

ASTEC INDUSTRIES INC  
Form 10-Q  
November 09, 2006

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2006.

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 0-14714

Astec Industries, Inc.

(Exact name of registrant as specified in its charter)

Tennessee

62-0873631

(State or other jurisdiction of  
incorporation or organization)

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

1725 Shepherd Road, Chattanooga, Tennessee

37421

(Address of principal executive offices)

(Zip Code)

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(423) 899-5898

(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

YES NO

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act. (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

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

Class	Outstanding at October 30, 2006
<b>Common Stock, par value \$0.20</b>	<b>21,644,920</b>

ASTEC INDUSTRIES, INC.

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PART I -- FINANCIAL INFORMATION

Item 1. Financial Statements

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Astec Industries, Inc. and Subsidiaries  
 Condensed Consolidated Balance Sheets  
 (In thousands)

	September 30, 2006 <u>(Unaudited)</u>	December 31, <u>2005</u>
ASSETS		
Current Assets:		
Cash and cash equivalents	\$ 34,299	\$ 22,598
Trade receivables, net	66,933	50,854
Other receivables	1,787	2,541
Inventories	151,437	135,503
Prepaid expenses and other	2,861	7,319
Deferred income tax assets	<u>8,857</u>	<u>7,213</u>
Total current assets	266,174	226,028
Property and equipment, net	109,401	96,114
Goodwill	19,639	19,361
Other assets	<u>5,634</u>	<u>5,080</u>
Total assets	\$ <u>400,848</u>	\$ <u>346,583</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Accounts payable - trade	\$ 39,343	\$ 39,775
Accrued product warranty	7,154	5,666
Customer deposits	13,425	12,063
Accrued payroll and related liabilities	2,670	2,616
Accrued loss reserves	7,621	6,454
Income taxes payable	5,073	2,461
Other accrued liabilities	<u>22,465</u>	<u>19,013</u>
Total current liabilities	97,751	88,048
Deferred income tax liabilities	5,293	4,651
Accrued retirement benefit costs	4,536	5,110
Other non-current liabilities	5,235	5,440
Minority interest in consolidated subsidiary	635	592
Total shareholders' equity	<u>287,398</u>	<u>242,742</u>
Total liabilities and shareholders' equity	\$ <u>400,848</u>	\$ <u>346,583</u>
See Notes to Unaudited Condensed Consolidated Financial Statements		

Astec Industries, Inc. and Subsidiaries

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Condensed Consolidated Statements of Income

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended		Nine Months Ended	
	September		September 30,	
	30,			
	2006	2005	2006	2005
Net sales	\$ 171,470	\$ 149,103	\$ 548,455	\$ 481,551
Cost of sales	<u>130,453</u>	<u>115,911</u>	<u>414,896</u>	<u>374,034</u>
Gross profit	41,017	33,192	133,559	107,517
Selling, general, administrative and engineering expenses	25,295	23,400	80,307	69,020
Gain on sale of real estate, net of real estate impairment charge	<u>-</u>	<u>6,531</u>	<u>-</u>	<u>6,531</u>
Income from operations	15,722	16,323	53,252	45,028
Interest expense	421	1,353	1,268	3,518
Other income, net of expense	<u>570</u>	<u>56</u>	<u>1,052</u>	<u>191</u>
Income before income taxes and minority interest in earnings	15,871	15,026	53,036	41,701
Income taxes	<u>5,807</u>	<u>4,938</u>	<u>19,666</u>	<u>14,541</u>
Income before minority interest in earnings	10,064	10,088	33,370	27,160
Minority interest in earnings	<u>38</u>	<u>29</u>	<u>82</u>	<u>88</u>
Net income	<u>\$ 10,026</u>	<u>\$ 10,059</u>	<u>\$ 33,288</u>	<u>\$ 27,072</u>
Earnings per common share				
Net income:				
Basic	<u>\$ 0.47</u>	<u>\$ 0.49</u>	<u>\$ 1.56</u>	<u>\$ 1.34</u>
Diluted	<u>\$ 0.46</u>	<u>\$ 0.47</u>	<u>\$ 1.52</u>	<u>\$ 1.30</u>
Weighted average common shares outstanding:				
Basic	<u>21,520,512</u>	<u>20,523,622</u>	<u>21,383,889</u>	<u>20,146,240</u>
Diluted	<u>21,927,051</u>	<u>21,239,420</u>	<u>21,960,133</u>	<u>20,799,050</u>

See Notes to Unaudited Condensed Consolidated Financial Statements

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## Condensed Consolidated Statements of Cash Flows

(In thousands) (Unaudited)

Nine Months Ended September 30,

	<u>2006</u>	<u>2005</u>
Cash flows from operating activities:		
Net income	\$ 33,288	\$ 27,072
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,686	8,056
Provision for doubtful accounts	457	226
Provision for inventory reserve	2,827	2,427
Provision for warranty reserve	9,318	8,033
Real estate impairment charge	-	1,183
Deferred compensation provision (benefit)	(864 )	1,350
Stock-based compensation	470	-
Excess tax benefit from stock-based compensation	(2,639 )	-
Deferred income tax benefit	(530 )	(269 )
Gain on sale and disposition of fixed assets	(21 )	(60 )
Gain on sale of assets held for sale	-	(7,714 )
Minority interest in earnings of subsidiary	(82 )	(29 )
(Increase) decrease in:		
Trade and other receivables	(15,752 )	(15,080 )
Inventories	(18,762 )	(4,523 )
Prepaid expenses and other	4,729	4,670
Other non-current assets	(1,073 )	(242 )
Increase (decrease) in:		
Accounts payable	(432 )	907
Accrued product warranty	(7,830 )	(7,001 )
Customer deposits	1,362	(2,017 )
Income taxes payable	5,252	6,012
Accrued loss reserves	1,167	408
Other accrued liabilities	3,481	630
Other	<u>-</u>	<u>133</u>
Net cash provided by operating activities	<u>23,052</u>	<u>24,172</u>
Cash flows from investing activities:		
Proceeds from sale of property and equipment	916	90
Proceeds from sale of assets held for sale	-	12,428

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Cash paid for acquisition of minority shares of subsidiary	(197 )	(19 )
Cash received from sale of minority shares of subsidiary	288	-
Expenditures for property and equipment	<u>(23,102 )</u>	<u>(9,321 )</u>
Net cash provided (used) by investing activities	<u>(22,095 )</u>	<u>3,178</u>
Cash flows from financing activities:		
Net repayments under revolving credit agreement	-	(8,517 )
Repayments under loan and note agreements	-	(19,467 )
Excess tax benefit from stock-based compensation	2,639	-
Contribution to Company supplemental executive retirement plan	(319 )	(285 )
Proceeds from issuance of common stock	<u>9,201</u>	<u>14,079</u>
Net cash provided (used) by financing activities	<u>11,521</u>	<u>(14,190 )</u>
Effect of exchange rate changes on cash	<u>(777 )</u>	<u>(294 )</u>
Net increase in cash and cash equivalents	11,701	12,866
Cash and cash equivalents at beginning of period	<u>22,598</u>	<u>8,349</u>
Cash and cash equivalents at end of period	<u>\$ 34,299</u>	<u>\$ 21,215</u>
See Notes to Unaudited Condensed Consolidated Financial Statements		

Astec Industries, Inc. and Subsidiaries

Condensed Consolidated Statement of Shareholders' Equity

For the Nine Months Ended September 30, 2006

Amounts in thousands, except shares

<u>Common Stock Shares</u>	<u>Common Stock Amount</u>	<u>Additional Paid in Capital</u>	<u>Retained Earnings</u>	<u>Accumulated Other Comprehensive Income</u>	<u>Company Shares Held by SERP</u>	<u>Total Shareholders' Equity</u>
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Balance December 31, 2005	21,177,352	\$ 4,235	\$ 79,723	\$ 158,073	\$ 2,605	\$ (1,894)	\$ 242,742
Net income				33,288			33,288
Foreign currency translation adjustment					(956)		(956)
Stock incentive plan expense, gross			470				470
Change in minority ownership of subsidiary					(2)		(2)
Exercise of stock options and stock to directors, including tax benefits	466,568	94	11,747				11,841
SERP transactions, net	<u>          </u>	<u>          </u>	<u>    194</u>	<u>          </u>	<u>          </u>	<u>   (179)</u>	<u>    15</u>
Balance, September 30, 2006	<u>21,643,920</u>	<u>\$ 4,329</u>	<u>\$ 92,134</u>	<u>\$ 191,361</u>	<u>\$ 1,647</u>	<u>\$ (2,073)</u>	<u>\$ 287,398</u>

See Notes to Unaudited Condensed Consolidated Financial Statements



ASTEC INDUSTRIES, INC. AND SUBSIDIARIES

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X promulgated under the Securities Act of 1933. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. In the opinion of management, all adjustments (consisting of normal recurring accruals) considered necessary for a fair presentation have been included. Operating results for the three and nine month periods ended September 30, 2006 are not necessarily indicative of the results that may be expected for the year ending December 31, 2006. It is suggested that these condensed financial statements be read in conjunction with the financial statements and the notes thereto included in the Astec Industries, Inc. and subsidiaries Annual Report on Form 10-K for the year ended December 31, 2005.

The condensed consolidated balance sheet at December 31, 2005 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements.

Certain reclassifications were made to the prior year presentation to conform to the current year presentation. For further information, refer to the consolidated financial statements and footnotes thereto included in the Astec Industries, Inc. and subsidiaries Annual Report on Form 10-K for the year ended December 31, 2005.

Recent Accounting Pronouncements

In November 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards ("SFAS") No. 151, "Inventory Costs" ("SFAS 151"). SFAS 151 amends the guidance in Accounting Research Bulletin No. 43, Chapter 4, "Inventory Pricing", to clarify that abnormal amounts of idle facility expense, freight, handling costs and wasted materials (spoilage) should be recognized as current-period charges and requires the allocation of fixed production overheads to inventory based on normal capacity of the production facilities. SFAS 151 is effective for fiscal years beginning after June 15, 2005. The Company adopted SFAS 151 effective January 1, 2006. The adoption of SFAS 151 did not have a significant impact on the Company's consolidated financial statements.

On October 22, 2004, President Bush signed the American Jobs Creation Act of 2004 (the "Jobs Creation Act"). The Jobs Creation Act provides a deduction for income from qualified domestic production activities, which will be phased in from 2005 through 2010. In return, the Jobs Creation Act also provides for a two-year phase-out ending January 1, 2007 (except for certain pre-existing binding contracts) of the existing Extraterritorial Income (ETI) exclusion tax benefit for foreign sales, which the World Trade Organization (WTO) ruled, was an illegal export subsidy. The European Union (EU) believes that the Jobs Creation Act fails to adequately repeal the illegal export subsidies because of the transitional provisions and has asked the WTO to review whether these transitional provisions are in compliance with their prior ruling. It is not possible to predict what impact this issue will have on future earnings pending the final resolution of this matter.

