

FLOW INTERNATIONAL CORP
Form S-1/A
December 12, 2005
Table of Contents

As filed with the Securities and Exchange Commission on December 9, 2005

Registration No. 333-125113

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 3

to

Form S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

Flow International Corporation

(Exact name of registrant as specified in its charter)

Washington
*(State or other jurisdiction of
incorporation or organization)*

3569
*(Primary Standard Industrial
Classification Code Number)*

91-1104842
*(I.R.S. Employer
Identification Number)*

Stephen R. Light

President and Chief Executive Officer

23500 64th Avenue South

Kent, WA 98032

(253) 850-3500

(Address, including zip code and telephone number, including area code, of Registrant's principal executive offices)

PTSGE Corp.

925 Fourth Avenue, Suite 2900

Seattle, WA 98104

(206) 623-7580

(Name, address, including zip code and telephone number, including area code, of agent for service)

Copies to:

Robert S. Jaffe

William Gleeson

Preston Gates & Ellis LLP

925 Fourth Avenue, Suite 2900

Seattle, WA 98104

(206) 623-7580

Approximate date of commencement of proposed sale to the public:

From time to time after the effective date of this registration statement,

as determined by market conditions and other factors.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box:

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering:

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering:

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering:

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box:

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to Be Registered	Amount to Be Registered(1)	Proposed Maximum Offering Price Per Security(4)	Proposed Maximum Aggregate Offering Price(4)	Amount of Registration Fee
Common Stock, \$0.01 par value.	17,473,116 Shares(2)	\$6.76	\$118,118,264.16	\$13,902.52(5)
Common Stock, \$0.01 par value.	3,219,245(3)	\$6.76	\$21,762,096	\$2,561.40(5)

- (1) In accordance with Rule 416(a), the registrant is also registering hereunder an indeterminate number of shares that may be issued and resold resulting from stock splits, stock dividends or similar transactions.
- (2) Represents shares of the registrant's common stock being registered for resale that have been issued to the selling shareholders named in this registration statement.
- (3) Represents shares of the registrant's common stock being registered for resale that have been or may be acquired upon the exercise of warrants issued to the selling shareholders named in this registration statement.
- (4) Estimated pursuant to Rule 457(c) under the Securities Act of 1933, solely for the purposes of calculating the registration fee, upon the basis of the average high and low prices of our common stock as reported on the Nasdaq National Market on May 16, 2005.
- (5) Previously paid.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

Table of Contents

PRELIMINARY PROSPECTUS

20,692,359 Shares

Common Stock

This prospectus relates to the offer and sale of up to 17,473,116 outstanding shares of the common stock of Flow International Corporation, a Washington corporation, and up to 3,219,245 shares that may be issued on the exercise of outstanding warrants. Such shares may be offered and sold from time to time by the persons described in this prospectus under the heading "Selling Shareholders" or by pledgees, donees, transferees, assignees or other successors-in-interest of such persons (collectively, the "Selling Shareholders"). As used in this prospectus, we, us, our and similar expressions refer to Flow International Corporation and its subsidiaries.

The Selling Shareholders may offer their shares from time to time through or to one or more underwriters, brokers or dealers, on the NASDAQ Stock National Market at market prices prevailing at the time of sale, in one or more negotiated transactions at prices acceptable to the Selling Shareholders or in private transactions. We will not receive any proceeds from the sale of shares by the Selling Shareholders. In connection with any sales, the Selling Shareholders and any underwriters, agents, brokers or dealers participating in such sales may be deemed to be underwriters within the meaning of the Securities Act.

We will pay the expenses related to the registration of the shares covered by this prospectus. The Selling Shareholders will pay commissions and selling expenses, if any, incurred by them.

Our common stock trades on the NASDAQ National Market under the symbol "FLOW". On December 8, 2005, the closing price of one share of our common stock was \$7.17.

Investing in our securities involves risks. See Risk Factors beginning on page 6 of this prospectus.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this prospectus is _____, 2005.

Table of Contents

You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with different information. An offer to sell these securities is not being made in any state where the offer is not permitted. You should not assume that the information contained in this prospectus or any prospectus supplement is accurate as of any date other than the date of such documents. Our business, financial condition, results of operations and prospects may have changed since that date.

TABLE OF CONTENTS

	Page
<u>Prospectus Summary</u>	1
<u>The Company</u>	1
<u>The Offering</u>	2
<u>Historical Stock Price</u>	3
<u>Summary Financial Data</u>	4
<u>Risk Factors</u>	6
<u>Cautionary Note Regarding Forward-Looking Statements</u>	12
<u>Use of Proceeds</u>	13
<u>Dividend Policy</u>	13
<u>Pro-Forma Information</u>	14
<u>Selected Financial Data</u>	24
<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	26
<u>Business</u>	62
<u>Information Concerning Directors and Executive Officers</u>	67
<u>Board Structure, Committees and Compensation and Composition</u>	70
<u>Executive Compensation</u>	73
<u>Market Information</u>	78
<u>Stock Ownership of Management and Principal Shareholders</u>	79
<u>Selling Shareholders</u>	82
<u>Certain Relationships and Related Transactions</u>	85
<u>Description of Capital Stock</u>	86
<u>Plan of Distribution</u>	88
<u>Legal Matters</u>	90
<u>Experts</u>	90
<u>Where You Can Find More Information</u>	90
<u>Index to Consolidated Financial Statements</u>	91

ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission using the SEC's shelf registration rules. Under the shelf registration rules, using this prospectus and, if required, one or more prospectus supplements, the Selling Shareholders may sell from time to time, in one or more offerings, the shares of common stock covered by this prospectus. The shares covered by this prospectus include 17,473,116 outstanding shares of common stock and 3,219,245 shares of common stock issuable upon the exercise of warrants.

This prospectus also covers any shares of common stock that may become issuable pursuant to anti-dilution adjustment provisions that would increase the number of shares issuable upon exercise of the warrants as a result of stock splits, stock dividends or similar transactions.

A prospectus supplement may add, update or change information contained in this prospectus. We recommend that you read carefully this entire prospectus, especially the section entitled "Risk Factors" beginning on page 6, together with any supplements before making a decision to invest in our common stock.

Table of Contents

PROSPECTUS SUMMARY

This summary highlights key aspects of the information contained elsewhere in this prospectus. This summary does not contain all the information you should consider before investing in our common stock. You should read this entire prospectus carefully, especially the risks of investing in our common stock discussed under Risk Factors beginning on page 6, current events beginning on page 26 and our consolidated financial statements and the notes to those consolidated financial statements beginning on page F-1, before making an investment decision.

THE COMPANY

We design, develop, manufacture, market, install and service ultrahigh-pressure, or UHP, water pumps and UHP water management systems. Our core competency is the design and manufacture of UHP water pumps. Our UHP water pumps pressurize water from 40,000 to over 100,000 pounds per square inch (psi) and are integrated with water delivery systems so that water can be used to cut or clean material or pressurize food. Our products include standard and specialized waterjet cutting and cleaning systems. In addition to UHP water pumps and related systems, we provide non UHP automation and articulation systems, primarily to the automotive industry.

Our UHP technology has three broad applications: cutting, cleaning and food processing. In cutting and cleaning applications, the ultrahigh-pressure created by our pumps is released through a small orifice to create a jet of water. In food processing, we supply UHP pumps to Avure Technologies, Inc., a company we recently sold, which uses pressure to kill spoilage bacteria and pathogens in food products placed inside a pressure vessel.

On October 31, 2005, consistent with our strategy to divest operations that are not part of our core UHP water pump business, we sold our General Press operations and the non UHP portion of our Food reportable segment (the Avure Disposition). Included in the Avure Disposition were our Avure Technologies, Incorporated, Flow International FPS AB, Avure Technologies AB subsidiaries, and our 51% interest in Flow Autoclave Systems (together, the Avure Business). The Avure Business became a discontinued operation in accordance with FAS 144 Accounting for the Impairment or Disposal of Long-Lived Assets at the time it was sold and will be represented that way in future financial statements. In connection with the sale we agreed to continue to supply UHP pumps to the Avure Business.

The primary application of our UHP water pumps is cutting. In cutting applications, pressures from 50,000 to 87,000 psi create a thin stream of water traveling at three or more times the speed of sound which can cut both metallic and nonmetallic materials. UHP water pumps are used in aerospace, automotive, disposable products, food, glass, job shop, sign, metal cutting, marble, tile and other stone cutting, and paper slitting and trimming applications. Waterjet cutting is recognized as a more flexible alternative to traditional cutting methods such as lasers, saws or plasma. It is often faster, has greater versatility in the types of materials it can cut and eliminates the need for secondary processing operations. We also manufacture a waterjet product line used in cleaning, where pressures in the range of 40,000 to 55,000 psi are used in industrial cleaning, surface preparation, construction, and petro-chemical and oil field applications.

Our principal executive offices are at 23500 64th Avenue South, Kent, WA 98032 and our telephone number is (253) 850-3500. We maintain a website at www.flowcorp.com. The contents of our website are not incorporated into this prospectus.

Table of Contents

The Offering

Common Stock offered by the Selling Shareholders	20,692,359 Shares(1)
Offering	The Selling Shareholders may offer their shares from time to time through one or more underwriters, brokers or dealers, on the NASDAQ Stock National Market at market prices prevailing at the time of sale, in one or more negotiated transactions at prices acceptable to the Selling Shareholders or in private transactions.
Use of Proceeds	The proceeds from the sale of the shares covered by this prospectus will be received by the Selling Shareholders. We will not receive any of the proceeds from the sales by the Selling Shareholders of the shares covered by this prospectus.
Nasdaq National Market symbol	FLOW
Risk Factors	See Risk Factors beginning on page 6 for a discussion of factors that you should consider carefully before deciding to purchase our common stock.
Offering-related Information	<p>On March 21, 2005, in a Private Investment in Public Equity Transaction (PIPE Transaction), we sold 17,473,116 equity units at \$3.72 per unit for gross proceeds of \$65 million, and net proceeds of \$59.3 million. A unit consists of one share of our common stock and one warrant to buy 1/10th of a share of our common stock. Ten warrants give the holder the right to purchase one share of common stock for \$4.07. The closing price of our stock on Nasdaq National Market on the day before the agreement between the Company and the Selling Shareholders relating to the PIPE Transaction was entered into \$3.70 per share. On the day that the agreement was entered into, the closing price was \$4.28 per share. The exercise price of the warrants is a negotiated price.</p> <p>Proceeds of the PIPE were used to pay down existing debt of \$59.3 million, including all of our subordinated debt. Under the terms of warrants previously issued to our senior and subordinated lenders, we are obligated to issue additional warrants if shares of our common stock are issued for prices less than market price. Because the issuance price of the common stock of the PIPE Transaction (\$3.70) was less than market price (\$4.28), we issued approximately 304,000 anti-dilution \$0.01 warrants to our lenders. These warrants had a Black-Scholes value of approximately \$1.7 million. The majority of the charges resulting from the issuance of the additional warrants, \$1.5 million, were charged to interest expense in the fourth quarter of fiscal 2005 as the underlying debt associated with these warrants was retired in the fourth quarter of fiscal 2005. The remainder, \$200,000, was capitalized and amortized to interest expense through August 1, 2005.</p>

(1) Includes 3,219,245 shares of common stock issuable upon the exercise of outstanding warrants to purchase common stock.

Table of Contents

Under EITF 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock (EITF 00-19), the fair value of the warrants sold to the PIPE investors will be reported initially as a liability due to liquidated damages of 1% of the gross proceeds per month (\$650,000) which will be payable in the event that this Form S-1 is not be declared effective prior to December 31, 2005. Upon effectiveness of the Form S-1, the fair value of the warrants will be reclassified into Capital in Excess of Par in the Equity section of the Consolidated Balance Sheet. As of March 21, 2005, the warrants sold to the PIPE investors were valued at \$6.4 million using the Black-Scholes method, and the shares have been recorded at \$52.9 million, or the difference between the net proceeds and the value of the warrants. The warrants sold to the PIPE investors are considered a derivative financial instrument and will be marked to fair value quarterly until this Form S-1 is declared effective. Any changes in fair value of the warrants will be recorded through the Consolidated Statement of Operations.

Historical Stock Price

Our stock is traded on the NASDAQ National Market under the symbol FLOW. The range of high and low sales prices for our common stock for the first and second quarter of fiscal 2006 and the third quarter of fiscal 2006 through December 8, 2005 and the four quarters for fiscal 2005, 2004 and 2003 is set forth in the following table.

	Fiscal Year 2006		Fiscal Year 2005		Fiscal Year 2004		Fiscal Year 2003	
	High	Low	High	Low	High	Low	High	Low
First Quarter	\$ 7.83	\$ 5.87	\$ 3.66	\$ 2.15	\$ 1.94	\$ 1.13	\$ 10.90	\$ 5.05
Second Quarter	9.39	7.43	3.55	2.70	3.11	1.36	5.60	2.12
Third Quarter(1)	9.25	6.40	3.18	2.71	4.11	2.40	3.80	2.13
Fourth Quarter			6.60	2.85	3.74	2.20	3.28	1.08

(1) Prices for fiscal year 2006 reflect trading through December 8, 2005.

We have not paid dividends to common shareholders in the past. Our Board of Directors intends to retain future earnings, if any, to finance development and expansion of our business and reduce debt and does not expect to declare dividends to common shareholders in the near future. The credit agreement entered into on July 8, 2005 does permit us to pay dividends, however. Prior to this date however, our credit agreements contained restrictions on our ability to pay dividends to our shareholders.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

- (1) The Statement of Operations for fiscal 2001 includes the adoption of SEC Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements, as amended by SAB101A and 101B. We reflected this change in policy as a Cumulative Effect of Change in Accounting Principle.

Table of Contents

- (2) The Statement of Operations for fiscal 2002 includes the adoption of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (FAS 142). See Note 1 to the Consolidated Financial Statements for the year ended April 30, 2005 for further discussion of the impact of this adoption.
- (3) The Statement of Operations for fiscal 2003 includes the impact of management's launch of its restructuring program and resulting focus on cash generation. See the Fiscal 2003 Comprehensive Financial Review at the end of the Fiscal 2004 Compared to Fiscal 2003 financial analysis in the Management's Discussion and Analysis section for further discussion of the impact on our financial results.
- (4) As described in Note 2 to the April 30, 2005 Consolidated Financial Statements, we have restated our consolidated financial statements for the year ended April 30, 2005 to reflect additional charges in the Consolidated Statement of Operations associated with 1) the impairment of goodwill, 2) the revised valuation of anti-dilution warrants issued to our senior and subordinated lenders, 3) the revision of estimated losses on long-term contracts, 4) the correction of compensation expense for performance based equity awards and stock awards for services and 5) straight-line rent expense for leases with escalating rents. In addition, we restated certain balances for incorrect classification on our Consolidated Balance Sheet as of April 30, 2005 and 2004 and Consolidated Statement of Operations for the year ended April 30, 2005.
- (5) As reported in the Company's April 30, 2005 Form 10-K/A, the Company has identified errors in the Consolidated Financial Statements related to the presentation of percentage-of-completion related balances on the Consolidated Balance Sheet. Specifically, the Company noted inconsistencies between its divisions in the balance sheet presentation of accounts receivable and cash receipts relating to contracts accounted for using the percentage-of-completion method. The Company has, therefore, adjusted its financial statements to reflect a consistent presentation and comply with the provisions of SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts as of April 30, 2003, 2002 and 2001.

Pro forma financial information is included in this prospectus to reflect the sale of the Avure Business, which took place on October 31, 2005, and the closing of the PIPE transaction on March 21, 2005. The unaudited pro forma balance sheet data assumes the disposition occurred on July 31, 2005. Such pro forma information is based upon the historical balance sheet data of the Company as of that date. The unaudited pro forma statement of operations data give effect to the treatment of the Avure Business as a discontinued operation for the three months ended July 31, 2005 and for the year ended April 30, 2005. The following pro forma financial information is excerpted from the detailed presentation found on pages 14-21.

