

DAKTRONICS INC /SD/  
Form 10-Q  
February 23, 2007

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

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FORM 10-Q

*(Mark One)*

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

**For the Quarterly Period Ended January 27, 2007**

**OR**

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

**For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_**

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**Commission File Number: 0-23246**

**DAKTRONICS, INC.**

(Exact name of Registrant as specified in its charter)

**South Dakota**  
(State or other jurisdiction of  
incorporation or organization)

**46-0306862**  
(I.R.S. Employer  
Identification Number)

**331 32nd Avenue**  
**Brookings, SD 57006**  
(Address of principal executive offices) (zip code)

**(605) 697-4000**  
(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 an accelerated filer or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer  Accelerated Filer  Non-Accelerated Filer

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Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes [ ] No [ X ]

The number of shares of the registrant's common stock outstanding as of February 13, 2007 was 39,337,732.

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DAKTRONICS, INC. AND SUBSIDIARIES  
FORM 10-Q  
For the Quarter Ended January 27, 2007

TABLE OF CONTENTS

	Page
<u>SPECIAL NOTE REGARDING FORWARD LOOKING STATEMENTS</u>	2
<b><u>PART I. FINANCIAL INFORMATION</u></b>	
<b><u>ITEM 1. FINANCIAL STATEMENTS</u></b>	
<u>CONSOLIDATED BALANCE SHEETS AS OF JANUARY 27, 2007 AND APRIL 29, 2006</u>	3
<u>CONSOLIDATED STATEMENTS OF INCOME FOR THE THREE AND NINE MONTHS</u> <u>ENDED JANUARY 27, 2007 AND JANUARY 28, 2006</u>	5
<u>CONSOLIDATED STATEMENTS OF CASH FLOWS FOR THE NINE MONTHS</u> <u>ENDED JANUARY 27, 2007 AND JANUARY 28, 2006</u>	6
<u>NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS</u>	7
<u>ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS</u>	17
<u>ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK</u>	27
<u>ITEM 4. CONTROLS AND PROCEDURES</u>	28
<b><u>PART II. OTHER INFORMATION</u></b>	
<u>ITEM 1. LEGAL PROCEEDINGS</u>	29
<u>ITEM 1A. RISK FACTORS</u>	29
<u>ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS</u>	29
<u>ITEM 3. DEFAULTS UPON SENIOR SECURITIES</u>	29
<u>ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS</u>	29
<u>ITEM 5. OTHER INFORMATION</u>	29
<u>ITEM 6. EXHIBITS</u>	29
<b><u>SIGNATURE</u></b>	30
<b>EXHIBITS</b>	
<u>Ex. 31.1</u> CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER REQUIRED BY RULE 13a-14(a) OR RULE 15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002	
<u>Ex. 31.2</u> CERTIFICATION OF THE CHIEF FINANCIAL OFFICER REQUIRED BY RULE 13a-14(a) OR RULE 15d-14(a) OF THE SECURITIES EXCHANGE ACT OF 1934, AS ADOPTED PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002	
<u>Ex. 32.1</u> CERTIFICATION OF THE CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002 (18 U.S.C. SECTION 1350)	
<u>Ex. 32.2</u> CERTIFICATION OF THE CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002 (18 U.S.C. SECTION 1350)	

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**Special Note Regarding Forward-Looking Statements**

*This Quarterly Report on Form 10-Q (including exhibits and information incorporated by reference herein) contains both historical and forward-looking statements that involve risks, uncertainties and assumptions. The statements contained in this report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21B of the Securities Exchange Act of 1934, as amended, including statements regarding our expectations, beliefs, intentions and strategies for the future.*

These statements appear in a number of places in this Report and include all statements that are not historical statements of fact regarding our intent, belief or current expectations with respect to, among other things: (i) our financing plans; (ii) trends affecting our financial condition or results of operations; (iii) our growth strategy and operating strategy; and (iv) the declaration and payment of dividends. The words may, would, could, will, expect, estimate, anticipate, believe, intend, plan and similar expressions and variations thereof are intended forward-looking statements. Investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risk and uncertainties, many of which are beyond our ability to control, and that actual results may differ materially from those projected in the forward-looking statements as a result of various factors discussed herein and those factors discussed in detail in our filings with the Securities and Exchange Commission, including in our Annual Report on Form 10-K for the fiscal year ended April 29, 2006 in the section entitled *Item 1A. Risk Factors*.

## PART I. FINANCIAL INFORMATION

### Item 1. FINANCIAL STATEMENTS

#### DAKTRONICS, INC. AND SUBSIDIARIES

#### CONSOLIDATED BALANCE SHEETS

(in thousands, except share data)

	January 27, 2007 (unaudited)	April 29, 2006 (note 1)
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 3,491	\$ 26,921
Marketable securities		8,310
Accounts receivable, less allowance for doubtful accounts	49,856	46,019
Inventories	51,218	31,045
Costs and estimated earnings in excess of billings	25,794	17,375
Current maturities of long-term receivables	4,809	4,476
Prepaid expenses and other	3,228	2,522
Deferred income taxes	7,204	6,213
Income taxes receivable	1,034	97
Rental equipment available for sale	188	286
	<u>146,822</u>	<u>143,264</u>
Total current assets:		
Advertising rights, net	3,833	3,112
Long-term receivables, less current maturities	8,888	8,756
Investments in affiliates	9,513	582
Goodwill	4,189	2,706
Intangible and other assets	3,520	636
Deferred income taxes	115	232
	<u>30,058</u>	<u>16,024</u>
<b>PROPERTY AND EQUIPMENT:</b>		
Land	3,269	1,223
Buildings	33,429	20,470
Machinery and equipment	38,099	22,332
Office furniture and equipment	32,943	22,926
Equipment held for rental	2,122	2,182
Demonstration equipment	4,805	4,899
Transportation equipment	6,161	4,863
	<u>120,828</u>	<u>78,895</u>
Less accumulated depreciation	42,463	38,336

	January 27,	April 29,
	<u>78,365</u>	<u>40,559</u>
TOTAL ASSETS	\$ 255,245	\$ 199,847

See notes to consolidated financial statements.

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**DAKTRONICS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**(continued)  
(in thousands, except share data)

	January 27, 2007 (unaudited)	April 29, 2006 (note 1)
	<u>          </u>	<u>          </u>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Notes payable, bank	\$ 19,217	\$
Accounts payable	27,671	20,506
Accrued expenses and warranty obligations	22,247	15,396
Current maturities of long-term debt and marketing obligations	1,093	491
Billings in excess of costs and estimated earnings	14,467	19,760
Customer deposits	8,399	7,777
Deferred revenue	4,854	3,849
Income taxes payable	149	555
	<u>98,097</u>	<u>68,334</u>
Total current liabilities:	98,097	68,334
Long-term debt, less current maturities	599	131
Long-term marketing obligations, less current maturities	434	574
Long-term warranty obligations and other payables	5,801	3,864
Deferred income taxes	1,779	1,599
	<u>8,613</u>	<u>6,168</u>
TOTAL LIABILITIES	106,710	74,502
<b>SHAREHOLDERS' EQUITY:</b>		
Common stock, no par value, authorized 120,000,000 shares: 39,353,398 and 38,931,676 shares issued at January 27, 2007 and April 29, 2006, respectively	21,471	19,551
Additional paid-in capital	6,368	3,480
Retained earnings	120,948	102,381
Treasury stock, at cost, 19,680 shares	(9)	(9)
Accumulated other comprehensive income (loss)	(243)	(58)
	<u>148,535</u>	<u>125,345</u>
TOTAL SHAREHOLDERS' EQUITY	148,535	125,345
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 255,245	\$ 199,847

See notes to consolidated financial statements.

**DAKTRONICS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF INCOME**

(in thousands, except per share data)  
(unaudited)

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	January 27, 2007	January 28, 2006	January 27, 2007	January 28, 2006
Net sales	\$ 106,731	\$ 71,050	\$ 322,414	\$ 219,197
Cost of goods sold	74,375	49,024	228,196	152,660
<b>Gross profit</b>	<b>32,356</b>	<b>22,026</b>	<b>94,218</b>	<b>66,537</b>
Operating expenses:				
Selling	13,692	10,417	38,666	29,405
General and administrative	5,231	2,479	13,587	7,784
Product design and development	3,611	2,890	11,166	8,124
	22,534	15,786	63,419	45,313
<b>Operating income</b>	<b>9,822</b>	<b>6,240</b>	<b>30,799</b>	<b>21,224</b>
Nonoperating income (expense):				
Interest income (expense), net	72	417	1,146	1,206
Other income (expense), net	(63)	(25)	(604)	(102)
<b>Income before income taxes</b>	<b>9,831</b>	<b>6,632</b>	<b>31,341</b>	<b>22,328</b>
Income tax expense	2,804	2,591	10,435	8,471
<b>Net income</b>	<b>\$ 7,027</b>	<b>\$ 4,041</b>	<b>\$ 20,906</b>	<b>\$ 13,857</b>
Weighted average number of fully diluted shares and common equivalent shares	41,479	40,593	41,304	40,361
Earnings per share:				
Basic	\$ 0.18	\$ 0.10	\$ 0.53	\$ 0.36
Diluted	\$ 0.17	\$ 0.10	\$ 0.51	\$ 0.34
Cash dividend paid per share	\$	\$	\$ 0.06	\$ 0.05

See notes to consolidated financial statements.