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On December 21, 2004, FASB Staff Position (FSP) FAS 109-1, "Application of FASB Statement No. 109, Accounting for Income Taxes" ("FAS 109-1"), to the Tax Deduction on Qualified Production Activities Provided by the American Jobs Creation Act of 2004, was issued. FSP FAS 109-1 clarifies that this tax deduction should be accounted for as a special deduction in accordance with Statement No. 109. As such, the special deduction has no effect on deferred tax assets and liabilities existing at the date of enactment. Rather, the impact of this deduction is reported in the period in which the deduction is claimed on our tax return beginning with the Company's 2005 return. The Company has incorporated the expected impact of the new act (\$200,000 in 2005 and \$300,000 in the first three quarters of 2006) in its 2005 and 2006 tax provisions.

On December 21, 2004, FSP FAS 109-2, "Accounting and Disclosure Guidance for the Foreign Earnings Repatriation Provision within the American Jobs Creation Act of 2004," was issued. FSP 109-2 provides companies additional time, beyond the financial reporting period during which the Jobs Creation Act took effect, to evaluate the Jobs Creation Act's impact on a company's plan for reinvestment or repatriation of certain foreign earnings for purposes of applying Statement No. 109. FSP 109-2 was effective upon issuance. The Company has decided not to repatriate foreign earnings, and accordingly, the financial statements do not reflect any provisions for taxes on unremitted foreign earnings.

In December 2004, the FASB issued SFAS 153, "Exchanges of Nonmonetary Assets" ("SFAS 153"). SFAS 153 amends the guidance in APB Opinion No. 29, "Accounting for Nonmonetary Transactions" to eliminate certain exceptions to the principle that exchanges of nonmonetary assets be measured based on the fair value of the assets exchanged. SFAS 153 eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. This statement is effective for nonmonetary asset exchanges in fiscal years beginning after June 15, 2005. The adoption of SFAS 153 did not have an impact on the Company's consolidated financial statements.

In May 2005, the FASB issued SFAS No. 154, "Accounting Changes and Error Corrections," ("SFAS 154"). SFAS No. 154 replaces APB No. 20, "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements" and establishes retrospective application as the required method for reporting a change in accounting principle. The reporting of a correction of an error by restating previously issued financial statements is also addressed. SFAS No. 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 15, 2005. The adoption of SFAS No. 154 did not have a material effect on the Company's consolidated financial statements.

In December 2004, the FASB issued SFAS No. 123 (revised 2004), "Share-Based Payment" ("SFAS 123R"), which replaces SFAS No. 123, "Accounting for Stock-Based Compensation", supersedes APB No. 25, "Accounting for Stock Issued to Employees" and amends SFAS No. 95, "Statement of Cash Flows". SFAS 123R requires all share-based payments to employees, including grants of employee stock options, to be recognized as compensation in the financial statements based on the calculated fair value of the awards. The pro forma disclosure previously permitted under SFAS 123 no longer is an alternative to financial statement recognition for periods after adoption of SFAS 123R. SFAS 123R also requires the benefits of tax deductions in excess of recognized compensation costs to be reported as a financing cash flow. This requirement will reduce reported net operating cash flows and increase net financing cash flows in the periods after adoption. The Company adopted this statement effective January 1, 2006. The impact of adopting SFAS 123R is described in Note 2 below.

In June 2006, the FASB ratified Emerging Issues Talk Force ("EITF") Issue No. 06-3, "How Taxes Collected from Customers and Remitted to Governmental Authorities Should Be Presented in the Income Statement (That Is, Gross Versus Net Presentation)". This statement allows companies to present in their statements of income any taxes assessed by a governmental authority that are directly imposed on revenue-producing transactions between a seller and a customer, such as sales, use, value-added and some excise taxes, on either a gross (included in revenue and costs) or a net (excluded from revenue) basis. This standard will be effective in interim periods and fiscal years beginning after December 15, 2006. The Company presents these transactions on a net basis, and therefore the

adoption of this standard will have no impact on the Company's financial position and results of operations.

In July 2006, the FASB issued FASB Interpretation 48, "Accounting for Uncertainty in Income Taxes: an interpretation of FASB Statement No. 109, Accounting for Income Taxes" ("Interpretation 48"). Interpretation 48 defines a criterion that an income tax position would have to meet for some or all of the benefit of that position to be recognized in an entity's financial statements. Interpretation 48 requires that the cumulative effect of applying its provisions be reported as an adjustment to retained earnings at the beginning of the period in which it is adopted. Interpretation 48 is effective for fiscal years beginning after December 15, 2006 and the Company will begin applying its provisions effective January 1, 2007. The Company has not yet determined the impact, if any, that the adoption of this interpretation will have on the Company's financial statements.

In September 2006, the FASB issued SFAS No. 157, "Fair Value Measurements" ("SFAS No. 157"), which provides guidance on how to measure assets and liabilities that use fair value. SFAS No. 157 will apply whenever another US GAAP standard requires (or permits) assets or liabilities to be measured at fair value but does not expand the use of fair value to any new circumstances. This standard also will require additional disclosures in both annual and quarterly reports. SFAS No. 157 will be effective for financial statements issued for fiscal years beginning after November 15, 2007 and the Company will begin applying its provisions effective January 1, 2008. The Company has not yet determined the impact, if any, that the adoption of this statement will have on the Company's financial statements.

In September 2006, the SEC staff issued Staff Accounting Bulletin No. 108, "Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements" ("SAB No.108"). SAB No. 108 was issued in order to eliminate the diversity of practice in how public companies quantify misstatements of financial statements, including misstatements that were not material to prior years' financial statements. The Company will initially apply the provisions of SAB No. 108 in connection with the preparation of its annual financial statements for the year ended December 31, 2006. The Company does not expect the adoption of this bulletin will have a material impact on the Company's financial statements.

In September 2006, the FASB issued SFAS No. 158, "Employers Accounting for Defined Benefit Pension and Other Postretirement Plans - An Amendment of FASB Statements No. 87, 88, 106, and 132R" (" SFAS No. 158"). SFAS No. 158 requires companies to (1) recognize as an asset or liability, the overfunded or underfunded status of defined pension and other postretirement benefit plans; (2) recognize changes in the funded status through other comprehensive income in the year in which the changes occur; (3) measure the funded status of defined pension and other postretirement benefit plans as of the date of the company's fiscal year-end; and (4) provide enhanced disclosures. The provisions of SFAS No. 158 are effective for the Company's year-ending December 31, 2006. The Company is in the process of evaluating the impact that SFAS No. 158 will have on the Company's financial statements.

## Note 2. Stock-based Compensation

Under terms of the Company's stock option plans, officers and certain other employees may be granted options to purchase the Company's common stock at no less than 100% of the market price on the date the option is granted. The Company has reserved shares of common stock for exercise of outstanding non-qualified options and incentive options of officers and employees of the Company and its subsidiaries at prices determined by the Board of Directors. In addition, a Non-employee Directors Stock Incentive Plan has been established to allow non-employee directors to have a personal financial stake in the Company through an ownership interest. Directors may elect to receive their compensation in cash, common stock, deferred stock or stock options. Options granted under the Non-employee Directors Stock Incentive Plan and the Executive Officer Annual Bonus Equity Election Plan vest and become fully exercisable immediately. Generally, other options granted vest over 12 months. All stock options have a ten-year term. The shares reserved under the various stock option plans are as follows: (1) 1998 Long-term Incentive Plan - 1,235,696, (2) Executive Officer Annual Bonus Equity Election Plan - 16,892 and (3) 1998 Non-employee Directors Stock Plan - 16,290.

In August 2006, the Compensation Committee of the Board of Directors implemented a five-year plan to award key

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members of management restricted stock units each year. The details of the plan were formulated under the 2006 Incentive Plan approved by the Company's shareholders in their annual meeting held in April, 2006. The plan allows up to 511,000 shares to be granted to employees over the next five years. Units granted each year will be determined based upon individual subsidiaries and consolidated annual financial performance. Each award will vest at the end of five years from the date of grant, or at the time a recipient reaches age 65, if earlier. No awards have been granted to date, but based upon current estimated performance for 2006, management estimates that 62,500 will be granted in March, 2007. Compensation expense of \$89,000 has been recorded in the third quarter of 2006 to reflect the fair value of the 62,500 shares amortized over the vesting period. The fair value of the restricted stock units was \$25.25 per share at September 30, 2006.

Effective January 1, 2006, the Company adopted SFAS No. 123R, using the modified prospective method. SFAS 123R requires the recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements and is measured based on the grant date calculated fair value of the award. SFAS 123R also requires the stock option compensation expense to be recognized over the period during which an employee is required to provide service in exchange for the award (the vesting period). Prior to the adoption of SFAS 123R on January 1, 2006, the Company accounted for stock-based compensation plans in accordance with the provisions of APB No. 25 and applied the disclosure only provision of SFAS 123. Under APB 25, generally no compensation expense was recorded when the terms of the award were fixed and the exercise price of the employee stock option equaled or exceeded the market value of the underlying stock on the date of grant. The Company did not record compensation expense for option awards in periods prior to January 1, 2006.

For the nine month period ended September 30, 2006, the Company recorded compensation expense related to stock options that reduced income from operations by \$381,000, decreased the provision for income taxes by \$83,000, and decreased net income by \$298,000. All of this expense was recorded in the first two quarters of 2006. This resulted in a \$.01 and \$.01 reduction in basic and fully diluted earnings per share, respectively, for the nine months ended September 30, 2006. Cash received from options exercised during the three and nine month periods ended September 30, 2006 totaled \$190,000 and \$8,938,000, respectively, and is included in the accompanying condensed consolidated statement of cash flows as a financing activity. The excess tax benefit realized from the exercise of these options totaled \$243,000 and \$2,639,000 for the three and nine month periods ended September 30, 2006. The stock option compensation expense was included in selling, general and administrative expenses in the accompanying condensed consolidated statement of income. As of September 30, 2006, there is no unrecognized compensation costs related to stock options previously granted.

As the Company adopted SFAS 123R using the modified prospective method, information for periods prior to January 1, 2006 have not been restated to reflect the impact of applying the provisions of SFAS 123R. The following summary presents the Company's net income and per share earnings that would have been reported had the Company recorded stock-based employee compensation cost using the fair value method of accounting set forth under SFAS 123.