	Three Months Ended July 31, 2005	Year Ended April 30, 2005
	(unaudited)	(unaudited)
(In thousands, except per share amounts)		
Pro forma Statement of Operations Data:		
Sales	\$ 41,986	\$ 172,966
(Loss) Income from Continuing Operations	(1,327)	3,126
Basic (Loss) Income Share from Continuing Operations	(0.04)	0.09
Diluted (Loss) Income from Continuing Operations	(0.04)	0.09
		July 31, 2005
		(unaudited)
Pro forma Balance Sheet Data:		
Working Capital		\$ 22,241
Total Assets		91,607
Short-Term Debt		2,816
Long-Term Obligations		13,301
Shareholders' Equity		27,043

Table of Contents

RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the risks described below, together with the financial and other information contained in this prospectus, before making a decision to buy our common stock from the Selling Shareholder. If any of the following risks actually occur, our business, financial condition and results of operations could suffer. In these circumstances, the market price of our common stock could decline, and you may lose all or part of your investment in our common stock.

We have incurred losses in recent years and we may be unable to achieve profitability.

While we had net income of \$22,000 for the three months ended July 31, 2005, our net losses for each of the fiscal years ended April 30, 2003, 2004 and 2005 were \$70.0 million, \$11.5 million and \$20.6 million, respectively. We believe our recently completed restructuring and related cost-cutting initiatives will reduce overall spending. If our restructuring efforts fail to adequately reduce costs, or if our sales are less than we project, we will continue to incur losses in future periods. Economic weakness in our served markets may adversely affect our ability to meet our sales projections.

Economic weakness in our served markets may adversely affect our financial results.

The products we sell are capital goods with individual system prices ranging from \$150,000 to several million dollars. Many of our customers depend on long term financing from a financial institution to purchase our equipment. Economic weakness in the capital goods market and or a credit tightening by the banking industry would reduce our sales and accordingly affect our financial results.

If we fail to comply with our financing arrangements, our ability to continue operations would be impaired.

Under the Current Senior Credit Agreement (entered into on July 11, 2005), we are operating under a credit agreement with our senior lenders which expires July 8, 2008 and sets forth specific financial covenants to be attained on a quarterly basis. In addition, our agreement includes subjective acceleration clauses which permit the lenders to demand payment on the determination of a material adverse change in the business. In the event of default, the senior lenders may limit our access to borrow funds as needed. Our ability to continue operating is dependent on the senior lenders' willingness to grant access to funds. If we are unable to obtain the necessary funds, our ability to continue operations would be seriously impaired unless we are able to obtain alternative financing from another source. In the event of a default, obtaining alternative financing may be difficult and may be at less favorable terms. We may be unable to achieve our projected operating results and maintain compliance with the loan covenants which would trigger an event of default with our Lenders. In an event of default, the Lenders would be in the position to exercise default remedies which include applying a default interest rate and acceleration of payment schedules for our outstanding debt. Our Lenders may pursue any number of plans to reduce the outstanding debt, including, in certain circumstances, a liquidation of some or all of our assets.

If the registration statement of which this prospectus is a part does not become effective by December 31, 2005, or becomes ineffective for more than 40 days, after having gone effective, we may be subject to significant financial penalties.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Under terms of the Registration Rights Agreement entered into on March 20, 2005, as part of a Private Investment in Public Equity transaction (PIPE Transaction), we were required to have the Form S-1, which registers the shares sold in the PIPE Transaction and the related warrants, become effective no later than September 17, 2005. We have amended the Registration Rights Agreement to grant an extension until December 31, 2005 for the effective date of the registration of the shares and warrants issued in the PIPE Transaction. In addition, the registration statement cannot become ineffective for more than 40 days (not necessarily consecutive). If either of these events occur, then we will be subject to a cash penalty of up to \$650,000 per month for each month the registration statement is not effective. Certain factors that could cause the registration statement to become or remain ineffective are not within our control.

Table of Contents

If we are unable to retain the current members of our senior management team and other key personnel, our future success may be negatively impacted.

We may lose key management personnel and encounter difficulties replacing these positions. We may have to incur greater costs to attract replacement personnel.

Our inability to protect our intellectual property rights, or our possible infringement on the proprietary rights of others, and related litigation could be time consuming and costly.

We defend our intellectual property rights because unauthorized copying and sale of our proprietary equipment and consumables represents a loss of revenue to us. From time to time we also receive notices from others claiming we infringe their intellectual property rights. The number of these claims may grow in the future, and responding to these claims may require us to stop selling or to redesign affected products, or to pay damages. On November 18, 2004, Omax Corporation (Omax) filed suit against us alleging that our products infringe on Omax 's patents. The suit also seeks to have a specific patent we hold declared invalid. Although the suit seeks damages of over \$100 million, we believe Omax 's claims are without merit and we intend not only to contest Omax 's allegations of infringement but also to vigorously pursue our claims against Omax with regard to our own patent. See Note 15 to Consolidated Financial Statements for further discussion of contingencies.

Fluctuations in our quarterly operating results may cause our stock price to decline and limit our shareholders ' ability to sell our common stock in the public market.

In the past, our operating results have fluctuated significantly from quarter to quarter, and we expect them to continue to do so in the future due to a variety of factors, many of which are outside of our control. Our operating results may in some future quarter fall below the expectations of securities analysts and investors. In this event, the trading price of our common stock could decline significantly. In addition to the risks disclosed elsewhere in this prospectus, factors outside of our control that have caused our quarterly operating results to fluctuate in the past and that may affect us in the future include:

fluctuations in general economic conditions;

demand for UHP pumps and UHP water management systems generally;

fluctuations in the capital budgets of customers; and

development of superior products and services by our competitors.

In addition, factors within our control, such as our ability to deliver equipment in a timely fashion, have caused our operating results to fluctuate in the past and may affect us similarly in the future.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

The factors listed above may affect both our quarter-to-quarter operating results as well as our long-term success. Given the fluctuations in our operating results, you should not rely on quarter-to-quarter comparisons of our results of operations as an indication of our future performance or to determine any trend in our performance. Fluctuations in our quarterly operating results could cause the market price of and demand for our common stock to fluctuate substantially, which may limit your ability to sell our common stock on the public market.

We do business in industries that are cyclical, which may result in weakness in demand for our products.

Our products are sold in many industries, including machine tool, automotive and aerospace, that are highly cyclical. The machine tool industry, in particular from 1998 through 2003, experienced a significant decline in global demand. Cyclical weaknesses in the industries that we serve could lead to a reduced demand for our products.

Table of Contents

We may be affected by rising costs or lack of availability of materials, which could negatively impact our operations.

We have experienced and may continue to experience significant increases in the costs of materials we use in the manufacture of our products, such as steel, and we may not be able to either achieve corresponding increases in the prices of our products or reduce manufacturing costs to offset these increases, or if we do increase prices, we may experience lower sales. Any of the foregoing may adversely affect our financial results.

If we cannot develop technological improvements to our products through continued research and engineering, our financial results may be adversely affected.

In order to maintain our position in the market, we need to continue to invest in research and engineering to improve our products and technologies and introduce new products and technologies. If we are unable to make such investment, if our research and development does not lead to new and/or improved products or technologies, or if we experience delays in the development or acceptance of new and/or improved products, our financial results will be adversely affected.

We have received notice of material weaknesses in internal controls. Consequently, there is more than a remote likelihood that a material misstatement of our financial statements will not be prevented or detected in the current or any future period. Additionally we may conclude that our system of internal controls under Section 404 of Sarbanes-Oxley is not effective.

In December 2004, in connection with the restatement of our fiscal 2004, 2003 and 2002 financial statements, and in November 2005, in connection with the restatement of our fiscal 2005 and 2004 financial statements, our independent registered public accounting firm reported to management and to the Audit Committee material weaknesses in internal control over financial reporting. A material weakness is a control deficiency, or a combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Management agrees with and has responded to the Audit Committee with our plans to remediate the material weaknesses communicated by our independent registered public accounting firm. Remediation of these material weaknesses is ongoing.

The material weaknesses in our internal control over financial reporting are as follows:

The Company did not maintain effective controls over the financial reporting process due to an insufficient complement of personnel with an appropriate level of accounting knowledge, experience and training in the application of generally accepted accounting principles commensurate with its financial reporting requirements and the complexity of the Company's operations and transactions. Specifically, the Company incorrectly applied generally accepted accounting principles for (i) the impairment of goodwill, (ii) the classification of deferred tax balances, (iii) the valuation of anti-dilution warrants, (iv) the accrual of costs on contracts accounted for using the percentage-of-completion method and (v) leases with rent escalation clauses, affecting goodwill, capital in excess of par, minority interest, deferred income taxes, prepaid expenses, cost of sales, interest expense and other accrued liabilities. This material weakness contributed to the material weakness discussed below.

The Company did not maintain effective controls to ensure there is adequate (i) analysis, documentation, reconciliation and review of accounting records, and supporting data, and (ii) monitoring and oversight of the work performed by accounting and financial reporting personnel to ensure the accuracy and completeness of the consolidated financial statements in accordance with generally

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

accepted accounting principles. Specifically, the Company did not have effective controls designed and in place over the consolidation of the financial statements of subsidiaries, the reconciliation of inter-company accounts, the valuation of anti-dilution warrants, the accrual of costs on contracts accounted for using the percentage-of-completion method and the accounting for performance

Table of Contents

based equity awards, affecting goodwill, capital in excess of par, minority interest, general and administrative expense, interest expense, prepaid expenses, cost of sales, accounts receivables and customer deposits.

An in-depth review of the remediation process to date, as well as the steps remaining, can be found on page 22.

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to assess the design and effectiveness of our internal control systems effective April 30, 2006. Our independent registered public accounting firm is required to render an attestation report on managements assessment and the effectiveness of our system of internal control over financial reporting. We must complete the documentation, evaluation and remediation of our systems of internal control. The costs associated with such compliance are likely to be substantial and will negatively impact our financial results. In addition, there is no assurance that we will be able to conclude that our systems are appropriately designed or effective, which could result in noncompliance with Section 404 and a decline in the stock price.

We have outstanding options and warrants that have the potential to dilute the return of our existing common shareholders and cause the price of our common stock to decline.

We grant stock options to our employees and other individuals. At July 31, 2005, we had options outstanding to purchase 1,962,380 shares of our common stock, at exercise prices ranging from \$2.00 to \$12.25 per share of which 1,849,587 are fully vested. In addition, we currently have outstanding 2,309,764 fully vested warrants, for which we are registering the resale of the underlying shares hereby. The exercise price of the warrants range from \$.008 to \$4.07 per share.

As a result of accounting regulations, which become applicable to us on May 1, 2006, requiring companies to expense stock options, our expenses will increase and our stock price may decline.

A number of publicly traded companies have recently announced that they will begin expensing stock option grants to employees. In addition, the Financial Accounting Standards Board (FASB) has adopted rule changes with an effective date as of the beginning of fiscal years beginning after June 15, 2005 requiring expensing of stock options. Currently we include such expenses on a pro forma basis in the notes to our financial statements in accordance with accounting principles generally accepted in the United States, but do not include stock option expense for employee options in our reported financial statements. This change in accounting standards will require us to expense stock options, and as a result our reported expenses may increase significantly.

Washington law and our charter documents may make an acquisition of us more difficult.

Provisions in Washington law and in our articles of incorporation, bylaws, and rights plan could make it more difficult for a third-party to acquire us, even if doing so would benefit our shareholders. These provisions:

Establish a classified board of directors so that not all members of our board are elected at one time;

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Authorize the issuance of blank check preferred stock that could be issued by our board of directors (without shareholder approval) to increase the number of outstanding shares (including shares with special voting rights), each of which could hinder a takeover attempt;

Provide for a Preferred Share Rights Purchase Plan or poison pill;

Impose restrictions on certain transactions between a corporation and certain significant shareholders.

Provide that directors may be removed only at a special meeting of shareholders and provide that only directors may call a special meeting;

Require the affirmative approval of a merger, share exchange or sale of substantially all of the Corporation's assets by 2/3 of the Corporation's shares entitled to vote; and

Table of Contents

Provide for 60 day advance notification for shareholder proposals and nominations at shareholder meetings.

Market risk exists in our operations from potential adverse changes in foreign exchange rates relative to the U.S. dollar in our foreign operations.

A significant portion of our sales take place outside of the United States, and we transact business in various foreign currencies, primarily the Canadian dollar, the Eurodollar, the Japanese yen, and the New Taiwan dollar. In addition, our foreign divisions may have customer receivables and vendor obligations in currencies other than their local currency which exposes us to near-term and longer term currency fluctuation risks. The assets and liabilities of our foreign operations, with functional currencies other than the U.S. dollar, are translated into U.S. dollars at exchange rates in effect at the balance sheet date. Income and expense items are translated at the average exchange rates prevailing during the period. Aggregate net foreign exchange gains included in the determination of net loss amounted to \$531,000 for the year ended April 30, 2005. Based on our results for the year ended April 30, 2005 for our foreign subsidiaries, and based on the net position of foreign assets less liabilities, a near-term 10% appreciation or depreciation of the U.S. dollar in all currencies we operate could impact operating income by \$1.2 million and other income (expense) by \$3.7 million. Our financial position and cash flows could be similarly impacted.

Current year foreign sales have benefited from a weak U.S. dollar. If the dollar were to strengthen against certain foreign currencies, such as the euro and yen, our margins may be negatively affected.

A significant portion of our products sold outside the United States are manufactured domestically. The weaker U.S. dollar, relative to the local currency of many of the countries we sell into, has made our products less expensive, on a relative basis, when compared to locally manufactured products and products manufactured in certain other countries. As the U.S. dollar gains in value relative to these foreign currencies, our products will increase in cost to the customer relative to locally produced product and products manufactured in certain other countries, which could negatively impact sales.

Sales of registered stock could exert downward pressure on the market price of our stock and could encourage short selling that could exert further downward pressure.

To the extent the Selling Stockholders acquired their shares (whether such shares were acquired in the PIPE transaction or on the exercise of warrants, which are exercisable at \$0.01 per share) at prices less than the then current trading price of our common stock, they may have an incentive to immediately resell material amounts of such shares in the market which may, in turn, cause the trading price of our common stock to decline. Significant downward pressure on our stock price caused by the sale of stock registered in this offering could encourage short sales by the Selling Stockholders (and in particular short sales by warrant holders in anticipation of exercising their warrants) or third parties that would place further downward pressure on our stock price. In an ordinary or uncovered short sale, a seller causes his or her executing broker to borrow the shares to be delivered at the completion of the sale from another broker, subject to an agreement to return them upon request, thereby avoiding the need to deliver any shares actually owned by the seller stockholder on the settlement date for the sale. Since the seller does not own the shares that are sold, the seller must subsequently purchase an equivalent number of shares in the market to complete or cover the transaction. The seller stockholder will realize a profit if the market price of the shares declines after the time of the short sale, but will incur a loss if the market price rises and he or she is forced to buy the replacement shares at a higher price. Accordingly, a declining trend in the market price of our common stock may stimulate short sales.

The Company has advised each Selling Shareholder that it may not use shares registered on this Registration Statement to cover short sales of Common Stock made prior to the date on which this Registration Statement shall have been declared effective by the Commission. See Selling Shareholders on page 67.

Table of Contents

Under the terms of certain outstanding warrants, we could be required to make antidilution adjustments.

Certain of the Selling Shareholders hold warrants to purchase Company Common Stock at a price of \$.01 per share. Such warrants were originally issued to the Company's lenders (Lender Warrants). While such Lender Warrants are outstanding anti-dilution adjustments will be made in the Lender Warrants, if the Company issues Common Stock (other than pursuant to the exercise of warrants or other rights or convertible securities) at a price less than then current market price or the Company issues warrants or other rights or convertible securities to purchase or acquire Common Stock exercisable or convertible, at a price less than then current market price when the warrants, rights or convertible securities are issued. The anti-dilution adjustments will be made in the purchase price of the Common Stock under the Lender Warrants (multiplying the exercise price before the issuance by a fraction in which the numerator is the number of shares outstanding prior to the issuance and the denominator is the number of shares outstanding after the issuance) and the number of shares of common stock issuable in exercise of the Lender Warrants (multiplying the current number of shares subject to the warrants by a fraction in which the numerator is the purchase price before the issuance and the denominator is the purchase price after the issuance). The exercise of any currently outstanding warrants will not trigger any adjustments in the Lender Warrants because adjustments were made to the extent required on the issuance of such warrants. The Company has no additional plans to issue any additional Common Stock, or warrants to purchase Common Stock exercisable, at a price below the then current market price, except to the extent it may be required to issue Common Stock under currently outstanding warrants.