**DAKTRONICS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)  
(unaudited)

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	<u>Nine Months Ended</u>	
	<u>January 27, 2007</u>	<u>January 28, 2006</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 20,906	\$ 13,857
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation	8,835	6,224
Amortization	371	44
Gain on sale of property and equipment	4	(319)
Stock-based compensation	1,457	
Equity in earnings and losses of investments in affiliates	1,275	
Provision for doubtful accounts	(166)	(254)
Deferred income taxes, net	(694)	(2,041)
Change in operating assets and liabilities	(22,105)	(9,989)
	<hr/>	<hr/>
<b>Net cash provided by operating activities</b>	<b>9,883</b>	<b>7,522</b>
	<hr/>	<hr/>
<b>CASH FLOWS USED IN INVESTING ACTIVITIES:</b>		
Purchase of property and equipment	(46,576)	(13,227)
Cash consideration paid for investment in affiliates at equity	(13,800)	(165)
Sales (purchases) of marketable securities, net	8,310	(103)
Proceeds from sale of property and equipment	62	655
	<hr/>	<hr/>
<b>Net cash used in investing activities</b>	<b>(52,004)</b>	<b>(12,840)</b>
	<hr/>	<hr/>
<b>CASH FLOWS USED IN FINANCING ACTIVITIES:</b>		
Dividend paid	(2,339)	(1,917)
Excess tax benefits from stock-based compensation	926	
Principal payments on long-term debt	(69)	(894)
Net borrowing (payments) on notes payable	19,217	(87)
Proceeds from exercise of stock options and warrants	1,083	859
	<hr/>	<hr/>
<b>Net cash used in financing activities</b>	<b>18,818</b>	<b>(2,039)</b>
	<hr/>	<hr/>
EFFECT OF EXCHANGE RATE CHANGES ON CASH	(127)	53
	<hr/>	<hr/>
DECREASE IN CASH AND CASH EQUIVALENTS	(23,430)	(7,304)
	<hr/>	<hr/>
CASH AND CASH EQUIVALENTS BEGINNING OF PERIOD	26,921	15,961
	<hr/>	<hr/>
CASH AND CASH EQUIVALENTS END OF PERIOD	<b>\$ 3,491</b>	<b>\$ 8,657</b>
	<hr/>	<hr/>
Supplemental disclosures of cash flow information:		
Cash payments for:		
Interest	\$ 170	\$ 187
Income taxes, net of refunds	11,564	9,615
Supplemental schedule of non-cash investing and financing activities:		
Tax benefits related to exercise of stock options	\$ 1,431	\$ 517
Demonstration equipment transferred to inventory	1,625	
Purchase of plant and equipment included in accounts payable and notes payable	2,040	304
Transfers of equipment to affiliates	226	

See notes to consolidated financial statements.

**DAKTRONICS, INC. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands, except share and per share data)  
(unaudited)

**Note 1. Basis of Presentation**

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary to fairly present our financial position, results of operations and cash flows for the periods presented. The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts therein. Due to the inherent uncertainty involved in making estimates, actual results in future periods may differ from those estimates.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The balance sheet at April 29, 2006 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These financial statements should be read in conjunction with our financial statements and notes thereto for the year ended April 29, 2006, which are contained in our Annual Report on Form 10-K previously filed with the Securities and Exchange Commission. The results of operations for the interim periods presented are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year.

The consolidated financial statements include the accounts of our wholly-owned subsidiaries: Daktronics France SARL; Daktronics Shanghai, Ltd.; Daktronics GmbH; Star Circuits, Inc.; Daktronics Media Holdings, Inc. (formerly Sports Link, Ltd.); MSC Technologies, Inc.; Daktronics UK, Ltd.; Daktronics Hong Kong, Ltd.; Daktronics Canada, Inc., Daktronics Hoist, Inc. and Daktronics FZE. Investments in affiliates owned 50% or less are accounted for by the equity method. Intercompany balances and transactions have been eliminated in consolidation.

Use of estimates: The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the estimated total costs on long-term contracts, estimated costs to be incurred for product warranty, inventory valuation reserves for doubtful accounts and estimated effective annual tax rates. Changes in estimates are reflected in the periods in which they become known.

Reclassifications: Certain reclassifications have been made to the fiscal year 2006 financial statements to conform to the presentation used in the fiscal year 2007 financial statements. These reclassifications had no effect on shareholders' equity or net income as previously reported. We reclassified certain prepayments from accounts payable to prepaid expenses, reclassified certain deferred revenue amounts to accrued expenses and warranty obligations, reclassified equity investments on the balance sheet from intangibles and other assets, and netted current maturities of long-term debt and marketing obligations.

**Note 2. Significant Accounting Policies**

Prior to April 30, 2006, we accounted for share-based employee compensation plans under the measurement and recognition provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations, as permitted by Statement of Financial Accounting Standard (SFAS) No. 123, Accounting for Stock-Based Compensation. Accordingly, we recorded no share-based employee compensation expense for options granted under our current stock option plans during the three and nine months ended January 28, 2006, as all options granted under those plans had exercise prices equal to the fair market value of our common stock on the date of grant. We also recorded no compensation expense in those periods in connection with our Employee Stock Purchase Plan, as the purchase price of the stock was not less than 85% of the lower of the fair market value of our common stock at the beginning and end of each offering period. In accordance with SFAS No. 123 and SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, we provided pro forma net income and net income per share disclosures for each period prior to the adoption of SFAS No. 123(R), Share-Based Payment, as if we had applied the fair value-based method in measuring compensation expense for our share-based compensation plans.

Effective April 30, 2006, we adopted the fair value recognition provisions of SFAS No. 123(R), using the modified prospective transition method. Under that transition method, we recognized compensation expense for share-based payments that vested during the three and nine

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months ended January 27, 2007 using the following valuation methods: (a) for share-based payments granted prior to but not yet vested as of April 30, 2006, the grant date fair value was estimated in accordance with the original provisions of SFAS No. 123, and (b) for share-based payments granted on or after April 30, 2006, the grant date fair value was estimated in accordance with the provisions of SFAS No. 123(R). Because we elected to use the modified prospective transition method, results for prior periods have not been restated. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 107, Share-Based Payment, which provides supplemental implementation guidance for SFAS No. 123(R). We have applied the provisions of SAB No. 107 in our adoption of SFAS No. 123(R). See Note 11 for information on the impact of our adoption of SFAS No. 123(R) and the assumptions we use to calculate the fair value of share-based employee compensation.

As a result of adopting SFAS No. 123(R) on April 30, 2006, our income before income taxes and net income for the year ended April 29, 2006 would have been \$1,495 and \$1,405 lower, respectively, than if we had continued to account for share-based compensation under APB Opinion 25. Basic and diluted earnings per share for the year ended April 29, 2006 would have been \$0.04 and \$0.03 lower, respectively, if we had not adopted SFAS No. 123(R) at the beginning of fiscal year 2006.

Commitments and Contingencies. We are involved in various claims and legal actions arising in the ordinary course of business. In our opinion, based upon consultation with legal counsel, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position.

In connection with the sale of equipment to a financial institution, we entered into a contractual arrangement whereby we agreed to repurchase equipment at the end of the lease term at a fixed price of approximately \$1,100. We have recognized a guarantee in the amount of \$200 under the provisions of Financial Accounting Standards Board (FASB) Interpretation No. 45, Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. Revenue related to this transaction of \$3,476 was recognized during the second quarter of fiscal year 2007.

Product Warranties. We offer standard warranty coverages on many of our products, which include parts and in some cases labor, maintenance and support, for periods varying from one to 10 years. The specific terms and conditions of these warranties vary depending on the product sold and other factors. We estimate the costs that may be incurred under the warranty and record a liability in the amount of such costs at the time the product is shipped in the case of standard orders and prorated over the construction period in the case of custom projects. Factors that affect our warranty liability include historical and anticipated costs. We periodically assess the adequacy of our recorded warranty costs and adjust the amounts as necessary.

Changes in our product warranties for the nine months ended January 27, 2007 consisted of the following:

	<b>Amount</b>
Beginning accrued warranty costs	\$ 8,102
Warranties issued during the period	8,537
Settlements made during the period	(5,093)
Changes in accrued warranty costs for pre-existing warranties during the period, including expirations	(375)
	\$ 11,171
Ending accrued warranty costs	\$ 11,171

Lease Commitments. We lease office space for sales and service locations and various equipment, primarily office equipment. Rental expense for operating leases was \$1,411 and \$991 for the nine months ended January 27, 2007 and January 28, 2006, respectively. Future minimum payments under noncancelable operating leases, excluding executory costs such as management and maintenance fees, with initial or remaining terms of one year or more, consisted of the following at January 27, 2007:

<u>Fiscal Year</u>	<u>Amount</u>
2007	\$ 627
2008	2,125
2009	1,791
2010	1,205
2011	1,054
Thereafter	789
Total	\$ 7,591



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Purchase Commitments. From time to time, we commit to purchase inventory and advertising rights over periods that extend over a year. As of January 27, 2007, we were obligated to purchase inventory and advertising rights through fiscal year 2010 as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2007	\$ 74
2008	74
2009	74
2010	72
	<hr/>
Total	\$ 294

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### Note 3. Recently Issued Accounting Pronouncements

In June 2006, the FASB issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN No. 48), which clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, Accounting for Income Taxes (SFAS No. 109). FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods and disclosure. FIN No. 48 is effective for fiscal years beginning after December 15, 2006 and is required to be adopted by us effective April 29, 2007. We are currently evaluating the impact of FIN No. 48 on our financial statements.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurement. The standard provides guidance for using fair value to measure assets and liabilities. SFAS No. 157 clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. SFAS No. 157 is effective for us beginning in 2008; however, early adoption is permitted. We have not yet determined the impact, if any, that the implementation of SFAS No. 157 will have on our results of operations and financial condition.