The amounts shown below, except EPS, are in thousands:

	<u>Three Months Ended</u> <u>September 30, 2005</u>	<u>Nine Months</u> <u>Ended</u> <u>September 30,</u> <u>2005</u>
Net income, as reported	\$ 10,059	\$ 27,072
Stock compensation expense under SFAS 123, net of tax benefit,	<u>83</u>	<u>(336)</u>
less tax benefit from disqualifying dispositions of stock		

options

Proforma net income	\$ <u>10,142</u>	\$ <u>26,736</u>
Basic earnings per share, as reported	\$ 0.49	\$ 1.34
Proforma basic earnings per share	\$ <u>0.49</u>	\$ <u>1.33</u>
Diluted earnings per share, as reported	\$ 0.47	\$ 1.30
Proforma diluted earnings per share	\$ <u>0.48</u>	\$ <u>1.29</u>

The fair value of each option grant was estimated on the date of grant using the Black-Scholes option pricing model with the following weighted average assumptions:

	<u>2006 Grants</u>	<u>2005 Grants</u>
Expected life	5.5 Years	6 Years
Expected volatility	55.1%	47.5%
Risk-free interest rate	4.53%	3.77%
Dividend yield	--	--

The expected life of stock options represents the period of time that the stock options granted are expected to be outstanding and was based on the shortcut method allowed under SAB 107 for 2006 and based upon historical trends for 2005. The expected volatility is based on the historical price volatility of the Company's common stock. The risk free interest rate represents the U.S. Treasury bill rate for the expected life of the related stock options. No factor for dividend yield was incorporated in the calculation of fair value, as the Company has historically not paid dividends.

A summary of the Company's stock option activity and related information for the nine months ended September 30, 2006 follows:

	<u>Options</u>	<u>Weighted Average Exercise Price</u>	<u>Remaining Contractual Life</u>	<u>Intrinsic Value</u>
Options outstanding at December 31, 2005	1,737,429	\$ 21.51		
Options granted at market price	1,311	29.44		
Options forfeited	(4,900)	19.74		

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Options exercised	<u>(464,962)</u>	19.22		
Options outstanding at September 30, 2006	<u>1,268,878</u>	22.36	4.2 Years	\$3,664,000
Options exercisable at September 30, 2006	<u>1,268,878</u>	\$ 22.36	4.2 Years	\$3,664,000

The weighted average grant-date fair value of options granted during the three months ended September 30, 2006 and 2005 was \$11.40 and \$13.93, respectively. The weighted average grant-date fair value of options granted during the nine months ended September 30, 2006 and 2005 was \$16.02 and \$9.60, respectively. The total fair value of stock options that vested during the three months ended September 30, 2006 and 2005 was \$7,000 and \$5,000, respectively. The total fair value of stock options that vested during the nine months ended September 30, 2006 and 2005 was \$2,146,000 and \$119,000, respectively. The total intrinsic value of stock options exercised during the three months ended September 30, 2006 and 2005 was \$609,000 and \$10,518,000, respectively. The total intrinsic value of stock options exercised during the nine months ended September 30, 2006 and 2005 was \$7,803,000 and \$12,022,000, respectively.

Note 3. Receivables

Receivables are net of allowance for doubtful accounts of \$1,894,000 and \$1,877,000 as of September 30, 2006 and December 31, 2005, respectively.

**Note 4. Inventories**

Inventories are stated at the lower of first-in, first-out cost or market and consist of the following:

	(in thousands)	
	<u>September 30,</u> <u>2006</u>	<u>December 31, 2005</u>
Raw Materials	\$ 75,844	\$ 65,820
Work-in-Process	36,305	28,602
Finished Goods	29,677	29,702
Used Equipment	<u>9,611</u>	<u>11,379</u>
Total	<u>\$ 151,437</u>	<u>\$ 135,503</u>

Note 5. Earnings Per Share

Basic and diluted earnings per share are calculated in accordance with SFAS No. 128 and SFAS No. 123(R). Basic earnings per share exclude any dilutive effects of options, warrants and convertible securities.

The following table sets forth the computation of basic and diluted earnings per share:

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	<u>Thee Months Ended September</u>		<u>Nine Months Ended September</u>	
	<u>30,</u>	<u>30,</u>	<u>30,</u>	<u>30,</u>
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Numerator:				
Net income	\$ <u>10,026,000</u>	\$ <u>10,059,000</u>	\$ <u>33,288,000</u>	\$ <u>27,072,000</u>
Denominator:				
Denominator for basic earnings per share	21,520,512	20,523,622	21,383,889	20,146,240
Effect of dilutive securities:				
Employee stock options	287,427	599,527	459,850	534,696
Supplemental Executive Retirement Plan	<u>119,112</u>	<u>116,271</u>	<u>116,394</u>	<u>118,114</u>
Denominator for diluted earnings per share	<u>21,927,051</u>	<u>21,239,420</u>	<u>21,960,133</u>	<u>20,799,050</u>
Net income per share:				
Basic	\$ <u>0.47</u>	\$ <u>0.49</u>	\$ <u>1.56</u>	\$ <u>1.34</u>
Diluted	\$ <u>0.46</u>	\$ <u>0.47</u>	\$ <u>1.52</u>	\$ <u>1.30</u>

Options totaling approximately 673,000 and 507,000 for the three months ended September 30, 2006 and 2005, respectively, were antidilutive and were therefore not included in the diluted earnings per share computation. Options totaling approximately 225,000 and 930,000 for the nine months ended September 30, 2006 and 2005, respectively, were antidilutive and were therefore not included in the diluted earnings per share computation.

**Note 6. Property and Equipment**

Property and equipment is stated at cost, less any required impairment charge. Property and equipment is net of accumulated depreciation of \$107,867,000 and \$101,202,000 as of September 30, 2006 and December 31, 2005, respectively.

## Note 7. Comprehensive Income

Total comprehensive income for the three and nine month periods ended September 30, 2006 was \$9,311,000 and \$32,330,000, respectively. Total comprehensive income for the three and nine month periods ended September 30, 2005 was \$11,106,000 and \$26,825,000, respectively.

The components of comprehensive income for the periods indicated are set forth below:

	(in thousands) Three Months Ended <u>September 30,</u>		(in thousands) Nine Months Ended <u>September 30,</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Net income	\$10,026	\$10,059	\$33,288	\$27,072
Net increase in accumulated fair value of derivative financial instruments	-	-	-	134
Increase in minority interest ownership of subsidiary	(2)	-	(2)	-
Increase (decrease) in foreign currency translation	<u>(713)</u>	<u>1,047</u>	<u>(956)</u>	<u>(381)</u>
Total comprehensive income	<u>\$ 9,311</u>	<u>\$ 11,106</u>	<u>\$32,330</u>	<u>\$26,825</u>

## Note 8. Contingent Matters

Certain customers have financed purchases of Astec products through arrangements in which the Company is contingently liable for customer debt of approximately \$7,610,000 and for residual value guarantees aggregating approximately \$147,000 at September 30, 2006 and contingently liable for customer debt of approximately \$10,185,000 and for residual value guarantees aggregating approximately \$315,000 at December 31, 2005. The Company's credit facility with General Electric Capital Corporation dated May 14, 2003 limits contingent liabilities or guaranteed indebtedness created after May 14, 2003 to an aggregate total of \$5,000,000 at any time, or to \$2,000,000 for any one customer. As of September 30, 2006, guaranteed indebtedness created under the current loan agreement dated May 14, 2003 was \$407,000. At September 30, 2006, the maximum potential amount of future payments under these guarantees for which the Company would be liable is equal to \$7,757,000. The Company does not believe it will be called on to fulfill any of these contingencies, and therefore the carrying amounts on the consolidated balance sheets of the Company for these contingent liabilities are zero.

In addition, the Company is contingently liable under letters of credit of approximately \$6,902,000. Under the Company's credit facility, the terms of letters of credit are limited to one year. Under the credit facility of the Company's South African subsidiary, Osborn Engineered Products SA (Pty) Ltd., the Company is contingently liable for approximately \$1,820,000 in performance and retention bonds. As of September 30, 2006, the maximum potential amount of future payments under these letters of credit and bonds for which the Company could be liable is



approximately \$8,722,000.

The Company is engaged in certain pending litigation involving claims or other matters arising in the ordinary course of business. Most of these claims involve product liability or other tort claims for property damage or personal injury against which the Company is insured. As a part of its litigation management program, the Company maintains general liability insurance coverage for product liability and other similar tort claims in amounts the Company believes are adequate. The coverage is subject to a substantial self-insured retention under the terms of which the Company has the right to coordinate and control the management of its claims and the defense of these actions.

The Company is currently a party to various claims and legal proceedings that have arisen in the ordinary course of business. If management believes that a loss arising from such claims and legal proceedings is probable and can reasonably be estimated, the Company records the amount of the loss (including estimated legal costs), or the minimum estimated liability when the loss is estimated using a range, and no point within the range is more probable than another. As management becomes aware of additional information concerning such contingencies, any potential liability related to these matters is assessed and the estimates are revised, if necessary. If management believes that a loss arising from such claims and legal proceedings is either (i) probable but cannot be reasonably estimated or (ii) reasonably possible but not probable, the Company does not record the amount of the loss, but does make specific disclosure of such matter. Based upon currently available information and with the advice of counsel, management believes that the ultimate outcome of its current claims and legal proceedings, individually and in the aggregate, will not have a material adverse effect on the Company's financial position, cash flows or results of operations. However, claims and legal proceedings are subject to inherent uncertainties and rulings unfavorable to the Company could occur. If an unfavorable ruling were to occur, there exists the possibility of a material adverse effect on the Company's financial position, cash flows or results of operations.

## Note 9. Segment Information

The Company has four reportable operating segments, which include the Asphalt Group, the Aggregate and Mining Group, the Mobile Asphalt Paving Group and the Underground Group. The business units in the Asphalt Group design, manufacture and market a complete line of asphalt plants and related components, heating and heat transfer processing equipment and storage tanks for the asphalt paving and other non-related industries. The business units in the Aggregate and Mining Group design, manufacture and market equipment for the aggregate, metallic mining and recycling industries. The business units in the Mobile Asphalt Paving Group design, manufacture and market asphalt pavers, material transfer vehicles, milling machines and screeds. The business units in the Underground Group design, manufacture and market a complete line of trenching equipment and directional drills for the underground construction market. The Company also has one other category that contains the business units that do not meet the requirements for separate disclosure as an operating segment. The business units in the Other category include Astec Insurance Company and Astec Industries, Inc., the parent company.

