	49.8%	\$24.9	73.4%	\$ (11.6)	(46.6)%
Europe	11.9	44.6%	8.4	24.8%	3.5	41.7%
Asia	1.5	5.6%	0.6	1.8%	0.9	150.0%
	-----	-----	-----	-----	-----	-----
TOTALS	\$26.7	100.0%	\$33.9	100.0%	\$ (7.2)	(21.2)%
	=====	=====	=====	=====	=====	=====

The decrease in new order bookings for both the Automated Systems Group and North America in the first half of fiscal 2007 was primarily due to the significant level of AutoGauge(R) systems booked in the first half of fiscal 2006, principally as a result of several large orders to support a customer's new vehicle platform at several assembly plants in North America. Increased new order bookings in the Technology Components Group during the first half of fiscal 2007 primarily represented increased bookings of WheelWorks(R) and ScanWorks(R) products. The Company received its first order of \$900,000 in fiscal 2007 for its new commercial product and began shipments of this product during the third quarter of fiscal 2007. North American new order bookings were also negatively impacted by customer delays as a result of customer restructuring efforts and as programs were reassessed by customers in response to demand for more fuel efficient models. Increased new order bookings in Europe in the six-month period ended December 31, 2006, reflected strong orders received in the second quarter of fiscal 2007 and the generally weak state of many European economies in the 2006 period. Historically, the Company's rate of new orders has varied from quarter to quarter. Based on the timing of current customer programs that the Company is quoting, the Company expects new automotive order bookings for the third and fourth quarters of fiscal 2007 to be

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comparable to the level of new automotive orders received in the second quarter of fiscal 2007. The foregoing statements are "forward-looking statements" within the meaning of the Securities Exchange Act of 1934, as amended. See Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Safe Harbor Statement" for a discussion of a number of uncertainties which could cause actual results to differ materially from those set forth in the forward-looking statements.

**GROSS PROFIT** - Gross profit was \$9.0 million, or 39.4% of sales, in the first half of fiscal year 2007, as compared to \$13.9 million, or 46.4% of sales, in the first half of fiscal year 2006. The gross profit margin reduction was primarily due to higher installation labor and manufacturing costs as a percent of sales at the lower level of sales for the first half of fiscal 2007 and included a reserve for royalty costs, see note 8 to the Consolidated Financial Statements, "Commitments and Contingencies". The reduction was mitigated by the benefit from the strengthening Euro exchange rate this period and a favorable product mix compared with the first half of fiscal 2006.

**SELLING, GENERAL AND ADMINISTRATIVE (SG&A) EXPENSES** - SG&A expenses were \$8.1 million in the first half of fiscal 2007 compared to \$6.9 million in the same period one year ago. SG&A expenses were higher primarily due to salary and benefit increases, recruiting and relocation costs and travel of approximately \$660,000. These increases primarily related to the Company's new sales growth opportunities in Asia and to support the new commercial products business initiatives. The increase was also due to higher costs for various expenses including the unfavorable effect of the strengthening Euro on expenses and legal and auditing fees that were partially offset by lower commission expense and Michigan Single Business taxes.

**ENGINEERING, RESEARCH AND DEVELOPMENT (R&D) EXPENSES** - Engineering and R&D expenses were \$3.6 million for the six months ended December 31, 2006 compared to \$3.8 million for the six-month period a year ago. The decrease was principally due to lower expenses related to engineering materials and contract services and offset increases in salary and benefits.

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**INTEREST INCOME, NET** - Net interest income was \$579,000 in the first half of fiscal 2007 compared with net interest income of \$251,000 in the first half of fiscal 2006. The increase was due to higher interest rates compared to one year ago and also reflected in the six-month period of fiscal 2006 interest expense of approximately \$53,000 on additional taxes related to a tax audit in Germany covering fiscal years 2001 through 2003.

**FOREIGN CURRENCY** - There was a net foreign currency loss of \$21,000 in the first half of fiscal 2007 compared with a net loss of \$77,000 a year ago and represents foreign currency changes, particularly the Euro and Yen, within the respective periods.

**OTHER** - Other income in the first half of fiscal 2006 of \$161,000 primarily reflected the value of stock received by the Company when a mutual life insurance company was demutualized.