In September 2006, the SEC issued SAB No. 108 Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB No. 108). SAB No. 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for fiscal years ending on or after November 15, 2006, with early application encouraged. We do not expect the adoption of this standard to have any impact on our consolidated financial statements.

### Note 4. Revenue Recognition

*Long-term contracts:* Earnings on long-term contracts are recognized on the percentage-of-completion method, measured by the percentage of costs incurred to date to estimated total costs for each contract. Operating expenses are charged to operations as incurred and are not allocated to contract costs. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are estimable.

*Equipment other than long-term contracts:* We recognize revenue on equipment sales, other than long-term contracts, when title passes, which is usually upon shipment and then only if the revenue is fixed and determinable.

*Long-term receivables and advertising rights:* We occasionally sell and install our products at facilities in exchange for the rights to sell or to retain future advertising revenues. For these transactions, we recognize revenue for the amount of the present value of the future advertising payments if enough advertising is sold to obtain normal margins on the contract, and we record the related receivable in long-term receivables. On those transactions where we have not sold the advertising for the full value of the equipment at normal margins, we record the related cost of equipment as advertising rights. Revenue to the extent of the present value of the advertising payments is recognized in long-term receivables when it becomes fixed and determinable under the provisions of the applicable advertising contracts. At the time the revenue is recognized, costs of the equipment are recognized based on an estimate of overall margin expected.

In cases where we receive advertising rights, as opposed to only cash payments, in exchange for the equipment, revenue is recognized as it becomes earned, and the related costs of the equipment are amortized over the term of the advertising rights, which were owned by us. On these transactions, advance collections of advertising revenues are recorded as deferred income.

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The cost of advertising rights, net of amortization, was \$3,833 as of January 27, 2007 and \$3,112 as of April 29, 2006.

*Product maintenance:* In connection with the sale of our products, we also occasionally sell separately priced extended warranties and product maintenance contracts. The revenues related to such contracts are deferred and recognized ratably as net sales over the term of the contracts, which varies from one month to 10 years.

*Software:* We sell our proprietary software bundled with displays and certain other products. Pursuant to American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, Software Revenue Recognition, as amended by SOP 98-4, Deferral of the Effective Date of a Provision of SOP 97-2, and SOP 98-9, Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions, revenues from software license fees on sales, other than long-term contracts, are recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed and determinable and collection is probable. For sales of software included in long-term contracts, the revenue is recognized under the percentage-of-completion method for long-term contracts starting when all of the above-mentioned criteria have been met.

*Services:* Revenues generated by us for services such as event support, control room design, on-site training, equipment service and continuing technical support for operators of our equipment are recognized as net sales as the services are performed.

*Derivatives:* We utilize derivative financial instruments to manage the economic impact of fluctuations in currency exchange rates on those transactions that are denominated in currency other than our functional currency, which is the U.S. Dollar. We enter into currency forward contracts to manage these economic risks. SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 137 and No.138, requires us to recognize all of our derivative instruments on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through earnings. If a derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in the fair value of the hedged assets, liabilities or firm commitments through earnings or recognized in accumulated other comprehensive gain (loss) until the hedged item is recognized in earnings.

To protect against the reduction in value of forecasted foreign currency cash flows resulting from export sales over the next year, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue denominated in foreign currencies with forward contracts. When the dollar strengthens significantly against the foreign currencies, the decline in value of future foreign currency revenue is offset by gains in the value of the forward contracts designated as hedges. Conversely, when the dollar weakens, the increase in the value of future foreign currency cash flows is offset by losses in the value of the forward contracts.

During the nine months ended January 27, 2007, we assessed all hedges to be effective and recorded changes of value in other comprehensive income. Cash flow hedges were discontinued, causing the recognition of a gain or loss in other income (expense), net of (\$7). The fair value of all derivatives is included in prepaid expenses and other in the statement of financial condition.

As of January 27, 2007, we expect to reclassify \$1 of net gains (losses) on derivative instruments from accumulated other comprehensive income to earnings during the next 12 months due to actual sales.

### Note 5. Earnings Per Share

Basic earnings per share (EPS) is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that would occur if securities or other obligations to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in our earnings.

A reconciliation of the income and common share amounts used in the calculation of basic and diluted EPS for the three months ended January 27, 2007 and January 28, 2006 follows:

	Net Income	Shares	Per Share Amount
For the three months ended January 27, 2007:			
Basic earnings per share	\$ 7,027	39,290,401	\$ 0.18
Effect of dilutive securities:			
Exercise of outstanding stock options		2,188,615	(0.01)
Diluted earnings per share	\$ 7,027	41,479,016	\$ 0.17

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			<b>Per Share</b>
For the three months ended January 28, 2006:			
Basic earnings per share	\$ 4,041	38,706,725	\$ 0.10
Effect of dilutive securities:			
Exercise of outstanding stock options and warrants		1,886,442	
Diluted earnings per share	\$ 4,041	40,593,167	\$ 0.10
For the nine months ended January 27, 2007:			
Basic earnings per share	\$ 20,906	39,148,040	\$ 0.53
Effect of dilutive securities:			
Exercise of outstanding stock options and warrants		2,156,490	(0.02)
Diluted earnings per share	\$ 20,906	41,304,530	\$ 0.51
For the nine months ended January 28, 2006:			
Basic earnings per share	\$ 13,857	38,565,632	\$ 0.36
Effect of dilutive securities:			
Exercise of outstanding stock options and warrants		1,795,556	(0.02)
Diluted earnings per share	\$ 13,857	40,361,188	\$ 0.34

On May 25, 2006, our Board of Directors declared a two-for-one stock split in the form of a stock dividend payable to stockholders of record on June 8, 2006. All data related to common shares has been retroactively adjusted based on the new number of shares outstanding after the effect of the split for all periods presented.

On August 16, 2006, the shareholders of Daktronics approved an amendment to the articles of incorporation to increase the authorized number of shares of common stock from 60,000,000 shares to 120,000,000 shares.

**Note 6. Goodwill and Other Intangible Assets**

We account for goodwill and other intangible assets in accordance with SFAS No. 142, Goodwill and Other Intangible Assets, and we complete an impairment analysis on at least an annual basis and more frequently if circumstances warrant.

Goodwill, net of accumulated amortization, was \$4,189 at January 27, 2007 and \$2,706 at April 29, 2006. Accumulated amortization was \$157 at January 27, 2007 and at April 29, 2006. We performed our annual impairment analysis of goodwill as of October 27, 2006. The result of this analysis indicated that no goodwill impairment existed as of that date.

As required by SFAS No. 142, intangibles with finite lives continue to be amortized. Included in intangible assets are non-compete agreements and a patent license. Intangible assets before accumulated amortization were \$3,969 at January 27, 2007 and April 29, 2006. Accumulated amortization was \$950 and \$579 at January 27, 2007 and April 29, 2006, respectively. The net value of intangible assets is included as a component of intangible and other assets in the accompanying consolidated balance sheets. Estimated amortization expense based on intangibles as of January 27, 2007 was \$503 for the fiscal years ending 2007, \$314 for fiscal years 2008 to 2010, \$287 for 2011 and \$1,256 thereafter.

**Note 7. Inventories**

Inventories consist of the following:

	<b>January 27, 2007</b>	<b>April 29, 2006</b>
Raw Materials	\$ 30,086	\$ 15,841

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	January 27, 2007	April 29, 2006
Work-in-process	13,635	6,025
Finished goods	7,497	9,179
	\$ 51,218	\$ 31,045

**Note 8. Segment Disclosure**

Our chief operating decisionmaker reviews financial information presented on a consolidated basis, accompanied by disaggregated information about revenue and certain expenses, by market and geographic region, for purposes of assessing financial performance and making operating decisions. Accordingly, we consider ourselves to be operating in a single industry segment. We do not manage our business by solution or focus area.

We do not maintain information on sales by products and, therefore, disclosure of such information is not practical.

The following table presents information about us by geographic area:

	United States	Other	Total
Net sales for the nine months ended:			
January 27, 2007	\$ 280,759	\$ 41,655	\$ 322,414
January 28, 2006	194,516	24,681	219,197
Long-lived assets at:			
January 27, 2007	77,145	1,220	78,365
January 28, 2006	36,898	1,161	38,059

**Note 9. Equipment Held for Sale**

In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we review long-lived assets to be held and used and long-lived assets to be disposed of, including intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of the asset to the future undiscounted net cash flows expected to be generated by the asset. Recoverability of assets held for sale is measured by comparing the carrying amount of the assets to their estimated fair market value. If any assets are considered to be impaired, the impairment is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value.

*Impairment of Long-Lived Assets:* We recorded a pre-tax asset impairment charge of \$340 for the nine months ended January 27, 2007. The impairment charges related to technology changes in our demonstration equipment and tooling equipment. Impairment charges are included in selling expenses and cost of goods sold. We recorded the impairment in the first quarter of 2007.

**Note 10. Acquisitions**

During the first quarter of fiscal year 2007, we acquired a 50% equity interest in Arena Media Networks LLC, a company that owns and operates the nation's largest network of digital flat-panel displays in stadiums and arenas across the U.S. We paid approximately \$6,008 for the investment, and we account for this transaction under the equity method of accounting.

During the second quarter of fiscal year 2007, we acquired a 50% interest in FuelCast Media International, the largest pump-top display network in the nation. We paid approximately \$4,000 for the investment, and we account for this transaction under the equity method of accounting.