(in thousands)  
Three Months Ended  
September 30, 2006

	<u>Asphalt Group</u>	<u>Aggregate and Mining Group</u>	<u>Mobile Asphalt Paving Group</u>	<u>Underground Group</u>	<u>All Others</u>	<u>Total</u>
Net sales from external	\$ 45,076	\$ 69,083	\$ 28,961	\$ 28,350	\$ -	\$ 171,470

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customers						
Intersegment sales	2,705	1,461	806	844	-	5,816
Gross profit (loss)	11,160	16,688	5,989	7,200	(20)	41,017
Gross profit percent	24.8%	24.2%	20.7%	25.4%	-	23.9%
Segment profit (loss)	\$ 5,939	\$ 7,562	\$ 2,029	\$ 2,889	\$(8,188)	\$ 10,231

(in thousands)  
 Nine Months Ended  
 September 30, 2006

	<u>Asphalt Group</u>	<u>Aggregate and Mining Group</u>	<u>Mobile Asphalt Paving Group</u>	<u>Underground Group</u>	<u>All Others</u>	<u>Total</u>
Net sales from external customers	\$ 149,026	\$ 217,942	\$ 103,199	\$ 78,288	\$ -	\$ 548,455
Intersegment sales	8,071	7,706	2,891	2,671	-	21,339
Gross profit (loss)	37,981	53,292	24,641	17,687	(42)	133,559
Gross profit percent	25.5%	24.5%	23.9%	22.6%	-	24.4%
Segment profit (loss)	\$ 20,722	\$ 24,729	\$ 12,125	\$ 5,328	\$(29,347)	\$ 33,557

(in thousands)  
 Three Months Ended  
 September 30, 2005

	<u>Asphalt Group</u>	<u>Aggregate and Mining Group</u>	<u>Mobile Asphalt Paving Group</u>	<u>Underground Group</u>	<u>All Others</u>	<u>Total</u>
Net sales from external customers	\$ 34,962	\$ 63,262	\$ 27,964	\$ 22,915	\$ -	\$ 149,103
Intersegment sales	2,198	7,675	545	15	-	10,433
Gross profit (loss)	7,749	15,278	6,380	3,809	(24)	33,192
Gross profit percentage	22.2%	24.2%	22.8%	16.6%	-	22.3%
Segment profit (loss)	\$ 2,223	\$ 6,361	\$ 3,235	\$ 7,538	\$(9,303)	\$ 10,054

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(in thousands)  
 Nine Months Ended  
 September 30, 2005

	<u>Asphalt Group</u>	<u>Aggregate and Mining Group</u>	<u>Mobile Asphalt Paving Group</u>	<u>Underground Group</u>	<u>All Others</u>	<u>Total</u>
Net sales from external customers	\$ 136,286	\$ 186,277	\$ 91,384	\$ 67,604	\$ -	\$ 481,551
Intersegment sales	8,140	17,037	2,295	34	1,098	28,604
Gross profit (loss)	29,592	44,952	21,062	11,974	(63)	107,517
Gross profit percentage	21.7%	24.1%	23.0%	17.7%	-	22.3%
Segment profit (loss)	\$ 14,262	\$ 19,046	\$ 10,328	\$ 8,442	\$(24,940)	\$ 27,138

Reconciliation of the reportable segment totals for profit or loss to the Company's consolidated totals is as follows:

(in thousands)

	<u>Three Months Ended September 30,</u>		<u>Nine Months Ended September 30,</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Total profit for reportable segments	\$ 10,231	\$ 10,054	\$ 33,557	\$ 27,138
Minority interest in earnings	(38)	(29)	(82)	(88)
Recapture (elimination) of intersegment profit	<u>(167)</u>	<u>34</u>	<u>(187)</u>	<u>22</u>
Consolidated net income	<u>\$ 10,026</u>	<u>\$ 10,059</u>	<u>\$ 33,288</u>	<u>\$ 27,072</u>

Note 10. Seasonality

Based upon historical results of the past several years and expected results for this year, seventy-eight percent (78%) to seventy-nine percent (79%) of the Company's business volume typically occurs during the first nine months of the year. During the usual seasonal trend, the first three quarters of the year are the Company's stronger quarters for business volume, with the fourth quarter normally being the weakest quarter.

Note 11. Financial Instruments

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For the three and nine month periods ended September 30, 2006, the Company had no Other Comprehensive Income (OCI) amortized through interest expense. For the three and nine month periods ended September 30, 2005, the Company had OCI amortized through interest expense of approximately \$0 and \$134,000, respectively. Monthly amortization of OCI through interest expense was approximately \$38,000 through March 2005 with the balance of \$19,000 being amortized in April 2005.

Note 12. Goodwill

At September 30, 2006 and December 31, 2005, the Company had unamortized goodwill in the amount of \$19,639,000 and \$19,361,000, respectively.

The changes in the carrying amount of goodwill by operating segment for the periods ended September 30, 2006 are as follows:

	Aggregate and		(in thousands) Mobile Asphalt Paving	Underground	Total
	Asphalt Group	Mining Group	Group	Group	
Balance December 31, 2005	\$ 1,157	\$ 16,558	\$ 1,646	\$ -	\$ 19,361
Foreign currency translation	<u>-</u>	<u>11</u>	<u>-</u>	<u>-</u>	<u>11</u>
Balance March 31, 2006	1,157	16,569	1,646	-	19,372
Foreign currency translation	<u>-</u>	<u>323</u>	<u>-</u>	<u>-</u>	<u>323</u>
Balance June 30, 2006	1,157	16,892	1,646	-	19,695
Foreign currency translation	<u>-</u>	<u>(56)</u>	<u>-</u>	<u>-</u>	<u>(56)</u>
Balance September 30, 2006	<u>\$ 1,157</u>	<u>\$ 16,836</u>	<u>\$ 1,646</u>	<u>\$ -</u>	<u>\$ 19,639</u>

Note 13. Long-term Debt

The Company entered into a revolving credit facility and senior note agreement with General Electric Capital Corporation ("GECC") on May 14, 2003. During the third quarter of 2005, the Company used available cash to pay off the senior note (term loan) portion of the GECC debt early. Currently, under the amended GECC revolving credit facility, which expires on May 14, 2007, maximum borrowings of \$87,500,000 are based on a percentage of eligible receivables and inventory. The \$87,500,000 limit includes \$5,000,000 for use by the Canadian subsidiary Breaker Technology Ltd., as discussed further below. Availability under the revolving facility is adjusted monthly and interest is due in arrears. Interest rates are based on applicable index rates plus a sliding scale of applicable index margins from zero to three-fourths of one percent (0.75%), or at the option of the borrower, the LIBOR margin plus an applicable index margin from two percent (2.0%) to two and three-fourths percent (2.75%) based on a level of total funded debt ratio. Additionally, the GECC amended agreement permits the Company to hold inventory notes or customer financing of up to \$4,000,000 at any time. The credit facility contains certain restrictive financial covenants relative to operating ratios and capital expenditures. As of September 30, 2006, net availability under the revolving GECC credit facility was approximately \$79,907,000 and no borrowings were outstanding.

The Company was in compliance with the financial covenants under its credit facility as of September 30, 2006.

The Company's Canadian subsidiary, Breaker Technology Ltd, ("BTL") has available a credit facility issued by General Electric Capital-Canada ("GEC Canada") dated May 14, 2003, with a term of four years for \$5,000,000 to finance short-term working capital needs, as well as to cover the short-term establishment of letter of credit

guarantees. Interest rates are based on applicable index rates plus a sliding scale of applicable index margins from two percent (2.0%) to two and three-fourths percent (2.75%) based on a level of total funded debt ratio. At September 30, 2006, BTL did not have any outstanding balance under the credit facility but did have approximately \$389,000 in letter of credit guarantees under the facility. This amount is included in total letter of credit guarantees disclosed in "Note 8 - Contingent Matters" above. The Company is the primary guarantor to GEC Canada of payment and performance for this \$5,000,000 credit facility. The term of the guarantee is equal to the related debt. The maximum potential amount of future payments the Company would be required to make under its guarantee at September 30, 2006 is \$389,000.

The Company's South African subsidiary, Osborn Engineered Products SA (Pty) Ltd., ("Osborn") has available a credit facility of approximately \$2,578,000 (ZAR 20,000,000) to finance short-term working capital needs, as well as to cover the short-term establishment of letter of credit performance guarantees. As of September 30, 2006, Osborn had no outstanding borrowings under the credit facility, but approximately \$1,820,000 in performance and retention bonds were guaranteed under the facility. The facility is secured by Osborn's account receivables and retention balances. The available facility fluctuates monthly based upon fifty percent (50%) of Osborn's accounts receivables, retention and cash balances at the end of the prior month. As of September 30, 2006, Osborn Engineered Products had available credit under the facility of approximately \$758,000.

Note 14. Product Warranty Reserves

Changes in the Company's product warranty liability for the three and nine month periods ended September 30, 2006 and 2005 are as follows:

	(in thousands)			
	<u>Three Months Ended</u> <u>September 30.</u>		<u>Nine Months Ended</u> <u>September 30.</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Reserve balance at the beginning of the period	\$ 7,036	\$ 5,425	\$ 5,666	\$ 4,789
Warranty liabilities accrued during the period	2,751	2,616	9,318	8,033
Warranty liabilities settled during the period	<u>(2,633)</u>	<u>(2,220)</u>	<u>(7,830)</u>	<u>(7,001)</u>
Reserve balance at the end of the period	<u>\$ 7,154</u>	<u>\$ 5,821</u>	<u>\$ 7,154</u>	<u>\$ 5,821</u>

The Company warrants its products against manufacturing defects and performance to specified standards. The warranty period and performance standards vary by market and uses of its products. The Company estimates the costs that may be incurred under its warranties and records a liability at the time product sales are recorded. The product warranty liability is primarily based on historical claim rates, nature of claims and the associated cost.

**Note 15. Post Retirement Benefits**

The Company expects to contribute approximately \$700,000 to its pension plan and \$170,000 to its post-retirement benefit plan during 2006. Approximately \$568,000 of the contribution was paid to the pension plan and approximately \$158,000 was paid for post-retirement benefits during the nine months ended September 30, 2006.

The components of net periodic pension cost and post-retirement benefit cost for the nine months ended September 30, 2006 and 2005 are as follows:

(in thousands)

	<u>Pension Benefit</u>		<u>Post-Retirement Benefits</u>	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Service cost	\$ -	\$ -	\$ 46	\$ 83
Interest cost	408	402	43	75
Expected return on assets	(410)	(387)	-	-
				25
Amortization of transitional obligation	-	-	25	
Amortization of prior service cost	-	-	(4)	(4)
Amortization of net (gain) loss	<u>103</u>	<u>72</u>	<u>(59)</u>	<u>(23)</u>
Net periodic benefit cost	<u>\$ 101</u>	<u>\$ 87</u>	<u>\$ 51</u>	<u>\$ 156</u>

In May 2004, the FASB issued FSP No. 106-2, "Accounting and Disclosure Requirements Related to the Prescription Drug, Improvement and Modernization Act of 2003" ("FSP No. 106-2") which provides authoritative guidance on accounting for the Medicare Act. The Medicare Act provides for a possible federal subsidy of certain prescription drug claims for sponsors of retiree health care plans with drug benefits, beginning in 2006. The Company has determined that the Company's two post-retirement medical insurance plans, which provide prescription drug benefits, will not be entitled to the federal subsidy under the Medicare Act. Therefore, the application of the provisions of FSP No. 106-2 did not have a significant impact on the Company's consolidated financial statements.