**INCOME TAXES** - The effective tax rates for the six months ended December 31, 2006 of 28.8% primarily reflected the effect of the mix of operating profit and loss among the Company's various operating entities and their countries' respective tax rates. Tax rates are higher in Europe than in the United States. Income tax expense in the first half of fiscal 2006 included the recognition of a \$725,000 tax benefit associated with reversing a valuation allowance related

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to net operating losses in North America that the Company now believes will be utilized, and a \$290,000 tax expense related to the repatriation of \$6.3 million of unremitted earnings of certain of the Company's European subsidiaries under the provisions of the American Jobs Creation Act of 2004. The effective tax rate excluding these two items was 42.3% for the first half of fiscal 2006.

### LIQUIDITY AND CAPITAL RESOURCES

The Company's cash and cash equivalents were \$19.0 million at December 31, 2006, compared to \$25.2 million at June 30, 2006. The cash decrease of \$6.1 million for the six months ended December 31, 2006 resulted primarily from \$3.7 million used to repurchase shares of the Company's common stock and \$2.4 million used for operations. The Company also used \$791,000 for capital expenditures and received \$487,000 from the Company's stock plans. Depreciation and amortization was \$685,000 during the six months ended December 31, 2006.

The \$2.4 million used for operations was primarily related to \$4.0 million of inventory purchases and \$690,000 reflecting the net loss including the add back of non-cash items such as depreciation and non-cash stock based compensation expense that were partially offset by collections on receivables of \$2.6 million. The increase in inventory of \$4.0 million was primarily to support the initial production of the new commercial product, purchases of long lead time items to fulfill existing and anticipated orders and finished goods inventory related to shipments that were delayed by our customers and not shipped during the second quarter of fiscal 2007. The \$2.6 million decrease in receivables reflected cash collections and the lower level of sales achieved in the first half of fiscal 2007.

The Company provides a reserve for obsolescence to recognize the effects of engineering change orders, age and use of inventory that affect the value of the inventory. A detailed review of the inventory is performed yearly with quarterly updates for known changes that have occurred since the annual review. When inventory is deemed to have no further use or value, the Company disposes of the inventory and the reserve for obsolescence is reduced. During fiscal 2007, the Company's German subsidiary made a change to separate its reserve for obsolescence from its inventory value to reflect the methodology used by the rest of the Company. As a result, the inventory of the German subsidiary is reported at a gross value and the reserve for obsolescence increased by \$273,000, which had no effect on net income. Also during the first half of fiscal 2007, the Company disposed of \$2,000 of inventory that had previously been reserved for at June 30, 2006.

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The Company determines its allowance for doubtful accounts by considering a number of factors, including the length of time trade accounts receivable are past due, the Company's previous loss history, the customer's current ability to pay its obligation to the Company, and the condition of the general economy and the industry as a whole. The Company writes-off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance for doubtful accounts. The Company increased its allowance for doubtful accounts by \$49,000 and wrote off \$14,000 of receivables during the first half of fiscal 2007.

The Company had no debt outstanding at December 31, 2006.

The Company has a \$7.5 million secured Credit Agreement with Comerica Bank, which expires on November 1, 2008. Proceeds under the Credit Agreement may be used for working capital and capital expenditures. The security for the loan is

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substantially all assets of the Company held in the United States. Borrowings are designated as a Prime-based Advance or as a Eurodollar-based Advance. Interest on Prime-based Advances is payable on the last day of each month and is calculated daily at a rate that ranges from a 1/2% below to a 1/4% above the bank's prime rate (8.25% as of December 31, 2006) dependent upon the Company's ratio of funded debt to earnings before interest, taxes, depreciation and amortization ("EBITDA"). Interest on Eurodollar-based Advances is calculated at a specific margin above the Eurodollar Rate offered at the time and for the period chosen (approximately 7.24% as of December 31, 2006) dependent upon the Company's ratio of funded debt to EBITDA and is payable on the last day of the applicable period. Quarterly, the Company pays a commitment fee on the daily unused portion of the Credit Agreement based on a percentage dependent upon the Company's ratio of funded debt to EBITDA. The Credit Agreement prohibits the Company from paying dividends. In addition, the Credit Agreement requires the Company to maintain a Tangible Net Worth, as defined in the Credit Agreement, of not less than \$36.0 million as of December 31, 2006 and to have no advances outstanding for 30 consecutive days each calendar year.

At December 31, 2006, the Company's German subsidiary (GmbH) had an unsecured credit facility totaling 500,000 Euros (equivalent to approximately \$660,000 at December 31, 2006). The facility may be used to finance working capital needs and equipment purchases or capital leases. Any borrowings for working capital needs will bear interest at 9.0% on the first 100,000 Euros of borrowings and 2.0% for borrowings over 100,000 Euros. The German credit facility is cancelable at any time by either GmbH or the bank and any amounts then outstanding would become immediately due and payable. At December 31, 2006, GmbH had no borrowings outstanding. At December 31, 2006, the facility supported outstanding letters of credit totaling 82,700 Euros (equivalent to approximately \$109,000).