Table of Contents

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

SAFE HARBOR STATEMENT:

Statements made in this prospectus that are not historical facts are forward-looking statements that involve risks and uncertainties. Forward-looking statements typically are identified by the use of such terms as may, will, expect, believe, anticipate, estimate, plan and similar words, although some forward-looking statements are expressed differently. You should be aware that our actual results could differ materially from those contained in any forward-looking statement due to a number of factors, which include, but are not limited to the following: the special risk factors and uncertainties set forth in this document; our striving to continue to improve our customer's profitability through investment in the development of innovative products and services; our ability to absorb cyclical downturns through the flexibility of our UHP technology and market diversity; our confidence that we can continue to gain market share; our conclusion that waterjet technology is in the early adoption phase of its product life cycle; our ability to retain a technical lead over our competitors through non-patented proprietary trade secrets and know-how in UHP applications; the ability of our patents to act as a barrier to entry for competitors in the UHP technology field; increased market acceptance of waterjet cutting systems by the aerospace, automotive, and machine (Jobshop) industries will encourage other manufacturers, including those in other industries, to adopt waterjet solutions; our intent to contest Omax's allegations; our belief that the estimated cost of probable legal claims resolutions will not have an adverse effect on our consolidated financial position; our belief that the appropriate actions to remedy our material weakness are to implement new control policies and procedures and to hire additional accounting staff with appropriate levels of experience in order to improve the reconciliation process; our belief that our restructuring activities and related cost-cutting initiatives will reduce overall spending; our belief that the benefits of our restructuring activities will continue into fiscal 2006; spare parts sales will continue to increase as more systems are put into operation; expected severance and relocation costs; our belief that our existing cash and credit facilities at July 31, 2005 are adequate to fund our operations through April 30, 2006; our belief that compliance with covenants in the current senior credit agreement is achievable; our expectation that the funds necessary for capital expenditures will be generated internally and through available credit facilities; the strengthening of global economies; and global economic conditions and additional threatened terrorist attacks and responses thereto, including war. Additional information on these and other factors that could affect our financial results is set forth below. Finally, there may be other factors not mentioned above or included in our SEC filings that may cause our actual results to differ materially from those in any forward-looking statement. You should not place undue reliance on these forward-looking statements. We assume no obligation to update any forward-looking statements as a result of new information, future events or developments, except as required by federal securities laws.

All references to fiscal years are references to our fiscal year end of April 30.

Table of Contents

USE OF PROCEEDS

The proceeds from the sale of the shares covered by this prospectus will be received by the Selling Shareholders. We will not receive any of the proceeds from the sales by the Selling Shareholders of the shares covered by this prospectus.

We originally received gross proceeds of \$65 million and net proceeds of \$59.3 million on March 21, 2005 when we sold 17,473,116 equity units at \$3.72 per unit in the PIPE Transaction. A unit consists of one share of our common stock and one warrant to buy 1/10th of a share of our common stock. Ten warrants give the holder the right to purchase one share of common stock for \$4.07. We will receive an aggregate of up to \$7.1 million if the selling shareholders who participated in the PIPE Transaction, exercise all of their warrants to purchase common stock.

We used the gross proceeds to pay the entire balance of our subordinated debt and accrued interest totaling \$42.3 million in April 2005. The remaining proceeds were used to repay borrowings on our senior credit facility.

1,471,933 shares are issuable on the exercise of warrants issued to lenders, including approximately 304,000 warrants issued for anti-dilution. The exercise price of such warrants is \$0.008 per share.

We would expect to use any such proceeds for general corporate purposes.

DIVIDEND POLICY

We have not paid dividends to common shareholders in the past. Our Board of Directors intends to retain future earnings, if any, to finance development and expansion of our business and reduce debt and does not expect to declare dividends to common shareholders in the near future. The credit agreement entered into on July 11, 2005 does permit us to pay dividends however. Prior to this date however, our credit agreements contained restrictions on our ability to pay dividends to our shareholders.

Table of Contents

PRO FORMA INFORMATION

During the second quarter of fiscal 2006, the Board of Directors approved the sale of the Company's Avure Business consistent with the Company's strategy to divest itself of operations that are not part of its core ultrahigh-pressure water pump business. On September 30, 2005, the Company entered into an agreement to sell the Avure Business. The business was acquired by Quintus Holdings, LLC, an affiliate of the Gores Technology Group, LLC (Gores), a Los Angeles-based private equity firm. On October 31, 2005, the Company and Gores consummated the purchase and sale transaction. The consideration includes cash of \$6 million at closing, a promissory note of \$8 million due 90 days after closing at a simple interest rate of 10% per annum, and a promissory note of \$2 million due 3 years after closing at a simple interest rate of 6% per annum. The net proceeds received by the Company will be subject to adjustment for changes in the net working capital, pension balance and excess cash at time of the closing.

The Avure Business became a discontinued operation as of October 31, 2005 in accordance with FAS 144 *Accounting for the Impairment or Disposal of Long-Lived Assets*. It is, therefore, not presented as a discontinued operation in the historical financial statements presented elsewhere in this prospectus. Beginning with the second quarter of fiscal 2006, however, we will present the Avure Business as discontinued operations and will reclassify all historical financial periods to reflect this treatment.

The following unaudited pro forma financial statements give effect to the disposition of the Avure Business to be accounted for as a discontinued operation in accordance the FAS 144. The unaudited pro forma consolidated balance sheet assumes the disposition occurred on July 31, 2005. Such pro forma information is based upon the historical balance sheet data of the Company as of that date. The unaudited pro forma consolidated statements of operations give effect to the treatment of the Avure Business as a discontinued operation for the three months ended July 31, 2005 and for each of the three years ended April 30, 2005.

The unaudited pro forma consolidated statement of operations for the fiscal year ended April 30, 2005 also gives effect to the PIPE Transaction. The PIPE Transaction, as described on page 2, was completed in March 2005, and the transaction was reported in the Company's financial statements for the year ended April 30, 2005 and in the Company's Form 10-Q for the quarter ended July 31, 2005. There is, therefore, no impact on our pro forma balance sheet at of July 31, 2005 or our pro forma statement of operations for the quarter ended July 31, 2005. In addition, the effects of this transaction are not reflected in the pro forma statement of operations for the fiscal years ended April 30, 2004 and 2003 as this is not allowed by Article 11 of Regulation S-X.

In the PIPE Transaction, as described on page 2, we sold 17,473,116 shares of common stock and warrants to purchase 1,747,312 shares of common stock. The PIPE Transaction gross proceeds of \$65 million, less investment banking fees of \$5.1 million and other costs of \$626,000 resulted in net cash proceeds of \$59.3 million. As further described below, the pro forma presentation reflects application of all of the net proceeds to pay down debt. Our subordinated debt and related accrued interest was paid off in its entirety and the remaining net proceeds were used to pay down our Senior debt. In addition, the pro forma presentation includes the issuance of approximately 304,000 anti-dilution warrants. The warrants were issued to our senior and subordinated lenders. The fair value of these warrants was \$1.7 million.

The pro forma does not purport to be indicative of the results which would actually have been reported if the Avure disposition had occurred on such dates or which may be reported in the future. For example, the net working capital adjustment as of the actual closing date may be materially different from the pro forma adjustments as of July 31, 2005. These unaudited pro forma financial statements should be read in conjunction with the accompanying notes to unaudited pro forma financial statements, our historical financial statements and related notes, the sections of this prospectus entitled "Selected Financial Data" and "Management's Discussion and Analysis of Financial Condition and Results of Operations", and the consolidated financial statements and related notes appearing elsewhere in this prospectus.

Table of Contents**Unaudited Pro Forma Consolidated Balance Sheet as of July 31, 2005**

(In thousands)

	<u>Historical Consolidated</u>	<u>Adjustments for the Avure Disposition</u>	<u>Pro Forma Consolidated</u>
ASSETS:			
Current Assets:			
Cash & Cash Equivalent	\$ 15,219	\$ (642)(b) 6,000 (a) (1,241)(c) (3,952)(a)	\$ 15,384
Restricted Cash	2,527	(1,500)(b)	1,027
Receivables, Net	28,047	(6,142)(b) 8,000 (a)	29,905
Inventories, Net	26,034	(8,156)(b)	17,878
Prepaid Expenses	6,487	(502)(b)	5,985
Other Current Assets	2,052		2,052
Total Current Assets	80,366	(8,135)	72,231
Property, Plant & Equipment, Net	12,227	(1,403)(b)	10,824
Intangible Assets, Net	13,600	(10,723)(b)	2,877
Goodwill	2,764		2,764
Deferred income tax	1,527	(625)(b)	902
Other Assets	2,028	(1,269)(b) 2,000 (a) (750)(a)	2,009
	\$ 112,512	\$ (20,905)	\$ 91,607
LIABILITIES AND SHAREHOLDERS' EQUITY (DEFICIT):			
Current Liabilities:			
Notes Payable	\$ 3,841	\$ (1,500)(b)	\$ 2,341
Current Portion of Long-Term Obligations	475		475
Accounts Payable	14,606	(2,141)(b)	12,465
Accrued Payroll and Related Liabilities	7,265	(1,904)(b)	5,361
Taxes Payable and Other Accrued Taxes	2,452	(91)(b) (441)(b)	1,920
Deferred Income Taxes	839		839
Deferred Revenue	2,995	(250)(b)	2,745
Customer Deposits	14,509	(3,017)(b)	11,492
Warrant Obligation	7,374		7,374
Other Accrued Liabilities	11,513	(6,535)(b)	4,978
Total Current Liabilities	65,869	(15,879)	49,990
Long-Term Obligations	13,301		13,301
Other Long-Term Liabilities	2,986	(1,713)(b)	1,273
Total Liabilities	82,156	(17,592)	64,564
Commitments and Contingencies			

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Minority Interest	2,178	(2,178)(b)	
Shareholders' Equity:			
Common Stock	346		346
Capital in Excess of Par	114,022		114,022
Accumulated Deficit	(80,559)	353 (d)	(80,206)
Accumulated Other Comprehensive Loss:			
Cumulative Translation Adjustment	(5,194)	(1,925)(b)	(7,119)
Unrealized Loss on Cash Flow Hedges	(437)	437 (b)	
	<u>28,178</u>	<u>(1,135)</u>	<u>27,043</u>
Total Shareholders Equity	<u>\$ 112,512</u>	<u>\$ (20,905)</u>	<u>\$ 91,607</u>

Table of Contents**Notes to Unaudited Pro Forma Consolidated Balance Sheet as of July 31, 2005**

- (a) To record proceeds of the sale of the Avure Business.

In accordance with purchase and sale agreement, the proceeds consist of cash of \$6 million at closing, a promissory note of \$8 million due 90 days after closing at a simple interest rate of 10% per annum, and a promissory note of \$2 million due 3 years after closing at a simple interest rate of 6% per annum. Cash proceeds received by the Company at closing will be subject to adjustment for changes in net working capital and excess cash at time of closing. The \$2 million promissory note is also subject to an adjustment related to a pension obligation balance at closing. The Pro Forma Consolidated Balance Sheet reflects the adjustments for the items based on the balances at July 31, 2005. The actual adjustments upon closing at October 31, 2005 will be different based on balance sheet as of that date.

- (b) To record the elimination of the assets and liabilities and certain other comprehensive income balances of the Avure Business sold.
(c) To record the estimated transaction costs incurred from the sale.
(d) To record loss on the disposition (in thousands):

Total Proceeds:	
Cash at closing	\$ 6,000
Promissory note due 90 days after closing	8,000
Promissory note due 3 years after closing	2,000
	<u>16,000</u>
Less: Transaction costs	(1,241)
Less: Adjustment for net working capital and pension balance	(4,702)
	<u>10,057</u>
Net Proceeds	10,057
Less: Net book value of Avure Business sold	(9,704)
	<u>\$ 353</u>
Pro forma gain, net of income tax \$0	\$ 353

Because we have provided for full valuation allowances for our deferred tax assets in the United States, the pro forma gain would not trigger an income tax expense. Therefore we have not adjusted the impact of this pro forma item to reflect any tax effect.

Table of Contents**Unaudited Pro Forma Consolidated Statements of Operations for the Three Months Ended July 31, 2005**

(In thousands, except in share amounts)

	Historical Consolidated	Adjustments for the Avure Disposition	Pro Forma Consolidated
Sales	\$ 49,729	\$ (7,743)(a)	\$ 41,986
Cost of Sales	29,106	(4,854)(a)	24,252
Gross Margin	20,623	(2,889)	17,734
Operating Expenses:			
Marketing	8,545	(969)(a)	7,576
Research and Engineering	2,691	(813)(a)	1,878
General and Administrative	7,366	(1,151)(a)	6,215
Restructuring Charges	98	(a)	98
	18,700	(2,933)	15,767
Operating Income	1,923	44	1,967
Interest Expense	(798)	(128)(a)	(926)
Other Expense, net	(226)	(1,559)(a)	(1,785)
Income (Loss) from Continuing Operations Before Income Taxes	899	(1,643)	(744)
Provision for Income Taxes	(877)	294 (a)	(583)
Income (Loss) from Continuing Operations	\$ 22	\$ (1,349)	\$ (1,327)
Income (Loss) Per Share from Continuing Operations			
Basic	\$ 0.00		\$ (0.04)
Diluted	\$ 0.00		\$ (0.04)
Weighted Average Shares Used in Computing Basic and Diluted Income (Loss) per Share from Continuing Operations			
Basic	34,299		34,299
Diluted	36,010		34,299

Note to Unaudited Pro Forma Consolidated Statements of Operations

(a) To reclassify the results of operations for the Avure Business as a discontinued operation for the three months ended July 31, 2005.

Table of Contents**Unaudited Pro Forma Consolidated Statements of Operations for the Year Ended April 30, 2005**

(In thousands, except share amounts)

	Historical Consolidated	Adjustments for the Avure Disposition	Subtotal	PIPE Transaction	Pro Forma Consolidated
Sales	\$ 219,365	\$ (46,399)(a)	\$ 172,966		\$ 172,966
Cost of Sales	138,905	(31,161)(a)	107,744		107,744
Gross Margin	80,460	(15,238)	65,222		65,222
Operating Expenses:					
Marketing	32,657	(4,286)(a)	28,371		28,371
Research and Engineering	9,067	(3,178)(a)	5,889		5,889
General and Administrative	26,988	(4,139)(a)	22,849		22,849
Restructuring Charges	239	(239)(a)			
Financial Consulting Charges	623		623		623
Impairment Charges	9,064	(9,064)(a)			
	<u>78,638</u>	<u>(20,906)</u>	<u>57,732</u>		<u>57,732</u>
Operating Income	1,822	5,668	7,490		7,490
Interest Expense	(20,559)	217 (a)	(20,342)	16,048(b)	(4,294)
Interest Income	157	(51)(a)	106		106
Other Income, net	302	1,403 (a)	1,705		1,705
(Loss) Income from Continuing Operations Before Income Taxes	(18,278)	7,237	(11,041)	16,048	5,007
Provision for Income Taxes	(2,338)	457 (a)	(1,881)	(c)	(1,881)
(Loss) Income from Continuing Operations	<u>\$ (20,616)</u>	<u>\$ 7,694</u>	<u>\$ (12,922)</u>	<u>\$ 16,048</u>	<u>\$ 3,126</u>
(Loss) Income Per Share from Continuing Operations					
Basic	<u>\$ (1.16)</u>		<u>\$ (0.73)</u>		<u>\$ 0.09</u>
Diluted	<u>\$ (1.16)</u>		<u>\$ (0.73)</u>		<u>\$ 0.09</u>
Weighted Average Shares Used in Computing (Loss) Income per Share from Continuing Operations					
Basic	17,748		17,748		33,402
Diluted	17,748		17,748		35,427 (d)

Notes to Unaudited Pro Forma Consolidated Statements of Operations

(a) To reclassify the results of operations for the Avure Business as a discontinued operation for the year ended April 30, 2005.

(b) To record the interest expenses reduced due to the PIPE Transaction.