**Note 16. Accrued Loss Reserves**

The Company accrues reserves for losses related to workers' compensation and general liability claims that have been incurred but not yet paid or are estimated to have been incurred but not yet reported to the Company. The reserves are estimated based on the Company's evaluation of the type and severity of individual claims and historical information, primarily its own claims experience, along with assumptions about future events. Changes in assumptions, as well as changes in actual experience, could cause these estimates to change in the future.

**Note 17. Other Income, net of expense**

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For the three months ended September 30, 2006 and 2005, the Company had other income, net of expenses, totaling \$570,000 and \$56,000, respectively. For the nine months ended September 30, 2006 and 2005, the Company had other income, net of expenses, totaling \$1,052,000 and \$191,000, respectively. Major items comprising the net totals for the periods are as follows:

(in thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2006	2005	2006	2005
Interest income	\$ 518	\$ 248	\$ 1,018	\$ 451
Gain (loss) on foreign currency transactions	10	(133)	(234)	(116)
Other	<u>42</u>	<u>(59)</u>	<u>268</u>	<u>(144)</u>
Total	\$ <u>570</u>	\$ <u>56</u>	\$ <u>1,052</u>	\$ <u>191</u>

Item 2. Management's Discussion and Analysis of Financial Condition And Results of Operations

This Quarterly Report on Form 10-Q contains forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Statements contained anywhere in this Quarterly Report on Form 10-Q that are not limited to historical information are considered forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934 and are sometimes identified by the words, "believes," "anticipates," "intends," and "expects" and similar expressions. Such forward-looking statements include, without limitation, statements regarding the Company's expected sales during 2006, the Company's expected effective tax rates for 2006, the Company's expected capital expenditures in 2006, the expected benefit of financing arrangements, the ability of the Company to meet its working capital and capital expenditure requirements through September 30, 2007, the impact of the enactment of SAFTEA-LU, the Company's backlog levels, changes in the economic environment as it affects the Company, the timing and impact of changes in the economy, the market confidence of customers and dealers, the Company's general liability insurance coverage for product liability and other similar tort claims, the Company being called upon to fulfill certain contingencies, the expected contributions by the Company to its pension plan, its post-retirement plan and other benefits, the rise of interest rates and the impact of such rise on the financial results of the Company, changes in the prices of steel and oil, the change in the level of the Company's presence in international markets, the impact of SFAS 123R, the impact of research and development tax credits if approved by Congress and the ultimate outcome of the Company's current claims and legal proceedings.

These forward-looking statements are based largely on management's expectations which are subject to a number of known and unknown risks, uncertainties and other factors discussed in this Report and in other documents filed by the Company with the Securities and Exchange Commission, which may cause actual results, financial or otherwise, to be

materially different from those anticipated, expressed or implied by the forward-looking statements. All forward-looking statements included in this document are based on information available to the Company on the date hereof, and the Company assumes no obligation to update any such forward-looking statements to reflect future events or circumstances.

In addition to the risks and uncertainties identified elsewhere herein and in other documents filed by the Company with the Securities and Exchange Commission, most recently in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2005, the risk factors described in the section under the caption "Risk Factors" should be carefully considered when evaluating the Company's business and future prospects.

## Overview

The Company is a leading manufacturer and marketer of construction equipment. The Company's businesses:

- design, engineer, manufacture and market equipment that is used in road building, from quarrying and crushing the aggregate, to preparing and paving the road surface;
- manufacture certain equipment and components unrelated to road construction, including trenching, auger boring, directional drilling, industrial heat transfer; and
- manufacture and sell replacement parts for equipment in each of its product lines.

The Company has four reportable operating segments, which include the Asphalt Group, the Aggregate and Mining Group, the Mobile Asphalt Paving Group and the Underground Group. The business units in the Asphalt Group design, manufacture and market a complete line of asphalt plants and related components, heating and heat transfer processing equipment and storage tanks for the asphalt paving and other non-related industries. The business units in the Aggregate and Mining Group design, manufacture and market equipment for the aggregate, metallic mining and recycling industries. The business units in the Mobile Asphalt Paving Group design, manufacture and market asphalt pavers, material transfer vehicles, milling machines and screeds. The business units in the Underground Group design, manufacture and market a complete line of trenching equipment and directional drills and auger boring machines for the underground construction market. The Company also has one other category that contains the business units that do not meet the requirements for separate disclosure as an operating segment. The business units in the Other category include Astec Insurance Company and Astec Industries, Inc., the parent company.

The Company's financial performance is affected by a number of factors, including the cyclical nature and varying conditions of the markets it serves. Demand in these markets fluctuates in response to overall economic conditions and is particularly sensitive to the amount of public sector spending on infrastructure development, privately funded infrastructure development, changes in the price of crude oil (fuel costs and liquid asphalt) and changes in the price of steel.

Public sector spending at the federal, state and local levels has been driven in large part by federal spending under the six-year federal-aid highway program, the Transportation Equity Act for the 21<sup>st</sup> Century ("TEA-21"), enacted in June 1998. TEA-21 authorized the appropriation of \$217 billion in federal aid for road, highway and bridge construction, repair and improvement and other federal highway and transit projects for federal fiscal years October 1, 1998 through September 30, 2004. In August 2005, President Bush signed into law the Safe, Accountable, Flexible and Efficient Transportation Equity Act - A Legacy for Users ("SAFETEA-LU"), which authorizes appropriation of \$286.5 billion in guaranteed federal funding for road, highway and bridge construction, repair and improvement of the federal highway and transit projects for federal fiscal years October 1, 2004 through September 30, 2009. The Company



believes that the federal highway funding significantly influences the purchasing decisions of the Company's customers who are more likely to make purchasing decisions with the six-year legislation in place. The Federal funding provides for approximately 25% of highway, street and roadway construction funding in the United States.

The public sector spending described above is needed to fund road, bridge and mass transit improvements. Unquestionably, the Company believes that increased funding is needed to restore the nation's highways to a quality level required for safety, fuel efficiency and mitigation of congestion. In the Company's opinion, amounts needed are significantly above amounts proposed, and funding mechanisms such as the federal usage fee per gallon of gasoline, which has not been increased in twelve years, should be increased along with other measures to generate the funds needed.

In addition to public sector funding, the economies in the markets the Company serves, the price of oil and its impact on customers' purchase decisions and the price of steel may each affect the Company's financial performance. Economic downturns, like the one experienced from 2001 through 2003, generally result in decreased purchasing by the Company's customers, which, in turn, causes reductions in sales and increased pricing pressure on the Company's products. Rising interest rates also typically have the effect of negatively impacting customers' attitudes toward purchasing equipment. The Company believes interest rates may rise during the year, but it does not expect such increases to have a material impact on the financial results of the Company. In addition, significant portions of the Company's revenues are related to the sale of equipment that produces asphalt mix. A major component of asphalt is oil. A rise in the price of oil increases the cost of providing asphalt, which could likely decrease demand for asphalt, and therefore decrease demand for certain Company products. Steel is a major component in the Company's equipment. As steel prices increased during 2004, the cost of manufactured parts, as well as the costs of purchased parts and components, also increased. Steel prices abated somewhat during 2005 but remain at historically high levels. The Company has instituted price increases in response to rising steel prices, purchased parts and component prices. If the Company is not able to raise the prices of its products enough to cover the increased costs of goods, the Company's financial results will be negatively affected. The Company believes that steel prices will be relatively flat during the remainder of 2006 and into 2007. In addition, although oil prices have recently retreated from record highs experienced earlier this year, the Company expects oil prices to remain volatile during the balance of 2006 and into 2007. The Company's customers appear to be adapting their prices in response to the fluctuating oil prices and the fluctuations do not appear to be significantly impairing the equipment purchases by them at this time. In addition to the factors stated above, many of the Company's markets are highly competitive, and its products compete worldwide with a number of other manufacturers and distributors that produce and sell similar products.

The price of oil could have a significant impact on liquid asphalt prices as well as domestic and foreign economies which could result in increased volatility and a lack of economic visibility. The Company believes that, based on its backlog and customer activity, the economic environment as it impacts the Company will continue to remain strong. The Company also believes that SAFETEA-LU will result in sustained or increased federal availability of highway funds and such funding should have a positive impact on customers' attitudes toward purchasing new equipment. The 2007 federal funding proposals recently approved by the Senate Appropriation Committee and the House each provide for the largest funding level in history. In addition, the Company believes that an improving economy should increase state highway funding revenues and private commercial projects.

#### Results of Operations

For the three months ended September 30, 2006, net sales increased \$22,367,000, or 15.0%, to \$171,470,000 from \$149,103,000 for the three months ended September 30, 2005. Sales are generated primarily from new equipment purchases made by customers for use in construction for privately funded infrastructure development and public sector spending on infrastructure development. For the quarter ended September 30, 2006 compared to the quarter ended September 30, 2005, (1) net sales for the Asphalt Group increased approximately \$10,114,000 or 28.9%; (2) net sales for the Aggregate and Mining Group increased approximately \$5,821,000 or 9.2%; (3) net sales for the Underground Group increased approximately \$5,435,000 or 23.7%; and (4) net sales for the Mobile Asphalt Group increased

approximately \$997,000 or 3.6%. Parts sales for the quarter ended September 30, 2006 were \$40,239,000 compared to \$35,642,000 for the quarter ended September 30, 2005, for an increase of \$4,597,000 or 12.9%. For the quarter ended September 30, 2006 compared to the same period of 2005, the increase in sales for all business segments related to a significant increase in international sales. Domestic sales accounted for 65.8% and international sales 34.2% of the third quarter revenues of 2006 compared to 80.5% for domestic sales and 19.5% for international sales for the third quarter of 2005.

For the nine months ended September 30, 2006, net sales increased \$66,904,000, or 13.9%, to \$548,455,000 from \$481,551,000 for the nine months ended September 30, 2005. For the nine months ended September 30, 2006 compared to the nine months ended September 30, 2005, (1) net sales for the Asphalt Group increased approximately \$12,740,000 or 9.3%; (2) net sales of the Aggregate and Mining Group increased approximately \$31,665,000 or 17.0%; (3) net sales for the Underground Group increased approximately \$10,684,000 or 15.8%; and (4) net sales for the Mobile Asphalt Group increased approximately \$11,815,000 or 12.9%. For the nine months ended September 30, 2006 compared to the same period of 2005, the increase in the sales for all business segments related primarily to an increase in international sales. Domestic sales accounted for 73.2% and international sales 26.8% of revenues during the nine months ended September 30, 2006 compared to 81.2% for domestic sales and 18.8% for international sales during the nine months ended September 30, 2005.