On October 16, 2006, we acquired certain operating assets and liabilities of Hoffend & Sons, Inc. through our wholly-owned subsidiary. The business operates under the name Vortek, a division of Daktronics Hoist, Inc. Results of the operations of Vortek have been included in the consolidated financial statements since the date of acquisition. Hoffend was the world's leading supplier of patented hoist systems for theater and sporting systems and has been a supplier of ours in connection with center hung arena video systems. The aggregate purchase price, excluding

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contingent consideration, was approximately \$4,270 and includes \$500 due one year from the closing date. Contingent consideration of \$1,500 is due over the three calendar years following the closing date to the extent the gross profit on net sales of hoist products exceed predefined thresholds. In addition, contingent payments are due at the end of the fifth calendar year following closing to the extent gross profit on net sales of hoist products exceeds \$50,000. We are in the process of obtaining third-party valuations of certain intangible assets; thus, the allocation of the purchase price and related amounts assigned to intangibles and goodwill set forth below is preliminary. The following table summarizes the allocation of the purchase price along with the related amortization periods, if any:

	<b>Amount Allocated</b>	<b>Amortization Period</b>
Intangible assets subject amortization:		
Patents	\$ 2,282	10 years
Order backlog	300	Based on order ship dates
Non-compete agreements	200	5 years
Intangible assets not subject amortization:		
Registered trademarks	401	
Goodwill	1,514	
Net assets/(liabilities)	(427)	
Total purchase price	\$ 4,270	

The goodwill is expected to be deductible for tax purposes.

### Note 11. Share-Based Compensation

*Description of Plans.* We have two plans under which we are permitted to grant incentive and non-qualified stock options (the 1993 Incentive Stock Option Plan and the 2001 Incentive Stock Option Plan) and two plans under which we are permitted to grant non-qualified stock options (the 1993 Outside Directors Stock Option Plan and the 2001 Outside Directors Stock Option Plan). These plans authorize the awards of incentive stock options to our employees and nonqualified stock options to non-employees and outside directors as compensation for services rendered. Under these plans, options have a maximum term of 10 years in the case of the 1993 Incentive Stock Option Plan and the 2001 Incentive Stock Option Plan and seven years in the case of the 1993 Outside Directors Stock Option Plan and the 2001 Outside Directors Stock Option Plan. In addition, such options must have exercise prices equal to the market value of our common stock at the date of grant or 110% of the market value at the date of grant in the case of an employee who owns more than 10% of all voting power of all classes of our stock then outstanding. The options generally vest ratably over a five-year period in the case of options granted under the 1993 Incentive Stock Option Plan and the 2001 Incentive Stock Option Plan and three years in the case of options granted under the 1993 Outside Directors Stock Option Plan and the 2001 Outside Directors Stock Option Plan. The actual vesting period is determined at the time of grant.

*Impact of the Adoption of SFAS No. 123(R).* See Note 2 for a description of our adoption of SFAS No. 123(R) on April 30, 2006. A summary of the share-based compensation expense for stock options and our employee stock purchase plan that we recorded in accordance with SFAS No. 123(R) for the three and nine months ended January 27, 2007 is as follows:

	<b>Three-months ended January 27, 2007</b>	<b>Nine Months Ended January 27, 2007</b>
Cost of Sales	\$ 39	\$ 100
Selling	321	675
General and administrative	139	439
Product development and design	103	245
	\$ 602	\$ 1,459
Decrease of net income per share to common stockholders	\$ 0.01	\$ 0.03

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Prior to the adoption of SFAS No. 123(R), we presented all tax benefits for deductions resulting from the exercise of stock options as operating cash flows on our statement of cash flows. SFAS No. 123(R) requires the cash flows resulting from the tax benefits for tax deductions in excess of the compensation expense recorded for those options (excess tax benefits) to be classified as financing cash flows. Accordingly, we classified the \$251 in excess tax benefits as financing cash inflows rather than as operating cash inflows on our statements of cash flows for the nine months ended January 27, 2007.

*Valuation and Amortization Method.* We estimate the fair value of stock options granted using the Black-Scholes option valuation model. We amortize the fair value of the stock options on a straight-line basis. All options are amortized over the requisite service periods of the awards, which are generally the vesting periods.

*Expected Term.* The expected term of options granted represents the period of time that they are expected to be outstanding. We estimate the expected term of options granted based on historical exercise patterns, which we believe are representative of future behavior. Our estimate of the expected life of new options granted to our employees is five years, consistent with prior periods. We have examined our historical pattern of option exercises in an effort to determine if there were any discernable patterns of activity based on certain demographic characteristics. Demographic characteristics tested included age, salary level, job level and geographic location. We have determined that there were no meaningful differences in option exercise activity based on the demographic characteristics tested.

*Expected Volatility.* Also in light of implementing SFAS No. 123(R), we reevaluated our expected volatility assumption used in estimating the fair value of employee options. We estimate the volatility of our common stock at the date of grant based on historical volatility, consistent with SFAS No. 123(R) and SAB No. 107. Our decision to use historical volatility instead of implied volatility was based upon analyzing historical data along with the lack of availability of history of actively traded options on our common stock.

*Risk-Free Interest Rate.* We base the risk-free interest rate that we use in the Black-Scholes option valuation model on the implied yield in effect at the time of option grant on U.S. Treasury zero-coupon issues with equivalent remaining terms.

*Dividends.* We use an expected dividend yield consistent with our dividend yield over the period of time we have paid dividends in the Black-Scholes option valuation model.

*Forfeitures.* SFAS No. 123(R) requires us to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest. For purposes of calculating pro forma information under SFAS No. 123 for periods prior to fiscal 2006, we estimated forfeitures.

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because changes in the subjective input assumptions can materially affect the fair value estimate, in our opinion, the existing models do not necessarily provide a reliable single value of our options and may not be representative of the future effects on reported net income or the future stock price of our company.

*Share-Based Compensation Expense and Stock Option Activity.* We recorded \$1,457 in share-based compensation expense, which consists of \$1,213 for stock options and \$244 for our employee stock purchase plan, for the nine months ended January 27, 2007. As of January 27, 2007, there was \$7,236 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under all equity compensation plans. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures. We expect to recognize that cost over a weighted average period of five years.

During the nine months ended January 27, 2007, we granted options to purchase 48 shares of our common stock under the 2001 Directors Stock Option Plan, which had a fair value of \$400, and granted options to purchase 333 shares of our common stock under the 2001 Incentive Stock Option Plan, which had a fair value of \$4,141.

A summary of stock option activity under all stock option plans during the nine months ended January 27, 2007 is as follows:

	Stock Options	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding at April 29, 2006	3,292	\$ 6.31	4.91	\$ 33,370
Granted	381	32.64		

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Cancelled or Forfeited	(15)	11.35	(239)
Exercised	(367)	2.96	(8,198)
Outstanding at January 27, 2007	3,291	9.70	5.50
Exercisable at January 27, 2007	2,169	\$ 5.02	\$ 64,866

We define in-the-money options at January 27, 2007 as options that had exercise prices that were lower than the \$34.92 per share market price of our common stock at that date. The aggregate intrinsic value of options outstanding at January 27, 2007 is calculated as the difference between the exercise price of the underlying options and the market price of our common stock for the shares that were in-the-money at that date. There were 3,200 in-the-money options exercisable at January 27, 2007.

We received \$1,083 in cash from option exercises under all share-based payment arrangements for the nine months ended January 27, 2007. The actual tax benefits that we realized related to tax deductions for non-qualified option exercises and disqualifying dispositions under all share-based payment arrangements totaled \$925 for the same period.

*Comparable Disclosure.* Prior to April 30, 2006, we accounted for our share-based compensation plans under the recognition and measurement provisions of APB Opinion No. 25 and related Interpretations. No share-based employee compensation cost is reflected in the condensed consolidated statements of operations for the nine months ended January 28, 2006, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and net income per share if we had applied the fair value recognition provisions of SFAS No. 123 to share-based employee compensation prior to April 30, 2006:

	<b>Three Months Ended January 28, 2006</b>	<b>Nine Months Ended January 28, 2006</b>
Net income, as reported	\$ 4,041	\$ 13,857
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(224)	(560)
Pro forma net income	\$ 3,817	\$ 13,297
Net income per share:		
Basic as reported	\$ 0.10	\$ 0.36
Basic - pro forma	\$ 0.10	\$ 0.34
Diluted as reported	\$ 0.10	\$ 0.34
Diluted - pro forma	\$ 0.10	\$ 0.33

**Note 12. Comprehensive Income**

We follow the provisions of SFAS No. 130, Reporting Comprehensive Income, which establishes standards for reporting and display of comprehensive income and its components. Comprehensive income reflects the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. For us, comprehensive income represents net income adjusted for foreign currency translation adjustments and net gains and losses on derivative instruments. The foreign currency translation adjustment included in comprehensive income has not been tax effected, as the investment in the foreign affiliate is deemed to be permanent. In accordance with SFAS No. 130, we have chosen to disclose comprehensive income in the consolidated statement of shareholders' equity.

	<b><u>Nine Months Ended</u> January 27, 2007</b>	<b><u>January 28, 2006</u></b>
Net income	\$ 20,906	\$ 13,857
Net foreign currency translation adjustment	170	242
Net gain on derivatives	17	20

Total comprehensive income	\$ 21,093	\$ 14,119
	<u>          </u>	<u>          </u>

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

The following discussion highlights the principal factors affecting changes in financial condition and results of operations. This discussion should be read in conjunction with the accompanying unaudited consolidated financial statements and notes to the unaudited consolidated financial statements.