The subordinated debt and accrued interest at May 1, 2004 (the beginning of fiscal 2005) was \$42.3 million. The pro forma interest expense, net income and earnings per share information assumes the proceeds of the PIPE Transaction were used first to pay off the balance of the subordinated debt and accrued interest and the remaining net proceeds were used to pay-down Senior Credit Facility borrowings. The reduction between the Actual and Pro Forma amounts of interest expense is attributable to the reduced levels of senior and subordinated borrowings. Because the interest expense on the subordinated borrowings was all accrued and did not require cash payments, the pro forma proceeds applied to reduce senior borrowings are the full difference between net proceeds of \$59.3 million and \$42.3 million of subordinated borrowing and accrued

Table of Contents

interest or \$17.0 million. In addition, the pro-forma amounts exclude the amortization of the Debt Discount on the Subordinated debt of approximately \$1.1 million per year. No pro forma impact was ascribed to the antidilution warrants issued in conjunction with the PIPE Transaction as such impact is not determinable. The pro-forma interest expense includes the following adjustments:

In Thousands	Year Ended April 30, 2005
Reduced interest expense on subordinated debt	\$ 7,724
Reduced interest expense on senior debt	1,509
Exclude write-off of capitalized fees and debt discount	5,281
Exclude charges for the antidilution warrants	1,534
Total pro forma adjustment to interest expense	\$ 16,048

The pro forma presentation also excludes the write off of unamortized debt discount, write-off of any capitalized fees. These fees were expensed in the fourth quarter of fiscal 2005 when the underlying debt was retired. They amounted to \$5.3 million in additional charges. Charges taken in the fourth quarter of fiscal 2005 for the portion of the warrants (\$1,534,000) issued to our subordinated lender and those senior lenders who did not participate in an ongoing senior credit agreement are excluded from the pro forma results.

- (c) Because we have provided for full valuation allowances for our deferred tax assets in the United States, the reductions to our interest expense would not effect our income tax provision. Therefore we have not adjusted the impact of these pro forma items to reflect any tax effect.
- (d) The pro forma weighted average number of shares outstanding includes the following adjustments:

In Thousands	Year Ended April 30, 2005	
	Basic	Diluted
Common shares issued in PIPE Transaction	15,654	15,654
Dilutive potential common shares from warrants and options		2,025
Total additional shares included in weighted average shares outstanding	15,654	17,679

The weighted average shares are adjusted for the additional shares issued in the PIPE Transaction, as if they were issued May 1, 2004. Diluted income (loss) per share takes into consideration the warrants issued to purchasers of stock in the PIPE Transaction, as well as the anti-dilution warrants issued to then current warrant holders prior to the PIPE Transaction where their inclusion would be dilutive.

The Company's potential common stock equivalents were:

	April 30, 2005
	Actual
In Thousands	
Common stock options	2,030
Warrants	3,219
Total	5,249

1,982,046 options are excluded from dilutive potential common shares because they are out-of-the-money.

Table of Contents**Unaudited Pro Forma Consolidated Statements of Operations for the Year Ended April 30, 2004**

(In thousands, except share amounts)

	Historical Consolidated	Adjustments for the Source Disposition	Pro Forma Consolidated
Sales	\$ 177,609	\$ (44,748)(a)	\$ 132,861
Cost of Sales	112,382	(28,778)(a)	83,604
Gross Margin	65,227	(15,970)	49,257
Operating Expenses:			
Marketing	28,422	(5,579)(a)	22,843
Research and Engineering	10,651	(4,778)(a)	5,873
General and Administrative	23,261	(4,230)(a)	19,031
Restructuring Charges	3,256	(788)(a)	2,468
Financial Consulting Charges	1,520	(a)	1,520
	67,110	(15,375)	51,735
Operating Loss	(1,883)	(595)	(2,478)
Interest Expense	(13,171)	412 (a)	(12,759)
Interest Income	386	(249)(a)	137
Other Income, net	7,817	304 (a)	8,121
Loss from Continuing Operations Before Income Taxes	(6,851)	(128)	(6,979)
Provision for Income Taxes	(5,197)	(392)(a)	(5,589)
Loss from Continuing Operations	\$ (12,048)	\$ (520)	\$ (12,568)
Loss Per Share from Continuing Operations Basic and Diluted	\$ (0.78)		\$ (0.82)
Weighted Average Shares Used in Computing Basic and Diluted Loss per Share from Continuing Operations Basic and Diluted	15,415		15,415

Note to Unaudited Pro Forma Consolidated Statements of Operations

(a) To reclassify the results of operations for the Avure Business as a discontinued operation for the year ended April 30, 2004.

Table of Contents**Unaudited Pro Forma Consolidated Statements of Operations for the Year Ended April 30, 2003**

(In thousands, except share amounts)

	Historical Consolidated	Adjustments for the Source Disposition	Pro Forma Consolidated
Sales	\$ 144,115	\$ (22,282)(a)	\$ 121,833
Cost of Sales	108,074	(19,815)(a)	88,259
Gross Margin	36,041	(2,467)	33,574
Operating Expenses:			
Marketing	37,398	(7,966)(a)	29,432
Research and Engineering	13,501	(6,830)(a)	6,671
General and Administrative	23,026	(4,242)(a)	18,784
Impairment Charges	10,815	(3,670)	7,145
	84,740	(22,708)	62,032
Operating Loss	(48,699)	20,241	(28,458)
Interest Expense	(11,848)	488 (a)	(11,360)
Interest Income	686	(606)(a)	80
Other Income, net	3,000	2,947 (a)	5,947
Loss from Continuing Operations Before Income Taxes	(56,861)	23,070	(33,791)
Provision for Income Taxes	(12,603)	2,518 (a)	(10,085)
Loss from Continuing Operations	\$ (69,464)	\$ 25,588	\$ (43,876)
Loss Per Share from Continuing Operations Basic and Diluted	\$ (4.53)		\$ (2.86)
Weighted Average Shares Used in Computing Loss per Share from Continuing Operations Basic and Diluted	15,348		15,348

Note to Unaudited Pro Forma Consolidated Statements of Operations

(a) To reclassify the results of operations for the Avure Business as a discontinued operation for the year ended April 30, 2003.

Table of Contents

Controls and Procedures

In December 2004, in connection with the restatement of our fiscal 2004, 2003 and 2002 financial statements, and in November 2005, in connection with our restatement of our fiscal 2005 and 2004 financial statements, our independent registered public accounting firm reported to management and to the Audit Committee material weaknesses in internal control over financial reporting. A material weakness is a control deficiency, or a combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Management agrees with and has responded to the Audit Committee with our plans to remediate the material weaknesses communicated by our independent registered public accounting firm. Remediation of these material weaknesses is ongoing.

The material weaknesses in our internal control over financial reporting are as follows:

The Company did not maintain effective controls over the financial reporting process due to an insufficient complement of personnel with an appropriate level of accounting knowledge, experience and training in the application of generally accepted accounting principles commensurate with its financial reporting requirements and the complexity of the Company's operations and transactions. Specifically, the Company incorrectly applied generally accepted accounting principles for (i) the impairment of goodwill, (ii) the classification of deferred tax balances, (iii) the valuation of anti-dilution warrants, (iv) the accrual of costs on contracts and balance sheet presentation of accounts receivable and cash receipts relating to contracts accounted for using the percentage-of-completion method and (v) leases with rent escalation clauses, affecting receivables, deferred income taxes, prepaid expenses, goodwill, other accrued liabilities, other long-term liabilities, customer deposits, minority interest, capital in excess of par, cost of sales, general and administrative expenses, impairment charge, interest expense and other (expense) income. This material weakness contributed to the material weakness discussed below.

The Company did not maintain effective controls to ensure there is adequate (i) analysis, documentation, reconciliation and review of accounting records, and supporting data, and (ii) monitoring and oversight of the work performed by accounting and financial reporting personnel to ensure the accuracy and completeness of the consolidated financial statements in accordance with generally accepted accounting principles. Specifically, the Company did not have effective controls designed and in place over the consolidation of the financial statements of subsidiaries, the reconciliation of inter-company accounts, the valuation of anti-dilution warrants, the accrual of costs on contracts and balance sheet presentation of accounts receivable and cash receipts relating to contracts accounted for using the percentage-of-completion method, the classification of technical service expenses and the accounting for performance based equity awards, affecting receivables, prepaid expenses, other accrued liabilities, customer deposits, capital in excess of par, cost of sales, marketing expense, research and engineering, general and administrative expense and interest expense.

These control deficiencies resulted in the restatement of the Company's consolidated financial statements for the years ended April 30, 2005, 2004 and 2003, each of the quarters in 2004 and 2003 and the fourth quarter of 2005. Additionally, each of these control deficiencies could result in a material misstatement of the aforementioned account balances or disclosures that would result in a material misstatement to the annual or interim financial statements that would not be prevented or detected. Accordingly, management has determined that each of the above control deficiencies represents a material weakness.

Remediation of Material Weakness

Our management and Audit Committee have dedicated significant resources to assessing the underlying internal control deficiencies giving rise to the restatements and to ensure that proper steps have been and are being taken to improve our internal control over financial reporting. We have assigned the highest priority to the correction of these deficiencies and have taken and will continue to take action to fully correct them.

Table of Contents

Management is committed to instilling strong control policies and procedures and ensuring that the tone at the top is committed to accuracy and completeness in all financial reporting. The remedial measures include the following:

Insufficient compliment of personnel with an appropriate level of accounting knowledge, experience and training in the application of generally accepted accounting principles.

We have filled several positions in the corporate accounting and finance department with newly hired staff, including a financial planner, assistant controller and senior accountant. We have not completed the hiring process at corporate as we continue to assess our staffing needs. During August 2005, we hired a technical accounting manager to ensure compliance with all current and future accounting rules. Prior to that date the existing staff was addressing our application of technical accounting literature. We will continue to assess staffing needs at both corporate and our subsidiaries, and have identified the need for additional staff in the areas of accounting supervision and financial analysis. We have applied additional resources and time to improve the appropriateness and documentation of our conclusions on technical accounting issues. This will be enhanced with the addition of our technical accounting manager and other planned additions.

Lack of effective controls to ensure adequate analysis, documentation, reconciliation and review of accounting records. Lack of effective controls to ensure adequate monitoring and oversight of work period by accounting and financial reporting personnel.

We engaged a financial consulting firm to assist in both detail reconciliation work, as well as reviewing current processes and controls and assistance in the development of prospective processes and controls over the inter-company reconciliation process. We created a standardized template used in the reconciliation of all our inter-company accounts. These reconciliations are reviewed for accuracy and completeness by our Chief Financial Officer. Additionally, we have created a new template for use in generation of our Statement of Cash Flows. We have modified our monthly divisional close checklist to ensure all required reconciliations are completed, as well as help ensure adherence to corporate policies and procedures. We have begun to improve the documentation of our accounting policies and procedures to ensure that all transactions are recorded consistently and with the appropriate level of documentation. As is described in the above paragraph, we still need to hire additional experienced staff to provide enhanced review, analysis and documentation of accounting transactions and of the consolidated financial statements.

The implementation of the initiatives described above, are among our highest priorities. Our Audit Committee will continually assess the progress and sufficiency of these initiatives and make adjustments as and when necessary. As of the date of this report, management believes that the plan outlined above, when completed, will eliminate the material weaknesses in internal control over financial reporting as described above.

Table of Contents**SELECTED FINANCIAL DATA**

The following selected consolidated financial data should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes, which are included elsewhere in this prospectus. The selected consolidated statement of operations data for each of the fiscal years ended April 30, 2003, 2004 and 2005 and the selected consolidated balance sheet data as of April 30, 2004 and 2005 are derived from our audited consolidated financial statements, which are included elsewhere in this prospectus. The selected consolidated statement of operations data of each of the fiscal years ended April 30, 2002 and 2001 and the balance sheet as of April 30, 2003, 2002 and 2001 are derived from our unaudited financial statements that are not included in this prospectus. The selected consolidated statement of operations data for the three months ended July 31, 2005 and the selected consolidated balance sheet data as of July 31, 2005 are derived from our unaudited consolidated financial statements which are included in this prospectus. Our unaudited financial statements have been prepared on the same basis as our audited consolidated financial statements included elsewhere in this prospectus and, in the opinion of our management, reflect all adjustments, which include only normal recurring adjustments, necessary to state fairly our financial position and results of operations as of and for those periods.

	Year Ended April 30,					
	Three Months Ended July 31, 2005 (unaudited)	2005				
		(restated)(4)	2004	2003(3)	2002(2)	2001(1) (unaudited)
(In thousands, except per share amounts)						
Statement of Operations Data:						
Sales	\$ 49,279	\$ 219,365	\$ 177,609	\$ 144,115	\$ 176,890	\$ 204,854
(Loss) Income Before Cumulative Effect of Change in Accounting Principles and Discontinued Operations	22	(20,616)	(12,048)	(69,464)	(8,244)	4,038
Net (Loss) Income	22	(20,616)	(11,522)	(69,987)	(7,853)	1,630
Basic (Loss) Income Per Share Before Cumulative Effect of Change in Accounting Principles and Discontinued Operations	0.00	(1.16)	(0.78)	(4.53)	(0.54)	0.27
Basic (Loss) Earnings Per Share	0.00	(1.16)	(0.75)	(4.56)	(0.52)	0.11
Diluted (Loss) Income Per Share Before Cumulative Effect of Change in Accounting Principles and Discontinued Operations	0.00	(1.16)	(0.78)	(4.53)	(0.54)	0.27
Diluted (Loss) Income Per Share	0.00	(1.16)	(0.75)	(4.56)	(0.52)	0.11
April 30,						
		2005				
		(restated)(4)	(restated)(4)	(restated)(5)	(restated)(5)	(restated)(5)
(In thousands)						
Balance Sheet Data:						
Working Capital	\$ 14,497	\$ 6,233	\$ (9,060)	\$ (6,709)	\$ 84,532	\$ 91,750
Total Assets	112,512	118,417	129,272	147,088	205,572	206,270
Short-Term Debt	4,316	13,443	48,727	61,056	5,237	8,464
Long-Term Obligations, net	13,301	5,704	38,081	29,023	83,453	85,652
Shareholders' Equity (Deficit)	28,178	28,710	(9,552)	4,872	71,054	68,755

Table of Contents

- (1) The Statement of Operations for fiscal 2001 includes the adoption of SEC Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements, as amended by SAB101A and 101B. We reflected this change in policy as a Cumulative Effect of Change in Accounting Principle.
- (2) The Statement of Operations for fiscal 2002 includes the adoption of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (FAS 142). See Note 1 to the Consolidated Financial Statements for the year ended April 30, 2005 for further discussion of the impact of this adoption.
- (3) The Statement of Operations for fiscal 2003 includes the impact of management's launch of its restructuring program and resulting focus on cash generation. See the Fiscal 2003 Comprehensive Financial Review at the end of the Fiscal 2004 Compared to Fiscal 2003 financial analysis in the Management's Discussion and Analysis section for further discussion of the impact on our financial results.
- (4) As described in Note 2 to the April 30, 2005 Consolidated Financial Statements included elsewhere in this prospectus, we have restated our consolidated financial statements for the year ended April 30, 2005 to reflect additional charges in the Consolidated Statement of Operations associated with 1) the impairment of goodwill, 2) the revised valuation of anti-dilution warrants issued to our senior and subordinated lenders, 3) the revision of estimated losses on long-term contracts, 4) the correction of compensation expense for performance based equity awards and stock awards for services and 5) straight-line rent expense for leases with escalating rents. In addition, we restated certain balances for incorrect classification on our Consolidated Balance Sheet as of April 30, 2005 and 2004 and Consolidated Statement of Operations for the year ended April 30, 2005.
- (5) As reported in the Company's April 30, 2005 Form 10-K/A, the Company has identified errors in the Consolidated Financial Statements related to the presentation of percentage-of-completion related balances on the Consolidated Balance Sheet. Specifically, the Company noted inconsistencies between its divisions in the balance sheet presentation of accounts receivable and cash receipts relating to contracts accounted for using the percentage-of-completion method. The Company has, therefore, adjusted its financial statements to reflect a consistent presentation and comply with the provisions of SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts as of April 30, 2003, 2002, and 2001.

Table of Contents

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

Current Events

Avure Disposition

On October 31, 2005, consistent with our strategy to divest operations that are not part of our core UHP water pump business, we sold our General Press operations and the non UHP portion of our Food reportable segment (the Avure Disposition). Included in the Avure Disposition were our Avure Technologies, Incorporated, Flow International FPS AB, Avure Technologies AB subsidiaries, and our 51% interest in Flow Autoclave Systems (together, the Avure Business). The Avure Business became a discontinued operation in accordance with FAS 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* at the time it was sold and will be represented that way in future financial statements. In connection with the sale we agreed to continue to supply UHP pumps to the Avure Business.