On August 7, 2006, the Company's Board of Directors ("Board") approved a stock repurchase program authorizing the Company to repurchase up to \$3.0 million of the Company's Common Stock through August 2007. On November 13, 2006, the Board approved a \$2.0 million increase to the stock repurchase program bringing the total repurchase authority to \$5.0 million through August 2007. The Company may buy shares of its Common Stock on the open market or in privately negotiated transactions from time to time, based on market prices. The program may be discontinued at any time. The Company also announced that it had entered into a Rule 10b5-1 trading plan ("Repurchase Plan") with Barrington Research Associates, Inc. to purchase up to \$5.0 million of the Company's Common Stock through August 2007 (less the dollar amount of purchases by the Company outside the Repurchase Plan), in open market or privately negotiated transactions, in accordance with the requirements of Rule 10b-18. See Part II Item 2 "Unregistered Sales of Equity Securities and Use of Proceeds" for a discussion of the Repurchase Plan.

See Note 8 to the Consolidated Financial Statements, "Commitments and Contingencies", contained in this Quarterly Report on Form 10-Q, Item 3, "Legal Proceedings" and Note 6 to the Consolidated

Financial Statements, "Contingencies", of the Company's Annual Report on Form 10-K for fiscal year 2006, for a discussion of certain contingencies relating to the Company's liquidity, financial position and results of operations. See also, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies - Litigation and Other Contingencies" of the Company's Annual Report on Form 10-K for fiscal year 2006.

The Company expects to spend approximately \$1.5 million during fiscal year 2007

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for capital equipment, although there is no binding commitment to do so.

Based upon the Company's current business plan, the Company believes that available cash on hand and existing credit facilities will be sufficient to fund its currently anticipated fiscal 2007 cash flow requirements and its cash flow requirements for at least the next few years, except to the extent that the Company implements new business development opportunities, which would be financed as discussed below. The Company does not believe that inflation has significantly impacted historical operations and does not expect any significant near-term inflationary impact. The foregoing statements are "forward-looking statements" within the meaning of the Securities Exchange Act of 1934, as amended. See Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Safe Harbor Statement" for a discussion of a number of uncertainties which could cause actual results to differ materially from those set forth in the forward-looking statements.

The Company will consider evaluating business opportunities that fit its strategic plans. There can be no assurance that the Company will identify any opportunities that fit its strategic plans or will be able to enter into agreements with identified business opportunities on terms acceptable to the Company. The Company intends to finance any such business opportunities from available cash on hand, existing credit facilities, issuance of additional shares of its stock or additional sources of financing, as circumstances warrant.

### CRITICAL ACCOUNTING POLICIES

A summary of critical accounting policies is presented in Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations - Critical Accounting Policies" of the Company's Annual Report on Form 10-K for fiscal year 2006.

### MARKET RISK INFORMATION

The Company's primary market risk is related to foreign exchange rates. The foreign exchange risk is derived from the operations of its international subsidiaries, which are primarily located in Germany and for which products are produced in the United States. The Company may from time to time have interest rate risk in connection with its investment of its cash.

### FOREIGN CURRENCY RISK

The Company has foreign currency exchange risk in its international operations arising from the time period between sales commitment and delivery for contracts in non-United States currencies. For sales commitments entered into in the non-United States currencies, the currency rate risk exposure is predominantly less than one year with the majority in the 120 to 150 day range. At December 31, 2006, the Company's percentage of sales commitments in non-United States currencies was approximately 58.9% or \$13.3 million, compared to 31.1% or \$6.8 million at December 31, 2005.

The Company may use, from time to time, a limited hedging program to minimize the impact of foreign currency fluctuations. These transactions involve the use of forward contracts, typically mature within

one year and are designed to hedge anticipated foreign currency transactions. The Company may use forward exchange contracts to hedge the net assets of

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certain of its foreign subsidiaries to offset the translation and economic exposures related to the Company's investment in these subsidiaries.