International sales for the quarter ended September 30, 2006 compared to the same period of 2005 increased \$29,617,000, or 102.1%. International sales were \$58,619,000 for the quarter ended September 30, 2006 compared to \$29,002,000 for the quarter ended September 30, 2005. For the quarters ended September 30, 2006 and 2005, international sales accounted for approximately 34.2% and 19.5% of net sales, respectively. International sales increased for the third quarter of 2006 compared to the same period in 2005, in Canada, Europe, Africa, South America, China, Japan, Korea and the Middle East while for the comparable periods international sales decreased in Australia, Central America and the West Indies. The Company believes the overall increased level of international sales relates to improving economic conditions in certain foreign economies, continued weakness of the U.S. dollar compared to certain foreign currencies and increased sales efforts by the Company in foreign markets.

International sales for the nine months ended September 30, 2006 compared to the same period of 2005 increased \$56,265,000, or 62.1%. International sales were \$146,836,000 for the nine months ended September 30, 2006 compared to \$90,571,000 for the nine months ended September 30, 2005. For the nine months ended September 30, 2006 and 2005, international sales accounted for approximately 26.8% and 18.8% of net sales, respectively. International sales increased for the nine months ended September 30, 2006 compared to the same period in 2005, in Canada, Europe, South America, Australia, the Middle East and Africa while for the comparable periods international sales decreased in the West Indies, China, Japan, Korea and Central America. The Company believes the overall increased level of international sales relates to improving economic conditions in certain foreign economies, continued weakness of the U.S. dollar compared to certain foreign currencies, and increased sales effort by the Company in foreign markets.

Gross profit for the three months ended September 30, 2006 increased \$7,825,000 or 23.6%, to \$41,017,000 from \$33,192,000 for the three months ended September 30, 2005. Gross profit as a percentage of sales for the three months ended September 30, 2006 and 2005 was 23.9% and 22.3%, respectively, or an increase of 160 basis points. For the quarter ended September 30, 2006 compared to the same period in 2005, gross profit for the Asphalt Group increased from approximately \$7,749,000 to approximately \$11,160,000 or an increase of approximately \$3,411,000 or 44.0%. This resulted in an increase in gross profit as a percentage of sales from 22.2% to 24.8% or 260 basis points for the same periods for the Asphalt Group. For the quarter ended September 30, 2006 compared to the same period in 2005, gross profit for the Aggregate and Mining Group increased from approximately \$15,278,000 to approximately \$16,688,000 or an increase of approximately \$1,410,000 or 9.2%. Gross profit as a percentage of sales remained consistent at 24.2% for the third quarters of 2006 and 2005 for the Aggregate and Mining Group. For the quarter ended September 30, 2006 compared to the same period in 2005, gross profit for the Mobile Asphalt Paving Group decreased from approximately \$6,380,000 to approximately \$5,989,000 or a decrease of approximately \$391,000 or

6.1%. This resulted in a decrease in gross profit as a percentage of sales from 22.8% to 20.7% or 210 basis points for the same periods for the Mobile Asphalt Paving Group. The decrease in margins for the Mobile Asphalt Paving Group was primarily caused by product mix variations and production inefficiencies encountered during a plant expansion and related relocation of manufacturing equipment. For the quarter ended September 30, 2006 compared to the same period in 2005, gross profit for the Underground Group increased from approximately \$3,809,000 to approximately \$7,200,000 or an increase of approximately \$3,391,000 or 89.0%. This resulted in an increase in gross profit as a percentage of sales from 16.6% to 25.4% or 880 basis points for the same periods for the Underground Group. The gross profit percentage increase for the quarter ended September 30, 2006 compared to the same period of 2005 was primarily due to a favorable mix of products, including increased parts sales, increased international sales, price increases, more efficient utilization of the Company's manufacturing capacity and the impact of the Company's cost and design initiative programs.

Gross profit for the nine months ended September 30, 2006 increased \$26,042,000 or 24.2%, to \$133,559,000 from \$107,517,000 for the nine months ended September 30, 2005. Gross profit as a percentage of sales for the nine months ended September 30, 2006 and 2005 was 24.4% and 22.3%, respectively, or an increase of 210 basis points. For the nine months ended September 30, 2006 compared to the same period in 2005, gross profit for the Asphalt Group increased from approximately \$29,592,000 to approximately \$37,981,000 or an increase of approximately \$8,389,000 or 28.3%. This resulted in an increase in gross profit as a percentage of sales from 21.7% to 25.5% or 380 basis points for the same periods for the Asphalt Group. For the nine months ended September 30, 2006 compared to the same period in 2005, gross profit for the Aggregate and Mining Group increased from approximately \$44,952,000 to approximately \$53,292,000 or an increase of approximately \$8,340,000 or 18.6%. This resulted in an increase in gross profit as a percentage of sales from 24.1% to 24.5% or 40 basis points for the same periods for the Aggregate and Mining Group. For the nine months ended September 30, 2006 compared to the same period in 2005, gross profit for the Mobile Asphalt Paving Group increased from approximately \$21,062,000 to approximately \$24,641,000 or an increase of approximately \$3,579,000 or 17.0%. This resulted in an increase in gross profit as a percentage of sales from 23.0% to 23.9% or 90 basis points for the same periods for the Mobile Asphalt Paving Group. For the nine months ended September 30, 2006 compared to the same period in 2005, gross profit for the Underground Group increased from approximately \$11,974,000 to approximately \$17,687,000 or an increase of approximately \$5,713,000 or 47.7%. This resulted in an increase in gross profit as a percentage of sales from 17.7% to 22.6% or 490 basis points for the same periods for the Underground Group. The gross profit percentage increase for the nine months ended September 30, 2006 compared to the same period of 2005 was primarily due to a favorable mix of products, including increased parts sales, increased international sales, price increases and the impact of the Company's cost and design initiative program implemented in 2005 that continues in 2006.

Selling, general, administrative and engineering expenses for the quarter ended September 30, 2006 were \$25,295,000, or 14.8% of net sales, compared to \$23,400,000, or 15.7% of net sales for the quarter ended September 30, 2005, an increase of \$1,895,000 or 8.1%. The increase in selling, general, administrative and engineering expenses for the three months ended September 30, 2006 compared to the same period of 2005 related primarily to an increase in personnel expenses of approximately \$1,072,000 due to increased staffing in order to support increased sales volume. Group health insurance expense increased approximately \$1,553,000 due to an increase in the utilization rate as compared to the prior year and an increase in staffing. Sales commissions increased approximately \$370,000 due to increased sales volumes while travel expense, including airline tickets, rental cars, lodging and meals increased approximately \$410,000 due to increased selling efforts by the Company and cost increases by vendors in these services. These increases were offset by a reversal of expense of approximately \$1,708,000 related to the Company's SERP. In addition, the Company was able to offset franchise tax expense with approximately \$450,000 of jobs tax credits granted by the state of Tennessee during the third quarter. The Company also recorded certain legal expenses in the third quarter of 2005 of approximately \$1,052,000 that did not reoccur in the third quarter of 2006.

Selling, general, administrative and engineering expenses for the nine months ended September 30, 2006 were \$80,307,000, or 14.6% of net sales, compared to \$69,020,000, or 14.3% of net sales for the nine months ended September 30, 2005, an increase of \$11,287,000 or 16.4%. The increase in selling, general, administrative and

engineering expenses for the nine months ended September 30, 2006 compared to the same period of 2005 related primarily to an increase in personnel expenses of approximately \$8,472,000 due to increased staffing in order to support increased sales volume. Group health insurance expense increased approximately \$2,781,000 due to an increase in the utilization rate as compared to the prior year and an increase in staffing. Profit-sharing expense increased approximately \$1,239,000 and is a formula-driven amount based on the performance of the Company's subsidiaries. Sales commissions increased approximately \$1,327,000 due to increased sales volumes. Expenses related to advertising and exhibits increased approximately \$815,000 and stock option expense related to the adoption of SFAS 123R was approximately \$470,000. Travel expense, including airline tickets, rental cars, lodging and meals, increased approximately \$1,395,000 due to increased selling efforts and cost increases in these services.

On September 27, 2005, the Company closed on the sale of the vacated Grapevine, Texas facility for \$13,200,000. The disposed assets had previously been classified on the consolidated balance sheet as assets held for sale with a book value of \$4,886,000. As a result, the Company recorded a pretax gain, net of closing costs, on the disposal of the Grapevine, Texas facility of \$7,714,000. In addition, during the third quarter of 2005, as a result of the Company's periodic review of its operations, the Company determined that certain idle real estate on the consolidated balance sheet included in property and equipment-net was impaired. The gain on the sale of the Grapevine, Texas facility of \$7,714,000, net of the real estate impairment charge of \$1,183,000, resulted in a net gain of \$6,531,000, which is shown on the consolidated statement of income for the periods ending September 30, 2005 as "gain on sale of real estate, net of real estate impairment charge".

Effective January 1, 2006, the Company adopted SFAS 123R, using the modified prospective method. The fair value of each option grant was estimated based on the date of grant using the Black-Scholes option pricing model. SFAS 123R requires the recognition of the cost of employee services received in exchange for an award of equity instruments in the financial statements and is measured based on the grant date calculated fair value of the award. SFAS 123R also requires the stock option compensation expense to be recognized over the period during which an employee is required to provide service in exchange for the award (the vesting period). Prior to the adoption SFAS 123R on January 1, 2006, the Company accounted for stock-based compensation plans in accordance with the provisions of APB No. 25 and applied the disclosure only provision of SFAS 123. Under APB 25, generally no compensation expense was recorded when the terms of the award were fixed and the exercise price of the employee stock option equaled or exceeded the market value of the underlying stock on the date of grant. The Company did not record compensation expense for option awards in periods prior to January 1, 2006.

For the three months ended September 30, 2006, the Company recorded no compensation expense related to stock options.

For the nine months ended September 30, 2006, the Company recorded compensation expense related to stock options that reduced income from operations by \$381,000, decreased the provision for income taxes by \$83,000, decreased net income by \$298,000 and decreased basic and diluted net income per share by \$.01 each. Cash received from options exercised during the nine months ended September 30, 2006 totaled \$8,938,000 and is included in the accompanying condensed consolidated statement of cash flows as a financing activity. The excess tax benefit realized from the exercise of these options totaled \$2,639,000. The stock option compensation expense was included in selling, general and administrative expenses in the accompanying condensed consolidated statement of income. As of September 30, 2006, no unrecognized compensation costs related to stock options remained to be expensed.