Current Senior Credit Agreement

Until April 28, 2005, our long-term financing consisted of a senior credit agreement (originally entered into on July 28, 2004) whose maturity date was August 1, 2005 (Senior Credit Agreement) and a subordinated debt agreement (Subordinated Debt Agreement). On April 28, 2005, we entered into a new senior debt agreement (April Senior Credit Agreement) for the purpose of being able to pay off the Subordinated Debt Agreement, which was done. The April Senior Credit Agreement also had a maturity date of August 1, 2005. On July 8, 2005, we entered into a new senior credit agreement, with a maturity date of July 8, 2008 (Current Senior Credit Agreement). At certain places in this report, we refer to Senior Credit Arrangements referring to one or more of the senior credit agreements when identification of a particular agreement is not important. The Current Senior Credit Agreement is a \$30 million, three year agreement with Bank of America N.A. and U.S. Bank N.A. It bears interest at Bank of America's prime rate (5.75% at April 30, 2005) or is linked to LIBOR plus a percentage depending on our leverage ratios, at our option. The agreement sets forth specific financial covenants to be attained on a quarterly basis, which we believe, based on our financial forecasts, are achievable. The financial covenants in the Current Senior Credit Agreement are less restrictive than in the earlier Senior Credit Arrangements.

Restructuring

In fiscal 2005, we completed a plan intended to return us to profitability through reductions in headcount, consolidation of facilities and operations, and closure or divestiture of selected operations. We evaluated the workforce and skill levels necessary to satisfy the expected future requirements of the business. As a result, we implemented plans to eliminate redundant positions and realign and modify certain roles based on skill assessments. We recorded restructuring charges of \$3.3 million and \$239,000 for the years ended April 30, 2004 and 2005, respectively, which are shown in the table below (in thousands):

Year Ended	Year Ended
April 30, 2005	April 30, 2004

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Severance benefits	\$ 120	\$ 652
Facility exit costs	119	1,058
Inventory write-down		1,546
	\$ 239	\$ 3,256

These charges included employee severance related costs for approximately 50 individuals. The fiscal 2004 reductions in the global workforce were made across manufacturing, engineering and general and administrative functions. We have also recorded facility exit costs for the year ended April 30, 2004 primarily as a result of consolidating our two Kent facilities into one facility, vacating the manufacturing warehouse portion of our Flow

Table of Contents

Europe facility and reducing the space utilized in our Swedish manufacturing facility. In addition, we scrapped some obsolete parts, returned surplus parts to vendors and sold parts to third parties, in conjunction with the shutdown of our manufacturing operation in Europe and standardization of our product line. The fiscal 2005 restructuring related to employee reductions in the Food segment as well as closure of our Memphis sales office. See restructuring accrual information in Note 16 to Consolidated Financial Statements.

During the year ended April 30, 2005 and 2004, we incurred \$.6 million and \$1.5 million, respectively, of professional fees associated with the restructuring of our debt in July 2004 and July 2003, respectively. These costs were evaluated under EITF 98-14, *Debtor's Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements*, and as they were either expenses related to potential Senior Credit Arrangement with lenders that did not occur, or they related to expenses associated with our subordinated debt and did not result in an increase in the facility and accordingly they were expensed.

Robotics Division

In an effort to control costs and to focus on our core UHP waterjet systems, on June 2, 2005, we announced that we had expanded our strategic relationship with Motoman Inc., to deliver standard, pre-engineered robotic waterjet cutting solutions to the automotive industry. The relationship means that Motoman, Inc. will be the primary sales contact with the end user for standard systems and we will sell UHP pumps and parts to Motoman, Inc. to be integrated into the pre-engineered robotic cutting system. At the same time we announced that, in order to re-align our resources with this new strategic direction, our custom robotic waterjet cutting system manufacturing would be relocated from Wixom, Michigan to Burlington, Ontario. This closure is expected to be completed by the second quarter of fiscal 2006 with restructuring expenses of approximately \$1,000,000. These expenses include severance payments for employees, exit expenses for the facility as well as logistical expenses for moving and disposing of equipment and assets.

Other

We have also retained a broker to assist us in evaluating various opportunities for the Applications Group, our *Other* segment.

Three Months Ended July 31, 2005 Compared to Three Months Ended July 31, 2004

Changes in Financial Condition

We generated \$5.8 million of cash from operating activities during the three months ended July 31, 2005 compared to \$1.2 million of cash generated for the three months ended July 31, 2004. The current year's operating cash flow includes \$9.7 million of reduction in trade receivables from improved collections as well as cash collections on a number of percentage-of-completion projects, during the three months ended July 31, 2005. Trade receivables accounted for cash generation of \$2.5 million in the year ago comparable period. Additionally, customer deposits increased \$4.1 million. These deposits provide the funding for the manufacturing of our systems and primarily relate to large aerospace contracts that we have been awarded. The revenue associated with these deposits is expected to be recognized in the next twelve months. Increases in inventory of \$2.2 million and decreases in accounts payable of \$5.9 million from settlement of amounts outstanding during the three months ended July 31, 2005 offset the cash generated by receivables.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Net receivables are comprised of trade accounts and unbilled revenues. At July 31, 2005, the net receivables balance decreased \$10.3 million or 27% from April 30, 2005. The decrease in net receivables stemmed from the reduction in trade receivables of \$8.1 million or 22% from \$37.2 million at April 30, 2005 to \$29.0 million at July 31, 2005 on collection of standard waterjet system sales from the three months ended April 30, 2005. Receivables days sales outstanding (including unbilled revenues) decreased to 51 days at July 31, 2005 from 53 as of April 30, 2005. This decrease was compounded by a reduction in unbilled revenues from \$5.0 million at April 30, 2005 to \$2.7 million at July 31, 2005, a \$2.3 million or 46% decrease. A significant portion of unbilled receivables relates to equipment and systems sales accounted for on a percentage of completion basis. Unbilled

Table of Contents

revenues fluctuate due to the scheduling of production and achievement of certain billing milestones. In general, receivables can be negatively affected by the traditionally longer payment cycle outside the United States and the timing of billings and payments on large special system orders. We do not believe these timing issues will present a material adverse impact on our short-term liquidity requirements. Because of the lead-time to build and deliver such equipment, ultimate collection of such accounts can be subject to changing customer business and economic conditions.

Inventories, net at July 31, 2005 increased \$1.8 million or 7% from April 30, 2005 driven by increase in work in process from shipments of completed food units in-transit for delivery to customers in North America. Gross inventories increased \$1.7 million or 6% while the obsolescence reserve decreased slightly to \$2.8 million. The inventory increase at July 31, 2005 and reduced cost of goods sold in the quarter contributed to lower inventory turns of 4.5 turns compared with the quarter ended April 30, 2005 turns of 6.5 times.

Customer deposits remain high, increasing \$3.9 million to \$14.5 million at July 31, 2005, versus the \$10.6 million balance at April 30, 2005. The increase stems from milestone advances due under the significant aerospace contracts which we were awarded in fiscal 2005.

Liquidity and Capital Resources

Approximately \$14.7 million of our cash and restricted cash is held by divisions outside the United States. The repatriation of offshore cash balances from certain divisions will trigger tax liabilities. In fiscal 2004, we recorded a \$1.9 million liability for withholding taxes on future repatriation of historical foreign earnings. In fiscal 2005, we repatriated \$4.8 million from certain foreign subsidiaries. During the three months ended July 31, 2005, we repatriated \$1.4 million from a foreign subsidiary and we plan to continue repatriating additional funds in the future.

On March 21, 2005, in a Private Investment in Public Equity Transaction (PIPE Transaction), we sold 17,473,116 equity units at \$3.72 per unit for gross proceeds of \$65 million, and net proceeds of more than \$59 million. A unit consists of one share of our common stock and one warrant to buy 1/10th of a share of our common stock. Ten warrants give the holder the right to purchase one share of common stock for \$4.07. If all the warrant holders opted to exercise their warrants, we would receive \$7.1 million in cash proceeds.

Under terms of the PIPE Transaction, we were required to file an initial Form S-1 registration of the shares issued and issuable in the PIPE Transaction on or before May 20, 2005 (which we did) and were required to cause the Form S-1 to become effective on or before September 17, 2005. We have amended the Registration Rights Agreement to grant us an extension until December 31, 2005 for the effective date of the registration of the shares and warrants issued in the PIPE Transaction. We are subject to liquidated damages of \$650,000 per month, if we fail to meet the December 31, 2005 deadline. Because the market price of the common stock was greater than \$3.70, we issued approximately 304,000 anti-dilution warrants to current warrant holders prior to the PIPE Transaction which have a Black-Scholes value of approximately \$1.7 million. Approximately \$1.5 million of this amount relates to warrants issued under subordinated debt agreements and \$0.2 million relates to warrants issued under senior debt agreements. Proceeds of the PIPE were used to pay down existing debt, including all of the subordinated debt.

Our domestic senior credit agreement (Credit Agreement) is our primary source of external funding. Effective July 8, 2005, we executed a new \$30 million, three year senior credit agreement with Bank of America N.A. and U.S. Bank N.A. This credit agreement expires July 8, 2008 and bears interest at the bank's prime rate (6.25% at July 31, 2005) or is linked to LIBOR plus a percentage depending on our leverage ratios, at our option. The agreement sets forth specific financial covenants to be attained on a quarterly basis, which we believe, based on our financial forecasts, are achievable. At July 31, 2005, the balance outstanding on the Credit Agreement was \$8.0 million against a maximum borrowing of \$30 million. Our available credit at July 31, 2005, net of \$6.4 million in outstanding letters of credit, was \$15.6 million.

Table of Contents

We believe that our existing cash, cash from operations, and credit facilities at July 31, 2005 are adequate to fund our operations through April 30, 2006. If we fail to achieve our planned revenues, costs and working capital objectives, management believes it has the ability to curtail capital expenditures and reduce costs to levels that will be sufficient to enable us to meet our cash requirements and debt covenants through April 30, 2006.

On August 26, 2005, we received \$2.5 million for giving the exclusive right to Barton Mines Company to sell abrasive to our customers. Under a Purchase Agreement, we are also entitled to future annual payments of \$250,000 for the next three years based on achievement of system sales targets and royalty payments for systems sold over the next 10 years.

On October 31, 2005, we completed the sale of the North America Press and International Press segments, as well as the non ultrahigh-pressure portion of the Food segment with the Gores Technology Group, LLC (Gores) for estimated net proceeds of \$14.0 million, comprised of cash and notes. At closing, we also entered into a Supply Agreement with Gores whereby we have agreed to supply certain high pressure pump products on an exclusive basis to Gores. These segments do not meet the accounting criteria to be considered assets held for sale as of July 31, 2005 and accordingly the results of operations are shown as continuing operations and the related assets have not been reported as held for sale in our financial statements.

Off-Balance Sheet Arrangements

We do not have any special purpose entities or off-balance sheet financing arrangements.

Contractual Obligations

During the quarter ended July 31, 2005, there were no material changes outside the ordinary course of business in our contractual obligations and minimum commercial commitments as reported on page 59 for the year ended April 30, 2005.

Critical Accounting Policies and Judgments and New Accounting Pronouncements

There are no material changes in our critical accounting policies as disclosed on pages 59-61 for the year ended April 30, 2005. New accounting pronouncements are disclosed in Note 15 to the July 31, 2005 Condensed Consolidated Financial Statements.

Results of Operations

We analyze our business based on the utilization of ultrahigh-pressure (UHP), either as released pressure or contained pressure. The released pressure portion of our UHP business which we call Waterjet, is comprised of the following segments: North America Waterjet, Asia Waterjet, Other International Waterjet and Other. The contained pressure operation which is what we call Avure is made up of the Food, North America

Press and International Press segments.

Operational Overview:

Dollars in thousands, except per share data

	Three months ended July 31, 2005			Three months ended July 31, 2004		
	Waterjet	Avure	Consolidated	Waterjet	Avure	Consolidated
Sales	\$ 41,986	\$ 7,743	\$ 49,729	\$ 38,299	\$ 10,683	\$ 48,982
Cost of Sales	24,252	4,854	29,106	24,326	6,761	31,087
Gross Margin	17,734	2,889	20,623	13,973	3,922	17,895
Operating Expenses	15,568	3,132	18,700	12,940	3,324	16,264
Operating Income	\$ 2,166	\$ (243)	\$ 1,923	\$ 1,033	\$ 598	\$ 1,631

Table of Contents**Sales Summary:**

Dollars in thousands

	Three months ended July 31,		
	2005	2004	% Change
Operational breakdown:			
Waterjet:			
Systems	\$ 28,721	\$ 25,900	11%
Consumable parts and services	13,265	12,399	7%
Total	41,986	38,299	10%
Avure:			
Fresher Under Pressure	2,337	3,868	(40)%
General Press	5,406	6,815	(21)%
Total	7,743	10,683	(28)%
	\$ 49,729	\$ 48,982	2%
Geographic breakdown:			
United States	\$ 28,954	\$ 26,979	7%
Rest of Americas	4,181	4,895	(15)%
Europe	10,826	10,757	1%
Asia	5,768	6,351	(9)%
	\$ 49,729	\$ 48,982	2%

Three Months Ended July 31, 2005 Compared to Three Months Ended July 31, 2004*(Tabular amounts in thousands)***Sales.**

Our sales by segment for the periods noted below is summarized as follows:

	Three Months Ended July 31,			
	2005	2004	Difference	%

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Sales				
Waterjet:				
North America	\$ 22,927	\$ 15,900	\$ 7,027	44%
Asia	5,768	6,351	(583)	(9)%
Other International	8,453	7,136	1,317	18%
Other	4,838	8,912	(4,074)	(46)%
Waterjet Total	41,986	38,299	3,687	10%
Avure:				
Food	2,337	3,868	(1,531)	(40)%
North America Press	2,117	2,593	(476)	(18)%
International Press	3,289	4,222	(933)	(22)%
Avure Total	7,743	10,683	(2,940)	(28)%
Consolidated Total	\$ 49,729	\$ 48,982	\$ 747	2%

Waterjet. The Waterjet operation includes cutting and cleaning operations, which are focused on providing total solutions for the aerospace, automotive, job shop, surface preparation (cleaning) and paper industries. It is comprised of four reporting segments: North America Waterjet, Asia Waterjet, Other International Waterjet and

Table of Contents

Other. The North America, Asia and Other International Waterjet segments primarily represent sales of our standard cutting and cleaning systems throughout the world, as well as sales of our custom designed systems into the Aerospace industry. The Other segment represents sales of our automation and robotic waterjet cutting sells which are sold primarily into the North American automotive industry. For the three months ended July 31, 2005, total Waterjet sales of \$42.0 million increased \$3.7 million or 10% as compared to the prior year same period. \$7.0 million of increase was recognized in our North America Waterjet segment. Last year we believed the market awareness of waterjet technology was low and addressed this through an increase in marketing and tradeshow activity, including attendance at the bi-annual International Manufacturing Technology Show in early September 2004, as well as increasing the number of domestic waterjet cutting direct sales staff from 10 to 15, adding of two machine tool distributors and increasing domestic technical services staff from 12 to 24 persons. The growth in revenue in North America is a result of an increase in unit sales stemming from our increased sales and marketing activity. There were no significant price increases year over year; however, a price increase of 4% on selected systems was instituted on February 1, 2005. Aerospace sales, which are also included in the North America segment, were \$2.1 million for the three months ended July 31, 2005, up \$1.7 million from the prior year same period from work completed on aerospace contracts awarded in fiscal 2005. Growth in the Other International Waterjet segment represents primarily sales into Europe and South America. Revenues from our European operations have improved by \$1.0 million for the three months ended July 31, 2005 to \$7.5 million. Market specific pricing including some price reductions, standardization of system offerings, improved delivery and a recovering European marketplace have helped to increase our European sales. Sales into South America of \$0.9 million for the three months ended July 31, 2005 improved \$0.3 million over the respective prior year periods. We typically sell our products at higher prices outside the U.S. due to the costs of servicing these markets. As much of our product is manufactured in the U.S., the weakness of the U.S. dollar also has helped strengthen our foreign revenues.

The growth in our North America and Other International Waterjet segments were offset by declines in the Asia Waterjet and Other segments. Asia Waterjet sales were negatively impacted by sluggish Japanese consumption of machine tools yielding a decrease of 9% versus the prior year same quarter. The Other segment recorded a \$4.1 million decline from the prior year comparable quarter from a downturn in the domestic automotive industry as well as from the closing and relocation of our Wixom, Michigan facility to our Burlington, Ontario facility.