At December 31, 2006, the Company had forward exchange contracts to sell 6.0 million Euros (\$7.8 million equivalent) at a weighted average settlement rate of 1.30 Euros to the United States Dollar. The contracts outstanding at December 31, 2006, mature through June 29, 2007. The objective of the hedge transactions is to protect designated portions of the Company's net investment in its foreign subsidiary against adverse changes in the Euro/U.S. Dollar exchange rate. The Company assesses hedge effectiveness based on overall changes in fair value of the forward contract. Since the critical risks of the forward contract and the net investment coincide, there was no ineffectiveness. The accounting for the hedges is consistent with translation adjustments where any gains and losses are recorded to other comprehensive income. The Company recognized a charge of approximately \$97,000 and \$24,000 in other comprehensive income (loss) for the unrealized change in value of the forward exchange contracts during the three and six months ended December 31, 2006, respectively. Offsetting this amount in other comprehensive income (loss) was the translation effect of the Company's foreign subsidiary. Because the forward contracts were effective, there was no gain or loss recognized in earnings. The Company's forward exchange contracts do not subject it to material risk due to exchange rate movements because gains and losses on these contracts offset losses and gains on the assets, liabilities, and transactions being hedged.

At December 31, 2005, the Company had \$3.6 million of forward exchange contracts between the United States Dollar and the Euro with a weighted average settlement price of 1.20 Euros to the United States Dollar. The Company recognized income of approximately \$92,000 and \$132,000 in other comprehensive income (loss) for the unrealized change in value of the forward exchange contracts during the three and six months ended December 31, 2005.

The Company's potential loss in earnings that would have resulted from a hypothetical 10% adverse change in quoted foreign currency exchange rates related to the translation of foreign denominated revenues and expenses into U.S. dollars for the three and six months ended December 31, 2006 would have been approximately \$51,000 and \$69,000, respectively. The potential loss in earnings for the comparable periods in fiscal 2006 would have been approximately \$12,000 and \$73,000, respectively.

### INTEREST RATE RISK

The Company invests its cash and cash equivalents in high quality, short-term investments with primarily a term of three months or less. Given the short maturities and investment grade quality of the Company's investment holdings at December 31, 2006, a 100 basis point rise in interest rates would not be expected to have a material adverse impact on the fair value of the Company's cash and cash equivalents. As a result, the Company does not currently hedge these interest rate exposures.

### NEW ACCOUNTING PRONOUNCEMENTS

For a discussion of new accounting pronouncements, see Note 10 to the Consolidated Financial Statements, "New Accounting Pronouncements".

### SAFE HARBOR STATEMENT

We make statements in this Management's Discussion and Analysis of Financial Condition and Results of Operations that may be "forward-looking statements" within the meaning of the Securities Exchange Act of 1934, including the Company's expectation as to fiscal 2007 and future new order bookings,



revenue, expenses, net income and backlog levels, trends affecting its future revenue levels, the rate of new orders, the timing of revenue and net income increases from new products which we have recently released or have not yet released and from our plans to make important new investments, largely for personnel, for newly introduced products and geographic growth opportunities in the U.S., Europe, Eastern Europe, Asia, our ability to fund our fiscal year 2007 cash flow requirements and customers' current and future interest in our Value Added Services. We may also make forward-looking statements in our press releases or other public or shareholder communications. When we use words such as "will," "should," "believes," "expects," "anticipates," "estimates" or similar expressions, we are making forward-looking statements. We claim the protection of the safe harbor for forward-looking statements contained in the Private Securities Litigation Reform Act of 1995 for all of our forward-looking statements. While we believe that our forward-looking statements are reasonable, you should not place undue reliance on any such forward-looking statements, which speak only as of the date made. Because these forward-looking statements are based on estimates and assumptions that are subject to significant business, economic and competitive uncertainties, many of which are beyond our control or are subject to change, actual results could be materially different. Factors that might cause such a difference include, without limitation, the risks and uncertainties discussed from time to time in our reports filed with the Securities and Exchange Commission, including those listed in "Item 1A - Risk Factors" of the Company's Annual Report on Form 10-K for fiscal year 2006. Other factors not currently anticipated by management may also materially and adversely affect our financial condition, liquidity or results of operations, as well as the following: the dependence of the Company's revenue on a number of sizable orders from a small number of customers concentrated in the Automotive industry, particularly in the United States and Europe, the dependence of the Company's net income levels on increasing revenues, continued pricing pressures from the Company's customers, the timing of orders and shipments which can cause the Company to experience significant fluctuations in its quarterly and annual revenue, order bookings, backlog and operating results, timely receipt of required supplies and components which could result in delays in anticipated shipments, continued access to third party components for our ScanWorks(R) systems, the ability of the Company to successfully compete with alternative and similar technologies, the timing, number and continuation of the Automotive industry's retooling programs, including the risk that the Company's customers postpone new tooling programs as a result of economic conditions or otherwise, the ability of the Company to develop and introduce new products, the ability of the Company to expand into new markets in Eastern Europe and Asia, the ability of the Company to attract and retain key personnel, especially technical personnel, the quality and cost of competitive products already in existence or developed in the future, rapid or unexpected technological changes, the ability of the Company to identify and satisfy demand for the Company's Value Added Services, the ability of the Company to identify business opportunities that fit the Company's strategic plans, the ability to implement identified business opportunities on terms acceptable to the Company and the effect of economic conditions, particularly economic conditions in the domestic and worldwide Automotive industry, which has from time to time been subject to cyclical downturns due to the level of demand for, or supply of, the products produced by companies in this industry. The ability of the Company to develop and introduce new products, especially in markets outside of automotive, is subject to a number of uncertainties, including general product demand and market acceptance risks, the ability of the Company to resolve technical issues inherent in the development of new products and technologies, the ability of the Company to identify and satisfy market needs, the ability of the Company to identify satisfactory distribution networks, the ability of the Company to develop internally or identify externally high quality cost effective manufacturing