In August 2006, the Compensation Committee of the Board of Directors approved a five-year plan to award key members of management restricted stock units each year. The plan allows up to 511,000 shares to be granted to employees over the next five years. Units granted each year will be determined based upon individual subsidiaries and consolidated annual financial performance. Each award will vest at the end of five years from the date of grant, or at the time a recipient reaches age 65, if earlier. No awards have been granted to date, but based upon current estimated performance for 2006, management estimates that 62,500 will be granted in March, 2007. Compensation expense of \$89,000 has been recorded in the third quarter of 2006 to reflect the fair value of the 62,500 shares amortized over the

vesting period. The fair value of the restricted stock units was \$25.25 per share at September 30, 2006.

The Company adopted SFAS 123R using the modified prospective method and, consequently, the statement of operations for the quarter and nine months ended September 30, 2005 have not been restated to reflect the impact of applying the provisions of SFAS 123R. Had the Company accounted for stock-based compensation according to SFAS 123R during the quarter ended September 30, 2005, net income would have been increased by approximately \$83,000 resulting in no effect on basic earnings per share and an increase of \$0.01 in diluted earnings per share. Had the Company accounted for stock based compensation according to SFAS 123R during the nine months ended September 30, 2005, net income would have been reduced by approximately \$336,000 resulting in a \$0.01 reduction in basic and diluted earnings per share.

For the quarter ended September 30, 2006 compared to the quarter ended September 30, 2005, interest expense decreased \$932,000, or 68.9%, to \$421,000 from \$1,353,000. Interest expense as a percentage of net sales was 0.25% and 0.91% for the quarters ended September 30, 2006 and 2005, respectively. The decrease in interest expense for the three months ended September 30, 2006 compared to the same period of 2005 related primarily to the elimination of the Company's outstanding debt during late 2005 and the corresponding write-off of approximately \$520,000 of previously deferred financing fees along with no borrowings being made against the Company's line of credit in 2006. Interest expense for the three months ended September 30, 2006 related primarily to the amortization of prepaid loan fees and the payment of other monthly fees related to the GECC credit agreement which provides availability through May 2007.

For the nine months ended September 30, 2006 compared to the nine months ended September 30, 2005, interest expense decreased \$2,250,000, or 64.0%, to \$1,268,000 from \$3,518,000. Interest expense as a percentage of net sales was 0.23% and 0.73% for the nine month periods ended September 30, 2006 and 2005, respectively. The decrease in interest expense for the nine months ended September 30, 2006 compared to the same period of 2005 related primarily to the elimination of the Company's outstanding debt during late 2005 and no borrowings being made against the Company's line of credit in 2006. Interest expense for the nine months ended September 30, 2006 related primarily to the amortization of prepaid loan fees and the payment of other monthly fees related to the GECC credit agreement which provides availability through May 2007.

Other income, net was \$570,000 for the quarter ended September 30, 2006 compared to other income, net of \$56,000 for the quarter ended September 30, 2005, for an increase of \$514,000. Other income, net for the quarters ended September 30, 2005 and 2006 consisted primarily of interest income earned on the Company's available cash balances.

Other income, net was \$1,052,000 for the nine months ended September 30, 2006 compared to other income, net of \$191,000 for the nine months ended September 30, 2005, for an increase of \$861,000. Other income, net for the nine months ended September 30, 2005 and 2006 consisted primarily of interest income earned on the Company's available cash balances, offset by foreign currency exchange losses.

For the three months ended September 30, 2006, the Company recorded income tax expense of \$5,807,000, compared to income tax expense of \$4,938,000 for the three months ended September 30, 2005. This resulted in effective tax rates for the quarters ended September 30, 2006 and 2005 of 36.6% and 32.9%, respectively. The increase in the effective tax rate for the three months ended September 30, 2006 compared to the same period in 2005 is primarily due to the application of research and development credits from 2004 and prior years to the 2005 taxable income combined with an absence of research and development credits in the calculation of income tax expense in 2006. Although the Company has not claimed research and development credits in 2006 due to the lack of Congressional approval of such tax credits thus far, the Company fully expects to benefit from such credits during 2006 once Congress approves them. In addition, the meals and entertainment exclusion increased significantly relative to the same period last year.

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For the nine months ended September 30, 2006, the Company recorded income tax expense of \$19,666,000, compared to income tax expense of \$14,541,000 for the nine months ended September 30, 2005. This resulted in effective tax rates for the nine months ended September 30, 2006 and 2005 of 37.1% and 34.9%, respectively. The increase in the effective tax rate for the nine months ended September 30, 2006 compared to the same period in 2005 is primarily due to the application of research and development credits from 2004 and prior years to the 2005 taxable income combined with an absence of research and development credits in the calculation of income tax expense in 2006. Although the Company has not claimed research and development credits in 2006 due to the lack of Congressional approval of such tax credits thus far, the Company fully expects to benefit from such credits during 2006 once Congress approves them. In addition, the meals and entertainment exclusion increased significantly relative to the same period last year.

For the three months ended September 30, 2006, the Company had net income of \$10,026,000 compared to net income of \$10,059,000 for the three months ended September 30, 2005 for a decrease of \$33,000 or 0.3%. Earnings per diluted share for the three months ended September 30, 2006 were \$0.46 compared to earnings per diluted share for the quarter ended September 30, 2005 of \$0.47 for a decrease of \$0.01 or 2.1%. Diluted shares outstanding for the three months ended September 30, 2006 and 2005 were 21,927,051 and 21,239,420, respectively. The increase in shares outstanding is primarily due to the exercise of stock options by employees of the Company.

For the nine months ended September 30, 2006, the Company had net income of \$33,288,000 compared to net income of \$27,072,000 for the nine months ended September 30, 2005 for an increase of \$6,216,000 or 23.0%. Earnings per diluted share for the nine months ended September 30, 2006 were \$1.52 compared to earnings per diluted share for the nine months ended September 30, 2005 of \$1.30 for an increase of \$0.22 or 16.9%. Diluted shares outstanding for the nine months ended September 30, 2006 and 2005 were 21,960,133 and 20,799,050, respectively. The increase in shares outstanding is primarily due to the exercise of stock options by employees of the Company.

As shown on the chart below, the third quarter of 2005 earnings included an after tax gain on the sale of the Grapevine, Texas property of \$4,736,000, an after tax real estate impairment charge of \$726,000 and after tax costs of \$319,000 related to the payoff of the term loan. The gain on sale of real estate, net of real estate impairment charges, is presented as a separate line on the statement of income, and the costs related to the loan payoff are included in interest expense set forth therein. Excluding these items, net income for the third quarter of 2005 was \$6,368,000, compared to net income for the third quarter of 2006 of \$10,026,000, for a 57.4% increase. Diluted EPS in the third quarter of 2005 excluding these items was \$0.30 compared to \$0.46 in the third quarter of 2006 for a \$0.16 per share increase. Excluding these items, net income for the nine months ended September 30, 2005 was \$23,381,000, compared to net income for the nine months ended September 30, 2006 of \$33,288,000, for a 42.4% increase. Diluted EPS for the nine months ended 2005 excluding these items was \$1.12 compared to \$1.52 for the nine months ended September 30, 2006 for an increase of \$0.40 per share.

(amounts in thousands, except EPS)

	For the Three Months Ended September 30,		For the Nine Months Ended September 30,	
	<u>2006</u>	<u>2005</u>	<u>2006</u>	<u>2005</u>
Net income				
Unusual item net of tax:	\$ <u>10,026</u>	\$ <u>10,059</u>	\$ <u>33,288</u>	\$ <u>27,072</u>
Gain on sale of Grapevine facility	-	4,736	-	4,736

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Real estate impairment charge	-	(726)	-	(726)
Charge off of prepaid loan fees	<u>-</u>	<u>(319)</u>	<u>-</u>	<u>(319)</u>
Net income from unusual items	<u>-</u>	<u>3,691</u>	<u>-</u>	<u>3,691</u>
Net income excluding unusual items	\$ <u>10,026</u>	\$ <u>6,368</u>	\$ <u>33,288</u>	\$ <u>23,381</u>

EPS as reported:

Basic	\$0.47	\$0.49	\$1.56	\$1.34
Diluted	\$0.46	\$0.47	\$1.52	\$1.30

EPS excluding unusual items:

Basic	\$0.47	\$0.31	\$1.56	\$1.16
Diluted	\$0.46	\$0.30	\$1.52	\$1.12

The backlog of orders at September 30, 2006 was \$125,279,000 compared to \$72,233,000 at September 30, 2005, for an increase of \$53,046,000 or 73.4%. The increase in the backlog of orders at September 30, 2006 compared to September 30, 2005 related to an increase in domestic backlog totaling approximately \$30,793,000 and an increase in international backlog of orders of approximately \$22,253,000. The increase in domestic backlog at September 30, 2006 was due primarily to a \$20,001,000 increase in the Asphalt Group's domestic backlog and an increase of \$8,087,000 in the Underground group's domestic backlog. The increase in international backlog at September 30, 2006 related primarily to increased backlog for the Company's Aggregate and Mining Group, which increased approximately \$16,989,000 and Underground Group, which increased approximately \$4,236,000. The Company is unable to determine whether the increase in backlog was experienced by the industry as a whole.

Liquidity and Capital Resources

The Company entered into a revolving credit facility and senior note agreement with General Electric Capital Corporation ("GECC") on May 14, 2003. During the third quarter of 2005, the Company used available cash to pay off the senior note (term loan) portion of the GECC debt early. Currently, under the amended GECC revolving credit facility which expires on May 14, 2007, maximum borrowings of \$87,500,000 are based on a percentage of eligible receivables and inventory. The \$87,500,000 limit includes \$5,000,000 for use by the Canadian subsidiary Breaker Technology Ltd., as discussed further below. Availability under the revolving facility is adjusted monthly and interest is due in arrears. Interest rates are based on applicable index rates plus a sliding scale of applicable index margins from zero to three-fourths of one percent (0.75%), or at the option of the borrower, the LIBOR margin plus an applicable index margin from two percent (2.0%) to two and three-fourths percent (2.75%) based on a level of total funded debt ratio. Additionally, the GECC amended agreement permits the Company to hold inventory notes or customer financing of up to \$4,000,000 at any time. The credit facility contains certain restrictive financial covenants relative to operating ratios and capital expenditures. As of September 30, 2006, total availability under the revolving GECC credit facility was approximately \$79,907,000 and no borrowings were outstanding.

The Company was in compliance with the financial covenants under its credit facility as of September 30, 2006.