We also analyze our Waterjet revenues by looking at system sales and consumable sales. Systems sales were \$28.7 million, up \$2.8 million or 11%, for the three months ended July 31, 2005 due to strong domestic and European shapecutting sales as well as increased aerospace revenue. Consumables revenues recorded an increase of \$866,000 or 7% to \$13.3 million for the three months ended July 31, 2005, respectively. The majority of the increase in spares sales for the three months ended July 31, 2005 is domestic and is the result of the increasing number of systems in service and by our proprietary productivity enhancing kits and improved parts availability as well as the use of Flowparts.com, our easy-to-use internet order entry system. We believe that spare parts sales should continue to increase as more systems are put into service.

Avure. The Avure operation includes the Fresher Under Pressure technology (Food segment) as well as General Press operations (North America Press and International Press segments). Revenue in the Avure operations is recorded on the percentage of completion basis. Fresher Under Pressure meets the increasing demand in the U.S. for a post packaging, terminal pasteurization-like step (e.g. packaged ready-to-eat meats); the demand for high quality, minimally processed foods (e.g. fresh guacamole and salsas); and the demand to utilize the productivity enhancing capabilities of UHP in food processing (e.g. shellfish), while the General Press business manufactures systems which produce and strengthen advanced materials for the aerospace, automotive and medical industries. For the three months ended July 31, 2005, sales for the Food segment decreased \$1.5 million or 40%. The reduction in revenue recognized during the first quarter relates to the timing of production of the food systems.

Table of Contents

As outlined in the table above, both North America Press and International Press sales have declined in the three months ended July 31, 2005 as compared to the prior year same period. These decreases of \$476,000 and \$933,000, respectively, are the result of timing of both contract awards and performance of work under our percentage of completion accounting. General Press sales are almost exclusively large contract sales in excess of \$2 million per contract and accordingly revenue will vary depending on the number and stage of manufacture of these contracts. The sales and production cycle on a General Press can range from one to four years in length.

Cost of Sales and Gross Margins. Our gross margin by segment for the periods noted below is summarized as follows:

	Three Months Ended July 31,			
	2005	2004	Difference	%
Gross Margin				
Waterjet:				
North America	\$ 10,788	\$ 7,771	\$ 3,017	39%
Asia	2,810	2,855	(45)	(2)%
Other International	3,261	2,380	881	37%
Other	875	967	(92)	(10)%
Waterjet Total	17,734	13,973	3,761	27%
Avure:				
Food	1,249	1,015	234	23%
North America Press	370	323	47	15%
International Press	1,270	2,584	(1,314)	(51)%
Avure Total	2,889	3,922	(1,033)	(26)%
Consolidated Total	\$ 20,623	\$ 17,895	\$ 2,728	15%

Our gross margin as a percent of sales by segment for the periods noted below is summarized as follows:

	Three Months Ended July 31,	
	2005	2004
Gross Margin Percentage		
Waterjet:		
North America	47%	49%
Asia	49%	45%
Other International	39%	33%
Other	18%	11%
Waterjet Total	42%	36%
Avure:		
Food	53%	26%
North America Press	17%	12%
International Press	39%	61%

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Avure Total	37%	37%
Consolidated Total	41%	37%

Gross margin for the three months ended July 31, 2005 amounted to \$20.6 million or 41% of sales, as compared to gross margin of \$17.9 million or 37% of sales in the prior year same period. Generally, comparison of gross margin rates will vary period over period depending on the mix of sales, which includes special system, standard system and consumables sales. Gross margin rates on our systems sales are typically less than 45% as opposed to consumables sales which are in excess of 50%. On average, standard systems which are included in the North America, Asia and Other International Waterjet segments carry higher margins than the custom

Table of Contents

engineered systems, which are represented by the Other, Food, North America Press and International Press segments. In addition, gross margin as a percent of sales will vary amongst segments due to inter-company sales and the related inter-company transfer pricing.

Waterjet margins represented \$17.7 million of the overall consolidated margin or 42% of Waterjet sales for the three months ended July 31, 2005. For the first quarter of fiscal 2006, we experienced increased margin dollars in three of the four waterjet segments, and margin percentages improved over the prior year first quarter except in the North America Waterjet segment, where the margin percentage decreased from 49% in the prior year to 47%. The reduction in margin percentage is driven by the change in mix of systems and consumables toward more systems in the three months ended July 31, 2005 of 70% versus 61% for the three months ended July 31, 2004.

Avure margins amounted to \$2.9 million of the overall consolidated margin or 37% of Avure sales for the three months ended July 31, 2005. Food segment margin percentages improved for the first quarter of fiscal 2006 as sales of consumables increased 64% and we recognized revenue on a repossessed unit for which the receivable had been previously fully reserved. The North America Press segment margin dollars and percentage have increased for the three months ended July 31, 2005 compared to the prior year period. This is the result of a shift in product mix in fiscal 2006 towards less equipment manufactured by the International Press segment, for which the margins recognized by North America Press are lower due to our inter-company transfer pricing policies. International Press segment margins decreased to 39% in the quarter ended July 31, 2005 compared to the prior year. The International Press margin is the result of gross profit on external sales and gross profit on inter-company sales. Our segment reporting excludes inter-company sales, but not the related margins. The decrease in International margin in the quarter ended July 31, 2005 is a result of the decrease in external sales, plus the impact of the net decrease in inter-company production for both Food and North America Press.

Marketing Expenses. Our marketing expenses by segment for the periods noted below are summarized as follows:

	Three Months Ended July 31,			
	2005	2004	Difference	%
Marketing				
Waterjet:				
North America	\$ 4,014	\$ 2,994	\$ 1,020	34%
Asia	961	841	120	14%
Other International	2,264	1,972	292	15%
Other	325	417	(92)	(22)%
Waterjet Total	7,564	6,224	1,340	22%
Avure:				
Food	267	381	(114)	(30)%
North America Press	154	147	7	5%
International Press	560	557	3	1%
Avure Total	981	1,085	(104)	(10)%
Consolidated Total	\$ 8,545	\$ 7,309	\$ 1,236	17%

Marketing expenses increased \$1.2 million or 17% to \$8.5 million for the three months ended July 31, 2005, as compared to the prior year same period. The majority of this increase in the first quarter of fiscal 2006 was recorded in the North America Waterjet segment, which amounted to

\$1.0 million. This is due to increased expenses such as commissions, on higher sales, as well as increased marketing and advertising costs directed at increasing waterjet technology awareness. The increase in Other International Waterjet is commensurate with the percentage increase in sales, while the entities in our Other segment were able to hold dollar costs constant.

Table of Contents

Avure in total recorded a slight decrease in marketing expenses for the first quarter, with the primary reduction in the Food segment as a result of the closure of the sales office in January 2005. Expressed as a percentage of revenue, consolidated marketing expenses were 17% for the three months ended July 31, 2005. This compares to 15% of sales for the prior year same period.

Research and Engineering Expenses. Our research and engineering expenses by segment for the periods noted below are summarized as follows:

	Three Months Ended July 31,			
	2005	2004	Difference	%
Research and Engineering				
Waterjet:				
North America	\$ 1,509	\$ 1,213	\$ 296	24%
Asia	106	78	28	36%
Other International	139	170	(31)	(18)%
Other	19	56	(37)	(66)%
Waterjet Total	1,773	1,517	256	17%
Avure:				
Food	415	387	28	7%
North America Press				
International Press	503	700	(197)	(28)%
Avure Total	918	1,087	(169)	(16)%
Consolidated Total	\$ 2,691	\$ 2,604	\$ 87	3%

Research and engineering expenses increased \$87,000 or 3% for the three months ended July 31, 2005, as compared to the prior year same period. A \$296,000 increase was recorded in the North America Waterjet segment and is attributable to the addition of key engineering personnel related to our core UHP technology. This increase was offset by a \$197,000 decrease in the International Press segment, related to the timing of research and development work and continued cost cutting. Expressed as a percentage of revenue, research and engineering expenses were 5% for both the three months ended July 31, 2005 and 2004.

General and Administrative Expenses. Our general and administrative expenses by segment for the periods noted below are summarized as follows:

	Three Months Ended July 31,			
	2005	2004	Difference	%
General and Administrative				
Waterjet:				
North America	\$ 4,798	\$ 3,276	\$ 1,522	46%

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Asia	398	272	126	46%
Other International	575	635	(60)	(9)%
Other	362	393	(31)	(8)%
	<u> </u>	<u> </u>	<u> </u>	
Waterjet Total	6,133	4,576	1,557	34%
Avure:				
Food	247	284	(37)	(13)%
North America Press	178	179	(1)	(1)%
International Press	808	689	119	17%
	<u> </u>	<u> </u>	<u> </u>	
Avure Total	1,233	1,152	81	7%
	<u> </u>	<u> </u>	<u> </u>	
Consolidated Total	\$ 7,366	\$ 5,728	\$ 1,638	29%
	<u> </u>	<u> </u>	<u> </u>	

Table of Contents

General and administrative expenses increased \$1.6 million or 29% for the three months ended July 31, 2005, as compared to the prior year same period. The first quarter of fiscal 2006 increase was experienced primarily in the North America Waterjet segment which includes all of our corporate overhead costs. These costs were driven higher by patent litigation costs and costs associated with our disposition of Avure of \$825,000 and public company-related costs such as Sarbanes-Oxley consulting fees and Board fees of \$571,000. Expressed as a percentage of revenue, consolidated general and administrative expenses were 15% for the three months ended July 31, 2005, as compared to 12% for the three months ended July 31, 2004.

Restructuring Expenses. During the three months ended July 31, 2005, we incurred \$98,000 of severance benefits and other costs in the Other segment related to the closing and relocation of our Wixom, Michigan facility. No restructuring costs were incurred during the three months ended July 31, 2004.

Financial Consulting Expenses. No financial consulting costs were incurred for the three months ended July 31, 2005. For the three months ended July 31, 2004 we incurred \$623,000 of financial consulting costs associated with our efforts to refinance our subordinated debt. Because no new financing was obtained, these costs were charged to expense.

Operating Income (Loss). Our operating income (loss) by segment for the periods noted below are summarized as follows:

	Three Months Ended July 31,			
	2005	2004	Difference	%
Operating Income (Loss)				
Waterjet:				
North America	\$ 467	\$ (335)	\$ 802	NM
Asia	1,345	1,664	(319)	(19)%
Other International	283	(397)	680	NM
Other	71	101	(30)	30%
Waterjet Total	2,166	1,033	1,133	110%
Avure:				
Food	320	(37)	357	NM
North America Press	38	(3)	41	NM
International Press	(601)	638	(1,239)	NM
Avure Total	(243)	598	(841)	NM
Consolidated Total	\$ 1,923	\$ 1,631	\$ 292	18%

NM = Not Meaningful

Our operating income for the three months ended July 31, 2005 was \$1.9 million versus a \$1.6 million in the prior year period. The reasons for the changes in operating profit or loss by segment have been described in the paragraphs above addressing changes in sales, gross margin and operating expenses.

Interest and Other Expense, net. Current interest expense, net decreased to \$798,000 for the three months ended July 31, 2005. This net amount includes \$212,000 of interest income for the three months ended July 31, 2005. This decrease results from lower interest rates and lower average debt balance outstanding with the paydown of the subordinated debt in April 2005. During the three months ended July 31, 2005, we recorded Other Expense, net of \$238,000 compared to Other Expense, net of \$170,000 in the prior year three month period. This slight increase is the result of changes in realized and unrealized foreign exchange gains and losses as described in the table below, offset by the \$678,000 expense associated with the warrants used in the previously described PIPE transaction. The terms of these warrants require them to be marked-to-market at each reporting period with corresponding gains and losses reported on the Consolidated Statement of Operations.

Table of Contents

The following table shows the detail of Other Expense, net, in the accompanying Consolidated Statements of Operations:

<i>(in thousands)</i>	Three Months Ended	
	July 31,	
	2005	2004
Realized Foreign Exchange Gains, Net	\$ 129	\$ 527
Unrealized Foreign Exchange Gains (Losses), Net	372	(660)
Minority Interest	(26)	(6)
Fair Value Adjustment on Warrants Issued	(678)	
Other	(35)	(31)
	\$ (238)	\$ (170)

Income Taxes. For the three months ended July 31, 2005 and 2004, the tax provision consists of current expense related to operations in foreign jurisdictions which are profitable primarily in Taiwan, Japan and Sweden. In addition, operations in certain jurisdictions (principally Germany) reported net operating losses for which no tax benefit was recognized as it is more likely than not that such benefit will not be realized. During the fourth quarter of fiscal 2004, as a result of foreign asset collateral requirements and our amended credit agreements, we were no longer able to permanently defer foreign earnings and recorded a \$1.9 million liability for withholding taxes payable on future repatriation of foreign earnings. We also recorded a U.S. tax liability of \$6.7 million on foreign earnings which we have decided to no longer permanently defer. The total \$6.7 million tax liability was offset by a reduction of the valuation allowance. In addition, we continue to assess our ability to realize our net deferred tax assets. Recognizing the cumulative losses generated during the quarter ended July 31, 2005 and in prior periods, we have determined it appropriate to continue to maintain a valuation allowance on our domestic net operating losses, certain foreign net operating losses and certain other deferred tax assets based on the expected reversal of both deferred tax assets and liabilities. The domestic net operating losses can be carried forward 20 years to offset domestic profits in future periods and expire from fiscal 2022 through fiscal 2024 if not used. Our foreign net operating losses currently do not have an expiration date. We provided a full valuation allowance against the deferred tax assets associated with the losses recorded during the quarter ended July 31, 2005.

Net Income (Loss). Our consolidated net income in the three months ended July 31, 2005 amounted to \$22,000, or \$.00 per basic and diluted income per share as compared to a net loss of \$2.3 million, or \$.15 basic and diluted loss per share in the prior year same period.

Table of Contents**Operational and Financial***Operational Data as a Percentage of Sales*

	Year Ended April 30,		
	2005		
	(restated)	2004	2003
Sales	100%	100%	100%
Cost of Sales	63%	63%	75%
Gross Margin	37%	37%	25%
Expenses:			
Marketing	15%	16%	26%
Research & Engineering	4%	6%	9%
General & Administrative	12%	13%	16%
Restructuring Charges	%	2%	%
Financial Consulting Charges	%	1%	%
Impairment Charges	5%	%	8%
	36%	38%	59%
Operating Income (Loss)	1%	(1)%	(34)%
Interest Expense	(9)%	(7)%	(8)%
Interest Income	%	%	1%
Other Income (Expense), net	%	4%	2%
Loss Before Provision for Income Taxes	(8)%	(4)%	(39)%
Provision for Income Taxes	(1)%	(3)%	(9)%
Loss Before Discontinued Operations	(9)%	(7)%	(48)%
Discontinued Operations, Net of Tax	%	1%	(1)%
Net Loss	(9)%	(6)%	(49)%

Operational Overview:

Dollars in thousands	Year ended April 30, 2005			Year ended April 30, 2004			Year ended April 30, 2003		
	Waterjet (restated)	Avure (restated)	Consolidated (restated)	Waterjet	Avure	Consolidated	Waterjet	Avure	Consolidated

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Sales	\$ 172,966	\$ 46,399	\$ 219,365	\$ 132,861	\$ 44,748	\$ 177,609	\$ 121,833	\$ 22,282	\$ 144,115
Cost of Sales	107,693	31,212	138,905	83,604	28,778	112,382	88,620	19,454	108,074
Gross Margin	65,273	15,187	80,460	49,257	15,970	65,227	33,213	2,828	36,041
Operating Expenses	56,931	21,707	78,638	50,934	16,176	67,110	60,335	24,405	84,740
Operating (Loss) Income	\$ 8,342	\$ (6,520)	\$ 1,822	\$ (1,677)	\$ (206)	\$ (1,883)	\$ (27,122)	\$ (21,577)	\$ (48,699)

Table of Contents**Sales Summary:**

	Year ended April 30,			Year ended April 30,		
	2005	2004	% Change	2004	2003	% Change
Dollars in thousands						
Operational breakdown:						
Waterjet:						
Systems	\$ 122,129	\$ 85,015	44%	\$ 85,015	\$ 76,346	11%
Consumable parts and services	50,837	47,846	6%	47,846	45,487	5%
Total	172,966	132,861	30%	132,861	121,833	9%
Avure:						
Fresher Under Pressure	15,072	15,296	(1)%	15,296	4,851	215%
General Press	31,327	29,452	6%	29,452	17,431	69%
Total	46,399	44,748	4%	44,748	22,282	101%
	\$ 219,365	\$ 177,609	24%	\$ 177,609	\$ 144,115	23%
Geographic breakdown:						
United States	\$ 128,975	\$ 92,799	39%	\$ 92,799	\$ 79,450	17%
Rest of Americas	19,468	17,751	10%	17,751	15,673	13%
Europe	45,417	46,557	(2)%	46,557	31,326	49%
Asia	25,505	20,502	24%	20,502	17,666	16%
	\$ 219,365	\$ 177,609	24%	\$ 177,609	\$ 144,115	23%

Results of Operations

We analyze our business based on the utilization of ultrahigh-pressure, either as released pressure or contained pressure. The released pressure portion of our UHP business which we call Waterjet, is comprised of the following segments: North America Waterjet, Asia Waterjet, Other International Waterjet and Other. The contained pressure operation which is what we call Avure, is made up of the Food, North America Press and International Press segments.