### OVERVIEW

We design, manufacture and sell a wide range of display systems to customers in a variety of markets throughout the world. We focus our sales and marketing efforts on geographical regions, markets and products. The primary categories of markets include sport, commercial and transportation.

Our net sales and profitability historically have fluctuated due to the impact of large product orders, such as display systems for professional sport facilities and colleges and universities, as well as the seasonality of the sports market. Net sales and gross profit percentages also have fluctuated due to other seasonality factors, including the impact of holidays, which primarily impact our third fiscal quarter. Our gross margins on large product orders tend to fluctuate more than those for smaller standard orders. Large product orders that involve competitive bidding and substantial subcontract work for product installation generally have lower gross margins. Although we follow the percentage of completion method of recognizing revenues for large custom orders, we nevertheless have experienced fluctuations in operating results and expect that our future results of operations may be subject to similar fluctuations.

Orders are booked only upon receipt of a firm contract and, depending on terms, only after receipt of any required deposits related to the order. As a result, certain orders for which we have received binding letters of intent or contracts will not be booked until all required contractual documents and deposits are received. In addition, order bookings can vary significantly as a result of the timing of large orders.

We operate on a 52-53 week fiscal year, with fiscal years ending on the Saturday closest to April 30 of each year. Fiscal years 2007 and 2006 each contains 52 weeks.

For a summary of recently issued accounting pronouncements and the effects of those pronouncements on our financial results, refer to Note 3 of the notes to our consolidated financial statements, which are included elsewhere in this report.

### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The following discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On a regular basis, we evaluate our estimates, including those related to estimated total costs on long-term contracts, estimated costs to be incurred for product warranties and extended maintenance contracts, bad debts, excess and obsolete inventory and contingencies. Our estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies require significant judgments and estimates in the preparation of our consolidated financial statements:

*Revenue recognition on long-term contracts.* Earnings on long-term contracts are recognized on the percentage-of-completion method, measured by the percentage of costs incurred to date to estimated total costs for each contract. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are capable of being estimated. Generally, contracts we enter into have fixed prices established and, to the extent the actual costs to complete contracts are higher than the amounts estimated as of the date of the financial statements, the resulting gross margin would be negatively affected in future quarters when we revise our estimates. Our practice is to revise estimates as soon as such changes in estimates are known. We do not believe there is a reasonable likelihood that there will be a material change in future estimates or assumptions we use to determine these estimates.



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*Allowance for doubtful accounts.* We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. To identify impairment in the customer's ability to pay, we review aging reports, contact customers in connection with collection efforts and review other available information. Although we consider our allowance for doubtful accounts adequate, if the financial condition of our customers were to deteriorate and impair their ability to make payments to us, additional allowances may be required in future periods. We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to determine the allowance for doubtful accounts. As of January 27, 2007 and April 29, 2006, we had an allowance for doubtful accounts balance of approximately \$1.5 million and \$1.4 million, respectively.

*Warranties.* We have created a reserve for warranties on our products equal to our estimate of the actual costs to be incurred in connection with our performance under the warranties. Generally, estimates are based on historical experience taking into account known or expected changes. If we would become aware of an increase in our warranty reserves, additional reserves may become necessary, resulting in an increase in costs of goods sold. We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to determine our reserve for warranties. As of January 27, 2007 and April 29, 2006, we had approximately \$11.2 million and \$8.1 million reserved for these costs, respectively.

*Extended warranty and product maintenance.* We have deferred revenue related to separately priced extended warranty and product maintenance agreements. The deferred revenue is recognized ratably over the contractual term. If we would become aware of an increase in our estimated costs under these agreements in excess of our deferred revenue, additional reserves may be necessary, resulting in an increase in costs of goods sold. In determining if additional reserves are necessary, we examine cost trends and other information on the contracts and compare that to the deferred revenue. We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to determine estimated costs under these agreements. As of January 27, 2007 and April 29, 2006, we had \$4.9 million and \$3.8 million of deferred revenue related to extended warranty and product maintenance, respectively.

*Inventory.* Inventories are stated at the lower of cost or market. Market refers to the current replacement cost, except that market may not exceed the net realizable value (that is, estimated selling price in the ordinary course of business less reasonable predictable costs of completion and disposal); and market is not less than the net realizable value reduced by an allowance for normal profit margins. In valuing inventory, we estimate market value where it is believed to be the lower of cost or market, and any necessary charges are charged to costs of goods sold in the period in which it occurs. In determining market value, we review various factors such as current inventory levels, forecasted demand and technological obsolescence. We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to calculate the estimated market value of inventory. However, if market conditions change, including changes in technology, product components used in our products or in expected sales, we may be exposed to losses or gains that could be material.

*Income Taxes.* As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating the actual current tax expense as well as assessing temporary differences in the treatment of items for tax and accounting purposes. These timing differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheets. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income in each jurisdiction, and to the extent we believe that recovery is not likely, a valuation allowance must be established. We review deferred tax assets, including net operating losses, and for those not expecting to be realized, we have created a valuation allowance. If our estimates of future taxable income are not met, a valuation allowance for some of these deferred tax assets would be required.

We operate within multiple taxing jurisdictions, both domestic and international, and are subject to audits in these jurisdictions. These audits can involve complex issues, including challenges regarding the timing and amount of deductions and the allocation of income amounts to various tax jurisdictions. At any one time, multiple tax years are subject to audit by various tax authorities. The United States Internal Revenue Service (IRS) recently completed the process of examining our U.S. federal tax returns for fiscal years 2002 through 2005.

We record our income tax provision based on our knowledge of all relevant facts and circumstances, including the existing tax laws, the status of current IRS examinations and our understanding of how the tax authorities view certain relevant industry and commercial matters. In evaluating the exposures associated with our various tax filing positions, we record reserves for probable exposures. A number of years may elapse before a particular matter for which we have established a reserve is audited and fully resolved or clarified. We adjust our tax contingencies reserve and income tax provision in the period in which actual results of a settlement with tax authorities differs from our established reserve, when the statute of limitations expires for the relevant taxing authority to examine the tax position, or when more information becomes available. Our tax contingencies reserve contains uncertainties because management is required to make assumptions and to apply judgment to estimate the exposure associated with our various filing positions. We believe that any potential tax assessments from various tax authorities that are not covered by our income tax provision will not have a material adverse impact on our consolidated financial position or cash flow.

**RESULTS OF OPERATIONS**

The following table sets forth the percentage of net sales represented by items included in our consolidated statements of income for the periods indicated:

	<u>Three Months Ended</u>		<u>Nine Months Ended</u>	
	<u>January 27, 2007</u>	<u>January 28, 2006</u>	<u>January 27, 2007</u>	<u>January 28, 2006</u>
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	69.7%	69.0%	70.8%	69.6%
Gross profit	30.3%	31.0%	29.2%	30.4%
Operating expenses	21.1%	22.2%	19.7%	20.7%
Operating income	9.2%	8.8%	9.5%	9.7%
Interest income (expense)	0.1%	0.5%	0.4%	0.6%
Other income (expense), net	(0.1%)	0.0%	(0.2%)	(0.01%)
Income before income taxes	9.2%	9.3%	9.7%	10.2%
Income tax expense	2.6%	3.6%	3.2%	3.9%
Net income	6.6%	5.7%	6.5%	6.4%

**NET SALES**

Net sales increased 47.1% to \$322.4 million for the nine months ended January 27, 2007 as compared to \$219.2 million for the same period in fiscal year 2006. Net sales increased 50.2% to \$106.7 million for the three months ended January 27, 2007 as compared to \$71.1 million for the same period in fiscal year 2006.

For the nine months and three months ended January 27, 2007, net sales increased in all our markets, with the commercial market experiencing growth rates in excess of 65% for the nine-month period, the sports market growing more than 35% year-to-date and the transportation market up approximately 25%. For the three months ended January 27, 2007, commercial, sports and transportation markets net sales increased approximately 70%, 41% and 3%, respectively. Net sales for the three months ended January 27, 2007 increased domestically and on an international basis. On an international basis, net sales increased over 250% for the quarter and are up more than 50% year-to-date primarily as a result of performance in Asian markets. As a percent of overall net sales, small product orders as opposed to large custom orders were approximately 24% of net sales for the third quarter of fiscal 2007 and 22% year-to-date.

Overall, the level of net sales generated through the first two quarters of fiscal year 2007 and to some lesser extent in the third quarter of fiscal year 2007 in all markets was limited as a result of capacity constraints within our manufacturing facilities, both in terms of space and personnel. This trend began in the second quarter of fiscal year 2006 and diminished to a large degree in the third quarter as a result of the ramping up of facilities in Brookings and Sioux Falls, South Dakota. We will continue to develop increased manufacturing capabilities, including in Asia (which is not expected to be significant in the near term). During the third quarter of fiscal year 2007, these constraints became less of a factor, and based on the current outlook for the rest of the fiscal year, we do not expect to have significant capacity constraints; however, this is dependent on the timing of orders versus the expected delivery dates. At this point, other than the completion of our addition in Brookings, South Dakota, and the addition of a facility in Redwood Falls, Minnesota we do not expect to make any significant investments in buildings or land over the next 12 months for the purpose of meeting customer demand.