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capabilities for the products, general product development and commercialization difficulties, and the level of interest existing and potential new customers may have in new products and technologies generally. The ability of the Company to expand into new geographic markets is subject to a number of uncertainties, including the timing of customer acceptance of the Company's products and technologies, the impact of changes in local economic conditions, the ability of the Company to attract the appropriate personnel to effectively represent, install and service the Company's products in the market and uncertainties inherent in doing business in foreign markets, especially those that are less well developed than the Company's

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traditional markets, such as the impact of fluctuations in foreign currency exchange rates, foreign government controls, policies and laws affecting foreign trade and investment, differences in the level of protection available for the Company's intellectual property and differences in language and local business and social customs. The ability of the Company to identify and satisfy demand for the Company's Value Added Services is subject to a number of uncertainties including that these services represent discretionary spending by customers and so tend to decline during economic downturns even if product sales do not decline. Except as required by applicable law, we do not undertake, and expressly disclaim, any obligation to publicly update or alter our statements whether as a result of new information, events or circumstances occurring after the date of this report or otherwise. The Company's expectations regarding future bookings and revenues are projections developed by the Company based upon information from a number of sources, including, but not limited to, customer data and discussions. These projections are subject to change based upon a wide variety of factors, a number of which are discussed above. Certain of these new orders have been delayed in the past and could be delayed in the future. Because the Company's products are typically integrated into larger systems or lines, the timing of new orders is dependent on the timing of completion of the overall system or line. In addition, because the Company's products have shorter lead times than other components and are required later in the process, orders for the Company's products tend to be given later in the integration process. A significant portion of the Company's projected revenues and net income depends upon the Company's ability to successfully develop and introduce new products and expand into new geographic markets. Because a significant portion of the Company's revenues are denominated in foreign currencies and are translated for financial reporting purposes into U.S. Dollars, the level of the Company's reported net sales, operating profits and net income are affected by changes in currency exchange rates, principally between U.S. Dollars and Euros. Currency exchange rates are subject to significant fluctuations, due to a number of factors beyond the control of the Company, including general economic conditions in the United States and other countries. Because the Company's expectations regarding future revenues, order bookings, backlog and operating results are based upon assumptions as to the levels of such currency exchange rates, actual results could differ materially from the Company's expectations.

### ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Information required pursuant to this item is incorporated by reference herein from Item 2 "Management's Discussion and Analysis of Financial Condition and Results of Operations - Market Risk Information".

### ITEM 4. CONTROLS AND PROCEDURES

The Company carried out an evaluation, under the supervision and with the participation of the Company's management, including its Chief Executive Officer

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and Acting Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-15 of the Securities Exchange Act of 1934. Based upon that evaluation, the Company's Chief Executive Officer and Acting Chief Financial Officer concluded that, as of December 31, 2006, the Company's disclosure controls and procedures were effective in causing the material information required to be disclosed by the Company in the reports that it files or submits under the Securities Exchange Act of 1934 to be recorded, processed, summarized and reported, to the extent applicable, within the time periods required for the Company to meet the Securities and Exchange Commission's ("SEC") filing deadlines for these reports specified in the SEC's rules and forms. There have been no significant changes in the Company's internal controls over financial reporting during the quarter ended December 31, 2006 identified in connection with the Company's evaluation that has materially affected, or is reasonably likely to materially affect, the Company's internal controls over financial reporting.