Fiscal 2005 Compared to Fiscal 2004

(Tabular amount in thousands)

Sales.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Our sales by segment for the periods noted below is summarized as follows:

	<u>2005</u>	<u>2004</u>	<u>Difference</u>	<u>%</u>
Sales				
Waterjet:				
North America	\$ 82,381	\$ 59,044	\$ 23,337	40%
Asia	25,505	20,502	5,003	24%
Other International	34,530	28,160	6,370	23%
Other	30,550	25,155	5,395	21%
Waterjet Total	172,966	132,861	40,105	30%
Avure:				
Food	15,072	15,296	(224)	(1)%
North America Press	16,617	7,445	9,172	123%
International Press	14,710	22,007	(7,297)	(33)%
Avure Total	46,399	44,748	1,651	4%
Consolidated Total	\$ 219,365	\$ 177,609	\$ 41,756	24%

Table of Contents

Waterjet. The Waterjet operation includes cutting and cleaning operations, which are focused on providing total solutions for the aerospace, automotive, job shop, surface preparation (cleaning) and paper industries. It is comprised of four reporting segments: North America Waterjet, Asia Waterjet, Other International Waterjet and Other. The North America, Asia and Other International Waterjet segments primarily represent sales of our standard cutting and cleaning systems throughout the world, as well as sales of our custom designed systems into the aerospace industry. The Other segment represents sales of our automation and robotic waterjet cutting cells, as well as non-waterjet systems, which are sold primarily into the North American automotive industry. For the fiscal year ended April 30, 2005, we reported a \$40.1 million, or 30%, increase in revenue to \$173.0 million versus the prior year comparative period. All four segments reported an increase in revenue; however \$23.3 million of the \$40.1 million increase was recognized in our North America Waterjet segment. At the end of fiscal 2004, we believed the market awareness of waterjet technology was low and addressed this through an increase in marketing and tradeshow activity, including attendance at the bi-annual International Manufacturing Technology Show in early September 2004, as well as increasing the number of domestic waterjet cutting direct sales staff from 10 to 15, adding two machine tool distributors, acting as agents, and increasing domestic technical services staff from 12 to 24 persons. The growth in revenue in North America is a result of an increase in unit sales stemming from our increased sales and marketing activity. There were no significant price increases year over year, however a price increase of 4% on selected systems was implemented on February 1, 2005. Aerospace sales, which are also included in the North America segment, were \$5.5 million, up \$1.4 million (33%) from the prior year. The growth in our Other segment results from improved non-waterjet automated robotic system demand in the domestic automotive industry. We have not increased our marketing and sales staff in this segment year over year. Our waterjets are experiencing growing acceptance in the marketplace because of their flexibility and superior machine performance.

Outside the U.S., Waterjet revenue growth was positively influenced by growth in Asia Waterjet sales which were \$25.5 million, up \$5.0 million or 24% for the year ended April 30, 2005. This increase was driven largely by sales in China where we experienced strong demand for shapecutting and cutting cell systems from a strengthening automotive industry.

Our Other International Waterjet segment represents primarily sales in Europe and South America. Revenues from our European operations have improved by \$6.2 million (25%) for the year ended April 30, 2005 to \$30.7 million. Market specific pricing including some price reductions, standardization of system offerings, improved delivery and a recovering European marketplace have helped to increase our European sales. Sales in South America of \$3.8 million for the year ended April 30, 2005 were comparable to the respective prior year period. The economic conditions in the South America region make it difficult to increase sales. We are typically able to sell our products at higher prices outside the U.S. due to the costs of servicing these markets. As much of our product is manufactured in the U.S., the weakness of the U.S. dollar also has helped strengthen our foreign revenues.

We also analyze our Waterjet revenues by looking at system sales and consumable sales. Systems revenues for the year ended April 30, 2005 were \$122.1 million, an increase of \$37.1 million or 44%, compared to the prior year same period due to both strong domestic and global sales from recovering economic conditions. The majority, \$21.4 million, of the increase was generated domestically. Consumables revenues recorded an increase of \$3.0 million or 6% to \$50.8 million for the year ended April 30, 2005. The majority of the increase in spares sales is domestic and is the result of the increasing number of operating systems, increasing sales of our proprietary productivity enhancing kits, improved parts availability, as well as increased customer acceptance of Flowparts.com, our easy-to-use internet order entry system. We believe that spare parts sales should continue to increase as more systems are put into operation.

Avure. The Avure operation includes the Fresher Under Pressure technology (Food segment) as well as General Press operations (North America Press and International Press segments). These segments have been eliminated because we have sold Avure, as described earlier. Revenue in the Avure operations is recorded on the percentage of completion basis. Fresher Under Pressure meets the increasing demand in the U.S. for a post

Table of Contents

packaging, terminal pasteurization-like step (e.g. packaged ready-to-eat meats); the demand for high quality, minimally processed foods (e.g. fresh guacamole and salsas); and the demand to utilize the productivity enhancing capabilities of UHP in food processing (e.g. shellfish shucking), while the General Press business manufactures systems that produce and strengthen advanced materials for the aerospace, automotive and medical industries. For the year ended April 30, 2005, sales for the Food segment decreased \$.2 million or 1%.

General Press revenues vary from year to year due to the nature of its sales and production cycle. The sales and production cycle on a General Press can range from one to four years. As outlined in the table above, North American Press sales grew significantly in the year ended April 30, 2005 to \$16.6 million as compared to the prior year period. This growth is the result of revenue recognized under two large contracts obtained in fiscal 2004 and manufactured in fiscal 2005.

International Press sales for the year ended April 30, 2005 decreased \$7.3 million as compared to the prior year. The International Press sales are almost exclusively large contract sales in excess of \$2 million per contract and accordingly revenue will vary depending on the number and stage of manufacture of these contracts.

Cost of Sales and Gross Margins. Our gross margin by segment for the periods noted below is summarized as follows:

	2005			
	<u>(restated)</u>	<u>2004</u>	<u>Difference</u>	<u>%</u>
Gross Margin				
Waterjet:				
North America	\$ 38,018	\$ 25,170	\$ 12,848	51%
Asia	11,682	9,762	1,920	20%
Other International	12,034	9,890	2,144	22%
Other	3,539	4,435	(896)	(20)%
Waterjet Total	<u>65,273</u>	<u>49,257</u>	<u>16,016</u>	<u>33%</u>
Avure:				
Food	2,185	1,788	397	22%
North America Press	2,124	1,109	1,015	92%
International Press	10,878	13,073	(2,195)	(17)%
Avure Total	<u>15,187</u>	<u>15,970</u>	<u>(783)</u>	<u>(5)%</u>
Consolidated Total	<u>\$ 80,460</u>	<u>\$ 65,227</u>	<u>\$ 15,233</u>	<u>23%</u>

Our gross margin as a percent of sales by segment for the periods noted below is summarized as follows:

2005	2004
<u>(restated)</u>	<u></u>

Gross Margin Percentage		
Waterjet:		
North America	46%	43%
Asia	46%	48%
Other International	35%	35%
Other	12%	18%
Waterjet Total	38%	37%
Avure:		
Food	14%	12%
North America Press	13%	15%
International Press	74%	59%
Avure Total	33%	36%
Consolidated Total	37%	37%

Table of Contents

Gross margin for the year ended April 30, 2005 amounted to \$80.5 million or 37% of sales as compared to gross margin of \$65.2 million or 37% of sales in the prior year period. Generally, gross margin rates will vary period over period depending on the mix of sales, which includes special system, standard system and consumables sales. Gross margin rates on our systems sales are typically less than 45% as opposed to consumables sales which are in excess of 50%. On average, standard systems which are included in the North America, Asia and Other International Waterjet segments carry higher margins than the custom engineered systems, which are represented by the Other, Food, North America Press and International Press segments. In addition, gross margin as a percent of sales will vary amongst segments due to inter-company sales and the related inter-company transfer pricing.

For the year ended April 30, 2005, waterjet margins represented \$65.3 million of the overall consolidated margin or 38% of Waterjet sales. The waterjet operations gross margin percentage increased one percentage point from 37% of sales in fiscal 2004. The increase in North American waterjet margins were offset in part by the decrease of five percentage points in the Other segment in fiscal 2005. This weakness stems from a number of very low margin contracts built in fiscal 2005, including several loss contracts which totaled \$1.2 million in losses. All loss contracts were non-waterjet related systems. We have consolidated the management of this division within the Other segment and current contracts appear to be in line with historical gross margins in the automotive industry, between 15% and 25%.

Avure margins amounted to \$15.2 million of the overall consolidated margin or 33% of Avure sales. Food segment margin percentages improved in the current year as the prior year included several strategic sales at almost a zero margin. These sales represented the initial sale of equipment into the Ready-to Eat meat industry made in an effort to try and accelerate market adoption and the sale of a development project into the seafood industry that has other industry applications. The North America Press segment margin dollars have increased; however, the margin percentage has decreased for the year ended April 30, 2005 compared to the prior year period. This is the result of a shift in product mix in fiscal 2005 towards equipment manufactured by the International Press segment, for which the margins recognized by North America Press are lower due to our inter-company transfer pricing policies. The International Press margin is the result of gross profit on external sales and gross profit on inter-company sales. Our segment reporting excludes inter-company sales, but not the related margins. For fiscal 2005, inter-company production is up which has resulted in an increase in the International Press margin percentage to 74%. Gross margin percentages on similar type projects remain the same year over year.

Marketing Expenses. Our marketing expenses by segment for the periods noted below are summarized as follows:

	2005			
	(restated)	2004	Difference	%
Marketing				
Waterjet:				
North America	\$ 14,667	\$ 10,109	\$ 4,558	45%
Asia	3,704	3,022	682	23%
Other International	8,161	7,750	411	5%
Other	1,789	1,822	(33)	(2)%
Waterjet Total	28,321	22,703	5,618	25%
Avure:				
Food	1,324	1,658	(334)	(20)%
North America Press	602	499	103	21%
International Press	2,410	3,562	(1,152)	(32)%
Avure Total	4,336	5,719	(1,383)	(24)%

Consolidated Total	\$ 32,657	\$ 28,422	\$ 4,235	15%
--------------------	-----------	-----------	----------	-----

Table of Contents

Marketing expenses increased \$4.2 million or 15% to \$32.7 million for the year ended April 30, 2005 as compared to the prior year period. Waterjet increased \$5.6 million or 25% and Avure decreased \$1.4 million or 24% as compared to the prior year period. The Waterjet increase in North America was the result of improved sales and the market awareness programs. Fiscal 2005 also includes over \$.5 million in costs associated with the bi-annual International Manufacturing Technology Show held during the second quarter ended October 31, 2004. Asia and Other International Waterjet recorded cost increases in line with changes in sales and the Other segment held marketing costs constant. Within Avure, the majority of the decrease is attributable to International Press, due to both cost cutting and lower sales. Expressed as a percentage of sales, consolidated marketing expenses were 15% for fiscal 2005, as compares to 16% of sales for fiscal 2004.

Research and Engineering Expenses. Our research and engineering expenses by segment for the periods noted below are summarized as follows:

	2005			
	<u>(restated)</u>	<u>2004</u>	<u>Difference</u>	<u>%</u>
Research and Engineering				
Waterjet:				
North America	\$ 4,183	\$ 4,082	\$ 101	2%
Asia	348	295	53	18%
Other International	712	737	(25)	(3)%
Other	224	337	(113)	(34)%
	<u>5,467</u>	<u>5,451</u>	<u>16</u>	<u>%</u>
Waterjet Total				
Avure:				
Food	1,685	1,583	102	6%
North America Press				%
International Press	1,915	3,617	(1,702)	(47)%
	<u>3,600</u>	<u>5,200</u>	<u>(1,600)</u>	<u>(31)%</u>
Avure Total				
Consolidated Total	<u>\$ 9,067</u>	<u>\$ 10,651</u>	<u>\$ (1,584)</u>	<u>(15)%</u>

Research and engineering expenses decreased \$1.6 million or 15% for fiscal 2005 as compared to fiscal 2004. Waterjet expenses were up slightly associated with our aerospace programs, while Avure decreased \$1.6 million. The overall decreases were related to the timing of research and development work, the increased use of engineers on revenue generating projects and continued cost cutting across most segments. Expressed as a percentage of revenue, research and engineering expenses were 4% in fiscal 2005, as compared to 6% in fiscal 2004.

Table of Contents

General and Administrative Expenses. Our general and administrative expenses by segment for the periods noted below are summarized as follows:

	<u>2005</u>	<u>2004</u>	<u>Difference</u>	<u>%</u>
General and Administrative				
Waterjet:				
North America	\$ 16,620	\$ 12,767	\$ 3,853	30%
Asia	1,381	1,146	235	21%
Other International	2,653	3,064	(411)	(13)%
Other	1,866	1,842	24	1%
	<u>22,520</u>	<u>18,819</u>	<u>3,701</u>	<u>20%</u>
Avure:				
Food	1,075	1,245	(170)	(14)%
North America Press	716	601	115	19%
International Press	2,677	2,596	81	3%
	<u>4,468</u>	<u>4,442</u>	<u>26</u>	<u>1%</u>
Consolidated Total	<u>\$ 26,988</u>	<u>\$ 23,261</u>	<u>\$ 3,727</u>	<u>16%</u>

General and administrative expenses increased \$3.7 million or 16% for the year ended April 30, 2005, as compared to the prior year. The North America Waterjet segment increased \$3.9 million. This includes increased professional fees of \$900,000 associated with patent litigation, \$600,000 for increased audit fees and Sarbanes Oxley consulting fees, increased incentive compensation of \$1.5 million and increased labor and miscellaneous other costs associated with strengthening key corporate functions of \$900,000. As a percent of sales, however, North America Waterjet general and administrative expenses decreased from 22% to 20% in fiscal 2005. Expressed as a percentage of revenue, consolidated general and administrative expenses were 12% in fiscal 2004 as compared to 13% for the prior year period.

Table of Contents

Restructuring Charges. During fiscal 2005, we incurred \$.2 million of severance benefits and facility exit costs in the Food segment. During fiscal 2004, we incurred \$3.3 million of restructuring-related costs, including severance, lease termination and inventory related charges, primarily in the U.S., Germany and Sweden. The most significant parts of this total being incurred in the North America Waterjet segment, \$1.1 million, Other International Waterjet, \$1.4 million and International Press, \$.8 million.

The following table summarizes accrued restructuring activity for fiscal 2004 and 2005 (in thousands):

	North America Waterjet		Other International Waterjet		Other Waterjet		Food		International Press		Consolidated		Total	
	Facility Exit Costs	Other	Facility Severance Benefits	Facility Exit Costs	Other	Severance Benefits	Severance Benefits	Facility Exit Costs	Facility Severance Benefits	Facility Exit Costs	Severance Benefits	Facility Exit Costs		Other
Q1 restructuring charge	\$	\$	\$ 248	\$	\$	\$	\$	\$	\$	\$	\$ 248	\$	\$ 248	
Q1 cash payments			(128)								(128)		(128)	
Balance, July 31, 2003			120								120		120	
Q2 restructuring charge		178	(120)	105	302				201	191	81	296	480	
Q2 cash payments		(178)			(47)								(225)	
Q2 charge-offs					(255)								(255)	
Balance, October 31, 2003				105					201	191	201	296	497	
Q3 restructuring charge	407	170		85	484	89					89	492	654	
Q3 cash payments	(270)	(160)		(14)					(121)		(121)	(284)	(160)	
Q3 charge-offs		(10)		(85)	(484)							(85)	(494)	
Balance, January 31, 2004	137			91		89			80	191	169	419	588	
Q4 restructuring charge	15	412		255					234		234	270	412	
Q4 cash payments	(13)	(126)		(13)		(89)			(70)		(159)	(26)	(126)	
Q4 charge-offs		(286)											(286)	
Balance, April 30, 2004	139			333					244	191	244	663	907	
Q1 restructuring charge														
Q1 cash payments	(9)			(4)					(68)	(3)	(68)	(16)	(84)	
Balance, July 31, 2004	130			329					176	188	176	647	823	
Q2 restructuring charge														
Q2 cash payments	(9)			(4)					(64)	(3)	(64)	(16)	(80)	
Balance, October 31, 2004	121			325					112	185	112	631	743	
Q3 restructuring charge							120	119			120	119	239	
Q3 cash payments	(9)			(10)			(17)	(39)	(39)	(3)	(56)	(61)	(117)	
Balance, January 31, 2005	112			315			103	80	73	182	176	689	865	
Q4 restructuring charge														

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Q4 cash payments	(9)		(31)			(50)	(17)	(39)	(3)	(89)	(60)		(149)
Balance, April 30 2005	\$ 103	\$	\$ 284	\$	\$	\$ 53	\$ 63	\$ 34	\$ 179	\$ 87	\$ 629	\$	\$ 716

Table of Contents

Financial Consulting Charges. During the years ended April 30, 2005 and 2004, we incurred \$6 million and \$1.5 million, respectively, of professional fees associated with the restructuring of our debt in July 2004 and July 2003, respectively. These costs were either expenses related to potential Senior Credit Arrangements with lenders that did not occur, or they related to expenses associated with our subordinated debt and did not result in an increase in the facility, accordingly, they were expensed.