As we have reported in prior filings, we have made two investments in two media companies, one that owns and controls the nation's largest network of digital LCD and plasma screens in professional sports facilities and the other company that owns and controls the nation's largest gas pump digital display network. Both of these transactions are expected to help us generate more recurring revenue opportunities and expand our services businesses. Also, these companies are non-consolidated entities, and therefore their sales are not included in our net sales. During the second quarter of fiscal year 2007, we acquired certain operating assets of Hoffend & Sons, Inc., a leader in the automated hoist business for sporting and theater applications. Sales related to this business have exceeded \$4 million year-to-date, and we expect that for the fiscal year, it will exceed our previous estimates of \$5 million.

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*Commercial Market.* Net sales in the commercial market grew during the third quarter and first nine months of fiscal year 2007 as compared to the same periods of fiscal year 2006. For the first nine months of fiscal year 2007, net sales increased more than 65%, and for the quarter, they increased more than 70% as compared to the same periods of last fiscal year. This increase is attributable to increases in both standard and custom orders. The increase in custom projects for both the quarter and year-to-date is due primarily to an increase in orders from outdoor advertising companies, while the increase in standard products is due to the growth in our Galaxy display business within the national account portion of our business and through resellers. On an international basis, net sales increased over 50% year-to-date as compared to the same periods of last fiscal year, due in part to the increase in business in Asian markets, especially gaming opportunities in Macau. We continue to believe that we are gaining traction in our efforts to build our international business and are seeing a greater potential for higher sales overseas. However, as a result of the significant growth rates domestically, we would not expect international business in the commercial market to outpace our domestic growth in the near term.

Overall, the commercial market continues to benefit from increasing product acceptance, lower cost of displays, our expanding distribution network and a better understanding by our customers of the product as a revenue generation tool. The most significant factor for increasing sales has been the order volume of digital displays for outdoor advertising companies. This industry continues to increase its demand for digital displays in place of traditional billboards due to the enhanced margins and cash flow that they achieve. Our rate of growth could increase depending on our success in capturing and retaining the business of the major billboard companies. It is important to note that the same constraints that exist in the sign business overall with the regulatory environment apply to a greater degree to digital displays, although it appears that the outdoor advertising companies have been very successful in working through these constraints.

We expect that the growth in the commercial market will continue throughout fiscal year 2007 due to increased order volume in the billboard market, our expanded distribution network, greater product acceptance, our international expansion, the development of our resellers and our integrated product offerings. Net sales in the commercial market should also expand at rates faster than our other markets, and our national account business and billboard business within the commercial market could grow faster depending on our success in booking major accounts. We also expect to see growth generated through sales of our new ProTour line of mobile and modular displays, which we believe will drive improvements in profitability internationally.

Our growth in the commercial market depends to some degree on the state of the economy, which we do not believe had any adverse effects in the first nine months of fiscal year 2007 as opposed to the same period in fiscal year 2006.

Order bookings in the commercial market were up 9% for the third quarter of fiscal year 2007 and more than 53% year-to-date as compared to the same periods of fiscal year 2006. The smaller than expected increase for the quarter was due to a decline in orders in the outdoor advertising portion of our business, which we attribute more to the timing of orders, as we had an extensive backlog of orders in this niche as we entered the quarter. Increases overall were the result of the same factors as mentioned above in connection with net sales.

*Sports Market.* Within the sports markets, the increase in net sales in the third quarter of fiscal year 2007 as compared to the third quarter of fiscal year 2006 was the result of increases in large and small sports facilities, with the majority of the growth on a dollar basis occurring in the larger venues. In addition, most of the growth in net sales both for the quarter and on a year-to-date basis as compared to the prior fiscal year was in large contracts as opposed to standard orders. Included in our smaller sports venues sales are sales of hoists, a business we acquired in October of 2006 as described above. This has added in excess of \$4 million to our net sales since the acquisition date. Our sports market is subject to volatility based on the timing of large orders, especially orders for professional facilities, which can cause net sales to fluctuate year-to-year. The mid-sized and small facilities experience more consistency in growth rates due to the greater number of facilities. The increase in net sales to large sports venues for the year was attributable to increases at both college and professional sports facilities and included the benefit of the unusually large amount of orders booked in the first half of fiscal year 2007.

The growth in net sales for large and small sports venues was due to a number of factors, including the expanding market, with facilities spending more on larger display systems; our product and services offering, which remains the most integrated and comprehensive offering in the industry; and our network of sales and service offices, which is important to support our customers. We believe that the effects of the economy have a lesser impact on our sports market as compared to our other markets, since our products are generally revenue generation tools (through advertising) for facilities and the sports business in general is more resistant to negative factors in the economy as a whole.

An important trend that continues to gain momentum in large professional and college facilities is the demand for high definition video displays as well as more square footage of video equipment overall at facilities, both of which should have the effect of increasing order sizes on large projects. We believe that this could be an important factor in our growth for the future, along with the development of video systems for larger high school and smaller college facilities.

The dollar amount of orders (as opposed to net sales) in the sports market decreased in the third quarter of fiscal year 2007 as compared to the third quarter of fiscal year 2006. Orders are up approximately 30% year-to-date. This improved performance is due to the same reasons indicated for the increase in net sales in the sports market. The growth in orders was in the same niches as net sales. Orders on an international basis within the sports market were not significant.

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For the rest of fiscal year 2007, we expect that net sales and orders in the sports market will continue to outpace the prior periods of fiscal year 2006. We believe that the growth in the sports market over the long-term is driven by new product development, new uses for existing products, an expanding market as our products become more affordable to more institutions, growth internationally, and our overall product offerings, which we believe are the most complete systems in the marketplace.

*Transportation Market.* Net sales in the transportation market for the third quarter of fiscal year 2007, as compared to the third quarter of fiscal 2006, were flat, and for the year to date are up more than 24% as compared to fiscal year 2006, fueled by order bookings in the second quarter of fiscal 2006. Order bookings for the third quarter of fiscal year 2007 were up over 90%, creating a year-to-date growth of more than 30%. For the rest of fiscal year 2007 and into the fiscal year 2008, we believe that we will benefit from legislation passed during calendar year 2005 by Congress that provided for increased spending on transportation projects, including large increases associated with intelligent transportation systems, and that sales and orders will outpace fiscal year 2006.

*Other Markets.* We occasionally sell products in exchange for the advertising revenues generated from use of products. These sales represented less than 1% of net sales for the third quarter and nine months ended January 27, 2007, respectively. The gross profit percents on these transactions should typically be higher than the gross profit percents on other transactions of similar size, although the selling expenses associated with these transactions are typically higher.

Historically, our sales have declined in our third quarter on a sequential basis, primarily as a result of the time between the start of major sports seasons and the effects of the holidays. As our commercial market has developed, we have seen this decline on sales on a sequential basis generally diminish. However, as a result of our significant efforts during the second quarter of fiscal year 2007, which included numerous extra shifts and various other tactics to decrease backlog which were not sustainable, net sales declined sequentially as a percentage in the third quarter of fiscal 2007 more than in the third quarter of fiscal 2006. We expect that in the future, this decline will not be as great as it was in this fiscal year.

The order backlog as of January 27, 2007 was approximately \$98 million as compared to \$83 million as of January 28, 2006 and \$123 million at the beginning of the third quarter of fiscal year 2007. Historically, our backlog varies due to the timing of large orders. Our order backlog as of January 27, 2007 was higher in the commercial and transportation markets when compared to the backlog as of January 28, 2006 and January 27, 2007. The changes in the backlog were the result of the combination of the changes in orders and net sales discussed above as well as the constraints in capacity as mentioned above.

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### GROSS PROFIT

Gross profit increased 46.9% to \$32.4 million for the third quarter of fiscal 2007 as compared to \$22.0 million for the third quarter of fiscal year 2006. For the nine months ended January 27, 2007, gross profit increased 41.6% to \$94.2 million compared to \$66.5 million for the nine months ended January 28, 2006. As a percent of net sales, gross profit was 30.3% and 29.2% for three and nine months ended January 27, 2007 as compared to 31.0% and 30.4% for the three and nine months ended January 28, 2006.

The gross profit percentage decrease for both the quarter and nine months ended January 27, 2007 as compared to the same periods in fiscal year 2006 relate to a number of factors, including the lower margins on a few of larger projects described in our Quarterly Report on Form 10-Q for the quarter ended July 29, 2006 which effected primarily the first and second quarter of fiscal year 2007, the increased costs of expanding facilities, higher warranty costs, the mix between small orders versus large custom product orders and various other factors.

We strive towards higher gross margins as a percent of net sales, although depending on the actual mix, performance on larger projects, our ability to execute on the business and level of future sales, margin percentages may not increase and are likely to remain below the levels of the last fiscal year in the upcoming quarter due to the continuation of efforts to expand facilities.

We believe a gross profit margin of 30% is achievable for the fourth quarter of fiscal year 2007. There are a number of factors that could affect this expectation, including our actual mix of sales and performance on the orders, the level at which we book orders during the quarter and our ability to execute the rollout of the new facilities. Finally, our ability to estimate gross profit margin is subject at all times to the inherent volatility that comes with long-term contracts like our custom orders.

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### OPERATING EXPENSES

*Operating expenses.* Operating expenses, which are comprised of selling, general and administrative expenses and product design and development costs, increased by approximately 42.7% from \$15.8 million in the third quarter of fiscal year 2006 to \$22.5 million in the third quarter of fiscal year 2007. As a percent of net sales, operating expenses decreased from 21.1% of net sales to 19.7% of net sales. For the nine months ended January 27, 2007, operating expenses increased 40.0% from \$45.3 million for the nine months ended January 28, 2006 to \$63.4 million for the nine months ended January 27, 2007. All areas of operating costs were impacted by the costs of stock option expensing under SFAS No. 123(R) which became effective in fiscal year 2007, as well as by much higher than expected health insurance costs for the first and

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third quarters of fiscal year 2007.