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### PART II. OTHER INFORMATION

#### ITEM 1A. RISK FACTORS

No material changes were made to the risk factors listed in "Item 1A - Risk Factors" of the Company's Annual Report on Form 10-K for fiscal year 2006.

#### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

The following table sets forth information concerning the Company's repurchases of its common stock during the quarter ended December 31, 2006. All shares were purchased pursuant to the Company's stock repurchase program described below.

PERIOD	(A) TOTAL NUMBER OF SHARES PURCHASED	(B) AVERAGE PRICE PAID PER SHARE	(C) TOTAL NUMBER OF SHARES PURCHASED AS PART OF PUBLICLY ANNOUNCED PROGRAM	(D) APPROXIMATE DOLLAR VALUE OF SHARES THAT MAY YET BE PURCHASED UNDER THE PROGRAM
-----	-----	-----	-----	-----
October 1-31, 2006	124,900	\$8.25	124,900	\$3,204,486
November 1-30, 2006	95,200	\$8.23	95,200	\$2,421,008
December 1-31, 2006	111,900	\$8.39	111,900	\$1,482,477
	-----		-----	
Total	332,000	\$8.29	332,000	\$1,482,477
	=====		=====	

On August 7, 2006, the Company's Board of Directors ("Board") approved a stock repurchase program authorizing the Company to repurchase up to \$3.0 million of the Company's Common Stock through August 2007. On November 13, 2006, the Board approved a \$2.0 million increase to the stock repurchase program bringing the total repurchase authority to \$5.0 million through August 2007. The Company may buy shares of its Common Stock on the open market or in privately negotiated transactions from time to time, based on market prices. The program may be discontinued at any time. The Company also announced that it had entered into a Rule 10b5-1 trading plan ("Repurchase Plan") with Barrington Research Associates, Inc. to purchase up to \$5.0 million of the Company's Common Stock through August 2007 (less the dollar amount of purchases by the Company outside the Repurchase Plan), in open market or privately negotiated transactions, in

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accordance with the requirements of Rule 10b-18.

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### ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

The Company held its Annual Meeting of Shareholders on November 13, 2006 at which the following action was taken:

1. The Shareholders elected the following persons as the Company's Board of Directors, and the results of the vote on this matter were as follows:

Name	For	Withheld	Broker Non-Votes
----	-----	-----	-----
David J. Beattie	7,424,412	82,130	--
Kenneth R. Dabrowski	7,446,936	59,605	--
Philip J. DeCocco	7,397,462	109,080	--
W. Richard Marz	7,424,436	82,105	--
Robert S. Oswald	7,430,976	75,565	--
Alfred A. Pease	7,433,092	73,450	--
James A. Ratigan	7,405,070	101,472	--
Terryll R. Smith	7,431,792	74,750	--

### ITEM 6. EXHIBITS

- 4.12 Seventh Amendment to Credit Agreement dated October 24, 2002, between Perceptron, Inc. and Comerica Bank is incorporated by reference to Exhibit 10.1 of the Company's Report on Form 8-K filed on December 21, 2006.
- 10.44 Summary of 2007 Team Member Profit Sharing Plan is incorporated by reference to Exhibit 10.1 of the Company's Report on Form 8-K filed on November 17, 2006.
- 31.1 Certification by the Chief Executive Officer of the Company pursuant to Rule 13a-14(a) and Rule 15d-14(a).
- 31.2 Certification by the Acting Chief Financial Officer of the Company pursuant to Rule 13a-14(a) and Rule 15d-14(a).
- 32.1 Certification by the Chief Executive Officer of the Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2 Certification by the Acting Chief Financial Officer of the Company pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

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## SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

PERCEPTRON, INC.  
(Registrant)

Date: February 13, 2007

By: /S/ Alfred A. Pease

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Alfred A. Pease  
Chairman of the Board, President and  
Chief Executive Officer

Date: February 13, 2007

By: /S/ Sylvia M. Smith

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Sylvia M. Smith  
Acting Chief Financial Officer,  
Controller and Chief Accounting  
Officer  
(Principal Financial Officer)  
(Principal Accounting Officer)

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## Exhibit Index

Exhibit No. -----	Description -----
4.12	Seventh Amendment to Credit Agreement dated October 24, 2002, between Perceptron, Inc. and Comerica Bank is incorporated by reference to Exhibit 10.1 of the Company's Report on Form 8-K filed on December 21, 2006.
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