The Company's Canadian subsidiary, Breaker Technology Ltd, ("BTL") has available a credit facility issued by General Electric Capital-Canada ("GEC Canada") dated May 14, 2003, with a term of four years for \$5,000,000 to finance short-term working capital needs, as well as to cover the short-term establishment of letter of credit guarantees. Interest rates are based on applicable index rates plus a sliding scale of applicable index margins from two percent (2.0%) to two and three-fourths percent (2.75%) based on a level of total funded debt ratio. At September 30, 2006, no amounts were outstanding under the credit facility but BTL did have approximately \$389,000 in letter of credit guarantees under the facility. This amount is included in total letter of credit guarantees disclosed in "Note 8 - Contingent Matters". The Company is the primary guarantor to GEC Canada of payment and performance for this \$5,000,000 credit facility. The term of the guarantee is equal to the related debt. The maximum potential amount of future payments the Company would be required to make under its guarantee at September 30, 2006 was \$389,000.

The Company's South African subsidiary, Osborn Engineered Products SA (Pty) Ltd., ("Osborn") has available a credit facility of approximately \$2,578,000 (ZAR 20,000,000) to finance short-term working capital needs, as well as to cover the short-term establishment of letter of credit performance guarantees. As of September 30, 2006, Osborn had no outstanding borrowings under the credit facility, but approximately \$1,820,000 in performance and retention bonds were guaranteed under the facility. The facility is secured by Osborn's accounts receivable and retention balances. The available facility fluctuates monthly based upon fifty percent (50%) of Osborn's accounts receivables, retention and cash balances at the end of the prior month. As of September 30, 2006, Osborn Engineered Products had available credit under the facility of approximately \$758,000.

Net cash provided by operating activities for the nine months ended September 30, 2006 was \$23,052,000 compared to net cash provided by operating activities of \$24,172,000 for the nine months ended September 30, 2005. The decrease in net cash provided by operating activities for the nine months ended September 30, 2006 compared to the same period of 2005 relates primarily to an increase in inventory and the effect of a non-cash tax benefit related to stock based compensation, offset by increases in net income, customer deposits and other accrued liabilities.

Net cash used by investing activities for the nine months ended September 30, 2006 was \$22,095,000 compared to net cash provided by investing activities of \$3,178,000, for the nine months ended September 30, 2005. The increase in net cash used by investing activities for the nine months ended September 30, 2006 compared to the same period of 2005 relates primarily to an increase in capital expenditures during the nine months ended September 30, 2006 compared to the same period in 2005. Capital expenditures for the nine months ended September 30, 2006 were \$23,102,000 compared to \$9,321,000 for the nine months ended September 30, 2005. In addition, the Company had \$12,428,000 of proceeds from the sale of its Grapevine facility in 2005.

Net cash provided by financing activities for the nine months ended September 30, 2006 was \$11,521,000 compared to net cash used by financing activities of \$14,190,000 for the nine months ended September 30, 2005. The increase in net cash provided by financing activities for the nine months ended September 30, 2006 compared to the same period of 2005 relates primarily to higher proceeds from the exercise of stock options by Company employees in 2005 in comparison with 2006 and repayments of debt during 2005.

The Company believes that its current working capital, cash flows generated from future operations and available capacity remaining under its credit facility will be sufficient to meet the Company's working capital and capital expenditure requirements through September 30, 2007.

Capital expenditures for 2006 are forecasted to total approximately \$28,400,000. The Company expects to finance these expenditures using currently available cash balances and internally generated funds.

Contingencies



The Company is engaged in certain pending litigation involving claims or other matters arising in the ordinary course of business. Most of these claims involve product liability or other tort claims for property damage or personal injury against which the Company is insured. As a part of its litigation management program, the Company maintains general liability insurance coverage for product liability and other similar tort claims in amounts the Company believes are adequate. The coverage is subject to a substantial self-insured retention under the terms of which the Company has the right to coordinate and control the management of its claims and the defense of these actions.

As mentioned above, the Company is currently a party to various claims and legal proceedings that have arisen in the ordinary course of business. If management believes that a loss arising from such claims and legal proceedings is probable and can reasonably be estimated, the Company records the amount of the loss (including estimated legal costs), or the minimum estimated liability when the loss is estimated using a range, and no point within the range is more probable than another. As management becomes aware of additional information concerning such contingencies, any potential liability related to these matters is assessed and the estimates are revised, if necessary. If management believes that a loss arising from such claims and legal proceedings is either (i) probable but cannot be reasonably estimated or (ii) reasonably possible but not probable, the Company does not record the amount of the loss but does make specific disclosure of such matter. Based upon currently available information and with the advice of counsel, management believes that the ultimate outcome of its current claims and legal proceedings, individually and in the aggregate, will not have a material adverse effect on the Company's financial position, cash flows or results of operations. However, claims and legal proceedings are subject to inherent uncertainties and rulings unfavorable to the Company could occur. If an unfavorable ruling were to occur, there exists the possibility of a material adverse effect on the Company's financial position, cash flows or results of operations.

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

We have no material changes to the disclosure on this matter made in our Annual Report on Form 10-K for the year ended December 31, 2005.

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### Item 4. Controls and Procedures

#### Disclosure Controls and Procedures

The Company maintains disclosure controls and procedures designed to provide reasonable assurance that information required to be disclosed by the Company in the reports that the Company files or submits under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, and that such information is accumulated and communicated to the Company's management, including its Chief Executive Officer and its Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. As of September 30, 2006, the Company's Chief Executive Officer and Chief Financial Officer concluded that because the material weakness in the Company's internal controls over the financial reporting described in the Company's Annual Report on Form 10-K for the year ended December 31, 2005 has not been fully remedied, the Company did not maintain effective disclosure controls and procedures to provide reasonable assurance of the achievement of the objectives described above.

#### Changes in Internal Control over Financial Reporting

Management, with oversight of the Audit Committee of the Board of Directors, has been addressing the material weakness disclosed in the Company's 2005 Form 10-K and is committed to effectively remediating the underlying significant deficiencies in internal controls. Although the Company's remediation efforts are well underway, these

significant deficiencies will not be considered remediated until the new internal controls over financial reporting are fully implemented and operational for a period of time, are successfully tested, and management concludes that these controls are operating effectively. The Company's Chief Executive Officer and Chief Financial Officer have therefore concluded that there have been no changes made in the Company's internal controls over financial reporting in connection with its nine-month period ended September 30, 2006 evaluation that would materially affect, or are reasonably likely to affect, its internal control over financial reporting. The current status of the Company's remediation efforts related to the significant deficiencies identified at Astec Underground, Inc. is as follows:

I. Improvements to Steel Inventory Control- (a) The perpetual inventory procedure for the issuance of steel into production has been changed from relieving steel inventory late in the manufacturing process ("back flushing") to now issuing steel into production at the time it is used. This allows for easier and more accurate cycle counts of steel inventory; (b) The Company's prior practice of taking a full physical inventory once a year has been modified to include monthly physical counts of steel plate inventory and test counting of other steel inventory. Further refinements to the perpetual inventory procedures are continuing to be made; (c) Cycle count procedures are being modified to improve accuracy of our perpetual inventory to include using ABC classifications of inventory to obtain a higher dollar value of count coverage and improve the accuracy of the overall inventory valuation; (d) Bills of materials have been and are continuing to be reviewed for accuracy and corrections have been made as needed to improve the accuracy of the relief of inventory usage; (e) A new procedure has been developed whereby all inventory adjustments are reported and reviewed monthly for accuracy; and (f) Further enhancements to the way Underground's ERP (Enterprise Resource Planning) system is utilized, including MRPII (Manufacturing Resource Planning II) and control of finished goods in the Utility product line are being implemented. Additional cycle counts procedures and the use of scanners are also being implemented to improve the overall accuracy of inventory control efforts.

J. Accounting System Access Controls- Underground's management has completed a review of access to the ERP system, including the general ledger module, and has limited the access to only those individuals who are deemed to have a viable need to use a particular function. The documentation of all systems and controls has been completed and the needed refinements to user access has been made.

3. Journal Entry Authorization- Improved procedures are now in place to ensure that all journal entries posted are properly authorized including: (a) documented review of all journal entries entered; (b) comparison of journal entries entered to a revised journal entry checklist; and (c) review of accounting support documents to ensure that all reviews are properly documented and that all required reconciliations have been prepared and properly approved. Additionally, one individual in the accounting department has been assigned the responsibility to ensure that all supporting documents are properly approved and filed.

4. Monitoring Controls- The process of fully documenting controls and the development of the process of monitoring the significant controls has been completed.

#### Transition of Business and Financial Systems

During 2005, the Company's Telsmith subsidiary completed the process of installing the general ledger, purchasing, sales, production, product development and customer resource modules of a new ERP computer system as part of a phased implementation schedule. Additional refinements to the modules related to production, product development and customer resource management are scheduled for installation during the fourth quarter of 2006. The new systems installed were subjected to testing prior to and after installation and are functioning to ensure that information required to be disclosed by the Company in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. We have not experienced any significant difficulties to date in connection with the implementation or operations of the new systems.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

There have been no material developments in the legal proceedings previously reported by the registrant since the filing of its Annual Report on Form 10-K for the year ended December 31, 2005. See "Management's Discussion and Analysis of Financial Condition and Results of Operations - Contingencies" in Part I - Item 2 of this Report.

**Item 1A. Risk Factors**

In addition to the other information set forth in this Report, you should carefully consider the factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2005, which could materially affect our business, financial condition or future results. There have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2005. The risks described in our Annual Report on Form 10-K for the year ended December 31, 2005 are not the only risks facing our Company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or operating results.

**Item 6. Exhibits**

<u>Exhibit No.</u>	<u>Description</u>
31.1	Certification of the Chief Executive Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Certification of the Chief Financial Officer pursuant to Rule 13a-14(a)/15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32*	Certification of Chief Executive Officer and Chief Financial Officer of Astec Industries, Inc. pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

The Exhibits are numbered in accordance with Item 601 of Regulation S-K. Inapplicable Exhibits are not included in the list.

\* In accordance with Release No. 34-47551, this exhibit is hereby furnished to the SEC as an accompanying document and is not to be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to the liabilities of that section, nor shall it be deemed incorporated by reference into any filing under the Securities Act of 1933, as amended.

Items 2, 3, 4, and 5 are not applicable and have been omitted.

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.

ASTEC INDUSTRIES, INC.  
(Registrant)

Date November 9, 2006

/s/ J. Don Brock

J. Don Brock  
Chairman of the Board and  
President

Date November 9, 2006

/s/ F. McKamy Hall

F. McKamy Hall  
Chief Financial Officer, Vice  
President, and Treasurer

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