*Selling Expenses.* Selling expenses consist primarily of salaries, other employee-related costs, travel and entertainment expense, facilities-related costs for sales and service offices, and expenditures for marketing efforts, including collateral materials, conventions and trade shows, product demos and supplies.

Selling expenses increased 31.4% to \$13.7 million for the three months ended January 27, 2007 as compared to \$10.4 million for the same period in fiscal year 2006. Selling expenses increased 31.5% to \$38.7 million for the nine months ended January 27, 2007 from \$29.4 million for the same period in fiscal year 2006. Selling expenses decreased to 12.8% of net sales for the third quarter of fiscal year 2007 from 14.7% of net sales for the third quarter of fiscal year 2006. For the nine months ended January 27, 2007, selling expenses were 12.0% of net sales as compared to 13.4% of net sales for the nine months ended January 28, 2006.

Selling expenses for the quarter and the nine months ended January 27, 2007 were higher as a result of an increase in personnel costs, as we continued to build our sales infrastructure in all markets and internationally. This includes increases in initiatives such as support for sales of extended services, geographical expansion, and sales efforts related to new products and market niches. In addition, selling expenses increased due to the increasing investment in demonstration equipment and travel costs associated with the higher level of order bookings. Finally, selling expenses were impacted by the acquisition of the hoist business at the end of the second quarter of fiscal year 2007. We expect selling expense to increase slightly in the fourth quarter as compared to the third quarter of fiscal 2007.

*General and Administrative.* General and administrative expenses consist primarily of salaries, other employee-related costs, professional fees, shareholder relations fees, facilities and equipment-related costs for administration departments, amortization of intangibles and supplies.

General and administrative expenses increased 111.0% to \$5.2 million for the third quarter of fiscal year 2007 as compared to \$2.5 million for the third quarter of fiscal year 2006. General and administrative expenses increased 74.6% to \$13.6 million for the nine months ended January 27, 2007 as compared to \$7.8 million for the nine months ended January 28, 2006. General and administrative expenses increased to 4.9% as a percent of net sales for the third quarter of fiscal year 2007 from 3.5% of net sales for the third quarter of fiscal year 2006. For the nine months ended January 27, 2007, general and administrative expenses increased to 4.2% of net sales as compared to 3.6% of net sales for the nine months ended January 28, 2006.

The increase in general and administrative expenses for the first nine months of fiscal year 2007 as compared to the first nine months of fiscal year 2006 was due to the implementation of SFAS No. 123(R) relating to stock option expense; increases in personnel-related costs within general and administration, primarily information systems staff due to our growth and additions to human resources to support our growth overall; professional fees associated with the completion of the IRS audit, which are partially offset through a lower effective tax rate; information systems maintenance and support costs; international expansion; and higher recruiting and training costs of our expanding workforce. We expect that general and administrative costs will increase slightly in the fourth quarter of fiscal year 2007.

*Product Design and Development.* Product design and development expenses consist primarily of salaries, other employee-related costs, facilities and equipment-related costs, and costs of supplies.

Product design and development expenses increased 24.9% to \$3.6 million for the three months ended January 27, 2007 compared to \$2.9 million for the same period in fiscal year 2006. Product design and development expenses increased 37.4% to \$11.2 million for the nine months ended January 27, 2007 as compared to \$8.1 million for the nine months ended January 28, 2006. Product design and development expense was 3.4% of net sales for the third quarter of fiscal year 2007 and 4.1% of net sales for third quarter of fiscal 2006. Product design and development expenses were 3.5% and 3.7% of net sales for the nine months ended January 27, 2007 and January 28, 2006, respectively.

Generally, product design and development expenses increase when our engineering resources are not dedicated to long-term contracts, as the same personnel who work on research and development also work on long-term contracts. During the third quarter of fiscal 2007, we continued to invest in a number of critical initiatives. We expect that product design and development expenses will be less than 4% of net sales for all of fiscal year 2007.

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### INTEREST INCOME AND EXPENSE

We occasionally generate interest income through product sales on an installment basis, under lease arrangements or in exchange for the rights to sell and retain advertising revenues from displays, which result in long-term receivables. We also invest excess cash in short-term temporary cash investments and marketable securities that generate interest income. Interest expense is comprised primarily of interest costs on our notes payable and long-term debt. Interest income (expense), net, resulting from these items decreased 82.7% to \$0.07 million for the three months ended January 27, 2007 as compared to \$0.4 million for the third quarter of fiscal year 2006. For the nine months ended January 27, 2007, interest income (expense), net, decreased 5.0% to \$1.1 million from \$1.2 million for the nine months ended January 28, 2006. The change for the nine months as a whole was the result of lower average levels of temporary cash investments, marketable securities and long-term

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receivables outstanding during the respective periods as well as the higher level of debt outstanding, primarily in the third quarter of fiscal year 2007. The decline for the third quarter of fiscal 2007 was attributable to the significant investments we made in building our facilities and equipment, which caused the amounts of average cash, temporary cash investments and marketable securities to decline and the amount of debt to increase. We expect that during the rest of fiscal year 2007, our cash balances will increase and we will trend towards higher net interest income.

### **OTHER INCOME (EXPENSE), NET**

Other income (expense) did not significantly change from the third quarter of fiscal year 2007 as compared to the third quarter of fiscal year 2006. For the first nine months of fiscal year 2007, other income (expense), net decreased to (\$0.6) million from (\$0.1) million for the same period in fiscal year 2006. The change results from the effects of earnings attributable to unconsolidated affiliates and from currency gains and losses.

### **INCOME TAX EXPENSE**

Income taxes were approximately \$2.8 million in the third quarter of fiscal year 2007 and \$2.6 million for the third quarter of fiscal year 2006. For the first nine months of fiscal year 2007, income taxes increased to \$10.4 million as compared to \$8.5 million for the first nine months of fiscal year 2006. The effective tax rate for the nine months ended January 27, 2007 was 33.3% as compared to 37.9% for the first nine months of fiscal year 2006. The effective rate was lower in fiscal year 2007 as a result of the utilization of net operating losses in Europe, which had previously been offset by valuation allowances; benefits relating to transfer pricing assumptions; and the conclusion of an IRS audit, which examined tax returns from fiscal years 2002 through 2005. In addition, during the third quarter of fiscal year 2007, Congress passed legislation which was signed into law by the President reinstating the credit for qualified research and development expenses, retroactive to January 1, 2006. This allowed us to recognize the benefit of the credit for a 13-month period in the third quarter. We expect that the effective tax rate for the fourth quarter will approximate 34% and will increase to more than 36% in fiscal year 2008.

In the second quarter of fiscal year 2007, we completed an examination by the IRS primarily related to research and development credits we utilized in the past. The net result was a benefit to income tax expense. We also continue to be optimistic that as a result of perceived improvements in our international business, we will begin generating taxable income in foreign jurisdictions, which would allow us to recognize the benefits related to net operating loss carryforwards that have been offset by a valuation reserve.

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### **LIQUIDITY AND CAPITAL RESOURCES**

Working capital, consisting of current assets less current liabilities, was \$48.7 million at January 27, 2007 and \$74.9 million at April 30, 2006. We have historically financed working capital needs through a combination of cash flow from operations and borrowings under bank credit agreements.

Cash provided by operations for the nine months ended January 27, 2007 was \$9.9 million. Net income of \$20.9 million, plus depreciation and amortization of \$9.2 million, plus increases in accounts payable, billings in excess of costs and estimated earnings, deferred revenue, and income taxes payable, were offset by increases in inventory, accounts receivable, restricted cash, costs and estimated earnings in excess of billings, prepaid insurance and other assets and advertising rights and the effects of changes in various other operating assets and liabilities.

The changes overall in operating assets and liabilities are generally due to the impact of the timing of cash flows on large projects, which can cause significant fluctuations in the short term. We expect that as a result of various initiatives underway, including changes being made in manufacturing, purchasing, collections and payment processes, we expect to continue to improve our cash flow from operations and our balance sheet as a whole, relative to the sales level.

Cash used by investing activities was \$52.0 million for the nine months ended January 27, 2007. This included \$46.9 million for purchases of property and equipment. During the first nine months of fiscal year 2007, we invested approximately \$12.9 million in facilities additions, primarily related to manufacturing facilities in Brookings, South Dakota, Sioux Falls, South Dakota and Redwood Falls, Minnesota; \$1.6 million in transportation equipment; \$18.3 million in manufacturing equipment; \$8.1 million in information systems infrastructure, including software; \$2.5 million for rental equipment; \$2.0 million in land; and \$1.2 million in product demonstration equipment. These investments were made to support our continued growth and to replace obsolete equipment. During the first nine months of fiscal 2007, we made investments in two different entities and purchased assets from another entity, as described previously, which approximated \$13.8 million in cash. These investments are not expected to have significant impact on cash from operations. During the nine months ended January 27, 2007, we sold \$8.3 million of marketable securities.

In early fiscal 2007, we began construction of another addition to our facilities in Brookings, South Dakota. The majority of the addition is designed to be used for administrative and manufacturing space and is expected to be complete in early fiscal 2008. The total cost of the building and related equipment is approximately \$14 million. We expect that total capital equipment investments for all of fiscal 2007 will exceed \$50

million.

Cash provided by financing activities in the first nine months of fiscal year 2007 consisted of \$18.8 million, including advances on our line credit of \$19.2 million and proceeds from stock options of \$1.1 offset by the dividend paid to shareholders on June 23, 2006, of \$2.3 million, which were partially offset by option exercises and excess tax benefits from stock-based compensation. We expect that the bank debt will be repaid in the short term. Because we have funded the majority of the intended capital investments already through the first three quarters of the 2007 fiscal year, it is unlikely that we will need to incur any additional debt to fund the expansion plans over the rest of the fiscal year. During the second quarter of fiscal year 2007, we purchased a land parcel in Sioux Falls, South Dakota for long-term development and financed it through a note from the seller.

Included in receivables as of January 27, 2007 was approximately \$0.5 million of retainage on long-term contracts, all of which is expected to be collected in one year.

We have used and expect to continue to use cash reserves and bank borrowings to meet our short-term working capital requirements. On large product orders, the time between order acceptance and project completion may extend up to and exceed 18 months depending on the amount of custom work and the customer's delivery needs. We often receive a down payment or progress payments on these product orders. To the extent that these payments are not sufficient to fund the costs and other expenses associated with these orders, we use working capital and bank borrowings to finance these cash requirements.

Our product development activities include the enhancement of existing products and the development of new products from existing technologies. Product design and development expenses were \$3.6 million for the quarter ended January 27, 2007 and \$11.2 million for the nine months ended January 27, 2007. We intend to continue to incur these expenditures to develop new display products using various display technologies to offer higher resolution and more cost effective and energy efficient displays. We also intend to continue developing software applications for our display controllers to enable these products to continue to meet the needs and expectations of the marketplace.

We have a credit agreement with a bank that provides for a \$45.0 million line of credit, which includes up to \$10.0 million for standby letters of credit. The interest rate on the line of credit is equal to LIBOR plus 0.75% (5.3% at January 27, 2007) and is due on November 15, 2008. As of January 27, 2007, approximately \$19.2 million was outstanding under the line of credit. In addition, standby letters of credit were issued and outstanding for approximately \$1.0 million as of January 27, 2007. The credit agreement is unsecured and requires us to meet certain covenants, including a minimum interest bearing debt to earnings before interest taxes depreciation and amortization ratio, a limit on dividends and distributions, and a minimum adjusted fixed charge coverage ratio. Daktronics Canada, Inc., our subsidiary, has various credit agreements that provide up to \$0.2 million in borrowings under lines of credit. The interest rate on the lines of credit is equal to 1.0% above the prime rate of interest (6.0% at January 27, 2007). As of January 27, 2007, no advances under the line of credit were outstanding. The lines are secured primarily by accounts receivables, inventory and other assets of the subsidiary. Finally, as mentioned above, we incurred approximately \$1.1 million of debt secured by land purchased in Sioux Falls, South Dakota. The note bears no interest and matures on September 1, 2008.

On May 25, 2006, our Board of Directors approved a two-for-one stock split of our common stock in the form of a stock dividend. Stockholders of record at the close of business on June 8, 2006 received one additional share for each share of common stock held on that date of record. Our stock began trading on the split-adjusted basis on June 23, 2006. On that same date, our Board also declared an annual dividend payment of \$.06 per share (as adjusted for the two-for-one stock split declared by the Board of Directors on May 25, 2006) on our common stock for the year ended April 29, 2006. Although we intend to pay regular annual dividends for the foreseeable future, all subsequent dividends will be reviewed annually and declared by our Board of Directors at its discretion.

We are sometimes required to obtain performance bonds for display installations, and we have a bonding line available through a surety company that provides for an aggregate of \$100 million in bonded work outstanding. At January 27, 2007, we had approximately \$18.9 million of bonded work outstanding against this line.

We believe that based on our current growth estimates over the next 12 months, we have sufficient capacity under our lines of credit. Beyond that time, we may need to increase the amount of our credit facilities depending on various factors. We anticipate that we will be able to obtain any needed funds under commercially reasonable terms from our current lender. We believe that cash from operations from our existing or increased credit facility and from our current working capital will be adequate to meet the cash requirements of our operations in the foreseeable future.

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

**FOREIGN CURRENCY EXCHANGE RATES**

Through January 27, 2007, most of our net sales were denominated in United States dollars, and our exposure to foreign currency exchange rate changes was not significant. Net sales originating outside the United States through the third quarter of fiscal year 2007 were 13.7% of total net sales. We operate in various countries in Europe, Asia and the Middle East and in Canada through wholly-owned subsidiaries. Sales of those foreign subsidiaries comprised 10.0% of net sales during the third quarter of fiscal year 2007. If we believed that currency risk in any foreign location was significant, we would utilize foreign exchange hedging contracts to manage our exposure to the currency fluctuations.

We expect net sales to international markets in the future to increase and that a greater portion of this business will be denominated in foreign currencies. As a result, operating results may become subject to fluctuations based upon changes in the exchange rates of certain currencies in relation to the United States dollar. To the extent that we engage in international sales denominated in United States dollars, an increase in the value of the United States dollar relative to foreign currencies could make our products less competitive in international markets. This effect is also impacted by the sources of raw materials from international sources. We will continue to monitor and minimize our exposure to currency fluctuations and, when appropriate, use financial hedging techniques, including foreign currency forward contracts and options, to minimize the effect of these fluctuations. However, exchange rate fluctuations as well as differing economic conditions, changes in political climates, differing tax structures and other rules and regulations could adversely affect our financial results in the future.

**INTEREST RATE RISKS**

Our exposure to market rate risk for changes in interest rates relates primarily to our debt and long-term accounts receivables. We maintain a blend of both fixed and floating rate debt instruments. As of January 27, 2007, our outstanding debt approximated \$22.1 million, substantially all of which was in fixed rate obligations. Each 100 basis point increase or decrease in interest rates would have an insignificant annual effect on variable rate debt interest based on the balances of such debt as of January 27, 2007. For fixed-rate debt, interest rate changes affect its fair market value but do not affect earnings or cash flows.

In connection with the sale of certain display systems, we have entered into various types of financings with customers. The aggregate amounts due from customers include an interest element. The majority of these financings carry fixed rates of interest. As of January 27, 2007, our outstanding long-term receivables were approximately \$13.7 million. Each 25 basis point increase in interest rates would have an associated annual opportunity cost to us of less than \$0.1 million.

The following table provides information about our financial instruments that are sensitive to changes in interest rates, including debt obligations, for the three quarters ending January 27, 2007 and subsequent fiscal years.

	Principal (Notional) Amount by Expected Maturity					There- after
	(in thousands)					
	Fiscal Year					
	2007	2008	2009	2010	2011	
Assets:						
Long-term receivables, including current maturities:						
Fixed-rate	\$ 2,154	\$ 3,510	\$ 2,278	\$ 1,945	\$ 1,191	\$ 2,619
Average interest rate	6.9%	8.8%	7.6%	7.5%	8.0%	8.1%
Liabilities:						
Long- and short-term debt:						
Variable-rate	\$ 19,217	\$	\$	\$	\$	\$
Fixed-rate	\$ 44	\$ 543	\$ 541	\$ 24	\$ 21	\$
Average interest rate	5.5%	5.6%	5.7%	0.0%	0.0%	0.0%
Long-term marketing obligations, including current portion:						
Fixed-rate	\$ 122	\$ 285	\$ 341	\$ 125	\$ 50	\$ 30
Average interest rate	8.9%	8.3%	5.4%	8.7%	8.9%	8.5%

The carrying amounts reported on the balance sheet for long-term receivables and long- and short-term debt approximates their fair value.

Substantially all of our cash balances are denominated in United States dollars. Cash balances in foreign currencies are operating balances maintained in accounts of our foreign subsidiaries and accounts to settle euro-based payments. These balances are immaterial to us as a whole.



**Item 4. CONTROLS AND PROCEDURES**

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as that term is defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934, as of January 27, 2007, which is the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of January 27, 2007, our disclosure controls and procedures were effective.

Based on the evaluation described in the foregoing paragraph, our Chief Executive Officer and Chief Financial Officer concluded that during the quarter ended January 27, 2007, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION**

**Item 1. LEGAL PROCEEDINGS**

Not Applicable

**Item 1A. Risk Factors**

The discussion of our business and operations included in this Quarterly Report on Form 10-Q should be read together with the risk factors described in Item 1A of our Annual Report on Form 10-K for the year ended April 29, 2006. It describes various risks and uncertainties to which we are or may become subject. These risks and uncertainties, together with other factors described elsewhere in this report, have the potential to affect our business, financial condition, results of operations, cash flows, strategies or prospects in a material and adverse manner. New risks may emerge at any time, and we cannot predict those risks or estimate the extent to which they may affect financial performance.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

Not Applicable

**Item 3. DEFAULTS UPON SENIOR SECURITIES**

Not Applicable

**Item 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

Not Applicable

**Item 5. OTHER INFORMATION**

Not Applicable

**Item 6. EXHIBITS**

The following exhibits are filed with this Quarterly Report on Form 10-Q:

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- Ex 31.1 Certification of the Chief Executive Officer required by Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to section 302 of the Sarbanes-Oxley Act of 2002.
- Ex 31.2 Certification of the Chief Financial Officer required by rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act Of 2002.
- Ex 32.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350).
- Ex 32.2 Certification of the Chief Financial Officer pursuant to section 906 of the Sarbanes-Oxley Act Of 2002 (18 U.S.C. Section 1350).
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**SIGNATURE**

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.

By: /s/ William R. Retterath  
Daktronics, Inc.  
William R. Retterath,  
Chief Financial Officer  
Principal Financial Officer and Principal Accounting Officer

Date: February 22, 2007