Impairment Charges. During fiscal 2005, we conducted a review of the carrying value of our goodwill in accordance with Statement of Financial Accounting Standard No. 142 (FAS 142), Goodwill and Other Intangible Assets. In view of the possibility of the sale of our North America and International Press segments as well as the non ultrahigh-pressure portion of our Food segment, we determined that it was not appropriate to carry forward previous years' valuations of the reporting units in these segments that carried goodwill. We, therefore, updated our estimates of fair value of the reporting units based on the offer prices we had received from potential purchasers of the businesses. This exercise indicated that the fair value of the reporting units was less than carrying value and that their goodwill was fully impaired. Consequently, we recorded an impairment charge of \$9.1 million during the quarter ended April 30, 2005 of which, \$8.3 million was recorded in the International Press segment and \$0.8 million was recorded in the North America Press segment. At April 30, 2005, we also conducted an impairment review of our long-lived assets in accordance with Statement of Financial Accounting Standard No. 144 (FAS 144), Accounting for the Impairment or Disposal of Long-Lived Assets. This review resulted in no impairment charges. There were no impairment charges in fiscal 2004.

Operating Income (Loss).

Our operating income (loss) by segment for the periods noted below are summarized as follows:

	2005			
	(restated)	2004	Difference	%
Operating Income (Loss)				
Waterjet:				
North America	1,925	(4,390)	6,315	NM
Asia	6,249	5,299	950	18%
Other International	508	(2,921)	3,429	NM
Other	(340)	335	(675)	NM
Waterjet Total	8,342	(1,677)	10,019	NM
Avure:				
Food	(2,138)	(2,887)	749	(26)%
North America Press	41	9	32	NM
International Press	(4,423)	2,672	(7,095)	NM
Avure Total	(6,520)	(206)	(6,314)	NM
Consolidated Total	\$ 1,822	\$ (1,883)	\$ 3,750	NM

NM = Not Meaningful

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Our operating income for the year ended April 30, 2005 was \$1.8 million as compared to an operating loss of \$1.9 million for the year ended April 30, 2004. The reasons for the changes in operating profit or loss by segment have been described in the paragraphs above addressing changes in sales, gross margin and operating expenses.

Interest and Other Income (Expense), net. Interest expense increased to \$20.6 million for the year ended April 30, 2005, a \$7.4 million increase as compared to the prior year. This increase includes the write-off of debt discount of \$4.0 million associated with the pay-off of our subordinated debt, \$1.6 million in write off of capitalized loan costs under EITF 98-14 Debtor's Accounting for Changes in Line-of Credit or Revolving-Debt

Table of Contents

Arrangements (EITF 98-14) and \$1.6 million related to the expensing of anti-dilution warrants provided to lenders whose underlying debt was retired in April 2005 under EITF 98-14. During fiscal 2005, we recorded Other Expense, net of \$302,000 as outlined below. This compares to Other Income, net of \$7.8 million in the prior year period. Other income, net in fiscal 2004 includes a \$2.6 million gain on the sale of investment securities we held and net foreign exchange gains and losses.

The following table shows the detail of Other Income (Expense), net, in the accompanying Consolidated Statements of Operations:

	2005	
	(restated)	2004
Net realized foreign exchange gains	\$ 1,359	\$ 2,155
Net unrealized foreign exchange (losses) gains	(827)	2,827
Realized gain on sale of equity securities		2,618
Minority interest in joint venture	(40)	(35)
Other	(190)	252
Total	\$ (302)	\$ 7,817

Income Taxes. The fiscal 2005 and 2004 tax provision consists of current expense related to operations in foreign jurisdictions which are profitable, primarily in Taiwan and Japan. In addition, operations in certain jurisdictions (principally Germany and the United States) reported net operating losses for which no tax benefit was recognized as it is more likely than not that such benefit will not be realized. During the fourth quarter of fiscal 2004, as a result of foreign asset collateral requirements and our amended credit agreements, we were no longer able to permanently defer foreign earnings and recorded a \$1.9 million liability for withholding taxes payable on future repatriation of foreign earnings. We also recorded a U.S. tax liability of \$6.7 million on foreign earnings. The total \$6.7 million tax liability was offset by a reduction of the valuation allowance. In addition, we continue to assess our ability to realize our net deferred tax assets. Recognizing the continued losses generated during fiscal 2005 and in prior periods, we have determined it appropriate to continue to maintain a valuation allowance on our domestic net operating losses, certain foreign net operating losses and certain other deferred tax assets based on the expected reversal of both deferred tax assets and liabilities. The domestic net operating losses can be carried forward 20 years to offset domestic profits in future periods and expire between fiscal 2022 and fiscal 2024 if not used. Our foreign net operating losses currently do not have an expiration date. We provided a full valuation allowance against the deferred tax assets associated with the losses recorded during fiscal 2005.

Net Loss. For the year ended April 30, 2005, our consolidated net loss was \$20.6 million or \$1.16 per basic and diluted loss per share as compared to a net loss of \$11.5 million, or \$.75 basic and diluted loss per share in the prior year period.

The weighted average number of shares outstanding used for the calculation of basic and diluted loss per share is 17,748,000 for fiscal 2005 and 15,415,000 for fiscal 2004. There were 2,034,546 and 2,089,412 of potentially dilutive common shares from employee stock options and 3,219,245 and 860,000 of potentially dilutive shares from warrants which have been excluded from the diluted weighted average share denominator for fiscal 2005 and 2004, respectively, as their effect would be anti-dilutive.

Table of Contents*Fiscal 2004 Compared to Fiscal 2003. (Tabular amounts in thousands)***Sales.**

Our sales by segment for 2004 and 2003 is summarized as follows:

	<u>Year Ended April 30,</u>		<u>Dollar</u>	<u>Percent</u>
	<u>2004</u>	<u>2003</u>	<u>Change</u>	<u>Change</u>
Sales				
Waterjet:				
North America	\$ 59,044	\$ 53,995	\$ 5,049	9%
Asia	20,502	17,667	2,835	16%
Other International	28,160	23,279	4,881	21%
Other	25,155	26,892	(1,737)	(6)%
Waterjet Total	132,861	121,833	11,028	9%
Avure:				
Food	15,296	4,851	10,445	215%
North America Press	7,445	7,668	(223)	(3)%
International Press	22,007	9,763	12,244	125%
Avure Total	44,748	22,282	22,466	101%
Consolidated Total	\$ 177,609	\$ 144,115	\$ 33,494	23%

Waterjet. For the year ended April 30, 2004, total Waterjet revenue increased \$11.0 million or 9% to \$132.9 million from \$121.8 million in the prior year. All of this growth was recorded in the North America, Asia and Other International Waterjet segments, driven by market demand for our dynamic waterjet cutting head and improved global market conditions in the primary industries we serve. This growth was all volume related as we did not increase prices during fiscal 2004.

Included in the \$5.0 million increase in fiscal 2004 in North American waterjet sales is a \$3.3 million or 6% revenue increase over the prior year period for sales of our domestic standard waterjet cutting systems. Our waterjets are experiencing continued acceptance in the marketplace from their flexibility and superior machine performance. The remainder of the North America Waterjet increase relates to an increase in our aerospace business, which totaled \$4.1 million in fiscal 2004 driven by the manufacture of the Airbus A380. North American automotive and automation (our Other segment) sales decreased 6% or \$1.7 million in fiscal 2004 as compared to fiscal 2003 due to the cyclical nature of the automotive industry.

Outside the U.S., Waterjet revenue growth was positively influenced by growth in Asian revenues which were up \$2.8 million or 16% for the year ended April 30, 2004 to \$20.5 million, compared to \$17.7 million in the prior year. These increases were driven largely by sales in Japan where we experienced strong demand for our surface preparation and shapecutting systems, due in part to the refurbishment program for U.S.

Navy ships based in Japan.

Our Other International Waterjet segment represents primarily sales into Europe and South America. Revenues from our European operations have improved by \$3.0 million or 14% to \$24.6 million during fiscal 2004. Market specific pricing and standardization of system offerings and a recovering European marketplace contributed to this improvement. Sales into South America are up \$1.9 million due to improvements in sales of surface preparation equipment.

We also analyze our Waterjet revenues by looking at system sales and consumable sales. Systems revenues for the year ended April 30, 2004 were \$85.0 million, an increase of \$8.7 million or 11%, compared to the prior fiscal year due to strong global sales from recovering economic conditions driven by a weaker U.S. dollar.

Table of Contents

Consumables revenues also recorded an improvement of 5% or \$2.3 million to \$47.8 million for the year ended April 30, 2004, compared to the prior year consumable revenue of \$45.5 million. This is due to increased machine utilization by our customers in North and South America and Asia, all of which led to higher parts consumption. Consumables revenue continues to be positively impacted by our proprietary productivity enhancing kits and improved parts availability as well as the introduction of Flowparts.com, our easy-to-use internet order entry system.

Avure. For the year ended April 30, 2004, revenues for the Food segment were \$15.3 million, representing a \$10.4 million, or 215% improvement, compared to the prior year's revenue of \$4.9 million. A portion of this increase can be attributed to the reversal in the prior year of \$4.3 million of percentage of completion revenue previously recognized on three food systems (one customer) based on the customer's failure to fulfill its obligations under the contract terms. Additionally, in fiscal 2004, we were able to record revenue of \$3.7 million on fiscal 2003 orders where we delivered already-completed systems. These orders did not qualify for percentage of completion accounting and the corresponding revenue was recognized upon delivery and acceptance in fiscal 2004 of the systems that were sold. Increased acceptance of the technology drove the remainder of the growth.

For the year ended April 30, 2004, North America Press sales were essentially flat with the prior year at \$7.4 million.

International Press revenues for the year ended April 30, 2004 increased 125% or \$12.2 million from \$9.8 million for the prior year to \$22.0 million, on stronger order volume and production. Order and production volumes were significantly weaker in 2003 due to lower demand for industrial products following the September 2001 attacks. The majority of this revenue increase occurred in Europe and, accordingly, net consolidated revenues in Europe have increased over the prior year.

Cost of Sales and Gross Margins. Our gross margin by segment for 2004 and 2003 is summarized as follows:

	Year Ended April 30,		Dollar	Percent
	2004	2003	Change	Change
Gross Margin				
Waterjet:				
North America	\$ 25,170	\$ 21,408	\$ 3,762	18%
Asia	9,762	7,702	2,060	27%
Other International	9,890	1,782	8,108	NM
Other	4,435	2,321	2,114	91%
Waterjet Total	49,257	33,213	16,044	48%
Avure:				
Food	1,788	(5,099)	6,887	NM
North America Press	1,109	1,375	(266)	(19)%
International Press	13,073	6,552	6,521	100%
Avure Total	15,970	2,828	13,142	NM
Consolidated Total	\$ 65,227	\$ 36,041	\$ 29,186	81%

NM=Not meaningful

Table of Contents

Our gross margin percentage by segment for 2004 and 2003 is summarized as follows:

	<u>Year Ended April 30,</u>	
	<u>2004</u>	<u>2003</u>
Gross Margin Percent		
Waterjet:		
North America	43%	40%
Asia	48%	44%
Other International	35%	8%
Other	18%	9%
	<u> </u>	<u> </u>
Waterjet Total	37%	27%
Avure:		
Food	12%	(105)%
North America Press	15%	18%
International Press	59%	67%
	<u> </u>	<u> </u>
Avure Total	36%	13%
	<u> </u>	<u> </u>
Consolidated Total	37%	25%
	<u> </u>	<u> </u>

Gross margin for the year ended April 30, 2004 amounted to \$65.2 million or 37% of revenues, as compared to gross margin of \$36.0 million or 25% of revenues in the prior year. Fiscal 2003 gross margin was negatively impacted by a number of adjustments posted during the third quarter of that year which totaled \$11.1 million. Waterjet margins represented \$49.3 million of the overall margin or 37% of Waterjet revenues. We experienced improvement in the gross margin as a percent of revenues in each of the four segments that comprise the Waterjet operations. This gross margin improvement of 10 percentage points, 37% of revenues in fiscal 2004 compared to 27% of revenues in the prior year, was a result of better overhead absorption in light of higher sales volumes of \$11 million in the year and on fiscal 2003 inventory valuation charges of \$6.2 million which did not recur in 2004.

The Avure margins amounted to \$16.0 million or 36% of Avure revenues, up from \$2.8 million or 13% of revenues in the prior year. This improvement in margin of \$13.1 million was achieved in both the Food segment and International Press segment of Avure. In fiscal 2004 the Food gross margin was \$1.8 million or 12% of revenues, up from a gross loss of \$5.1 million in the prior year. This improvement resulted from increased production volumes and \$4.9 million in prior year adjustments related to percentage of completion and inventory valuation in the Food segment. While gross margin dollars increased in International Press due to higher volumes, the gross margin percentages in both the North America Press and International Press declined slightly in fiscal 2004 as compared to fiscal 2003. The decrease in North America Press is related to slightly declining sales and change in product mix. The International Press margin is the result of gross profit recognized on external as well as inter-company sales. The Company's segment reporting excludes inter-company sales but not the related gross profit margins. The decrease in margin on International Press results from increases on external sales at a greater rate than the increase in inter-company gross profit. Gross margins on International Press external sales were constant in 2004 and 2003.

Table of Contents

Marketing Expenses. Our marketing expense by segment for 2004 and 2003 is summarized as follows:

	<u>Year Ended April 30,</u>		<u>Dollar</u>	<u>Percent</u>
	<u>2004</u>	<u>2003</u>		
Marketing				
Waterjet:				
North America	\$ 10,109	\$ 12,713	\$ (2,604)	(20)%
Asia	3,022	3,008	14	%
Other International	7,750	10,684	(2,934)	(27)%
Other	1,822	2,780	(958)	(34)%
Waterjet Total	22,703	29,185	(6,482)	(22)%
Avure:				
Food	1,658	3,644	(1,986)	(55)%
North America Press	499	655	(156)	(24)%
International Press	3,562	3,914	(352)	(9)%
Avure Total	5,719	8,213	(2,494)	(30)%
Consolidated Total	\$ 28,422	\$ 37,398	\$ (8,976)	(24)%

Marketing expenses decreased \$9.0 million or 24% to \$28.4 million for the year ended April 30, 2004, as compared to the prior year marketing expenses of \$37.4 million. The majority of this decrease, \$6.5 million, was achieved in the Waterjet operations, while \$2.5 million of the decrease was recognized in Avure.

Fiscal 2003 included a \$4.1 million charge, in the Waterjet operations, to the allowance for doubtful accounts based on our assessment of the financial conditions of our individual customers and general marketplace conditions. The predominance of this increase in the allowance was recorded in the Other International Waterjet segment. The remainder of the reduction in Waterjet marketing expenses over the prior year results from the implementation of cost cutting measures during fiscal 2004 aimed at providing return on invested marketing dollars, as well as the fact that the fiscal 2003 North America Waterjet segment includes the costs of participation at the 2003 bi-annual IMTS tradeshow of approximately \$500,000.

Within Avure, the Food segment expense in fiscal 2003 included a \$1.2 million discount provided to a customer for early pay-off of long-term notes. All segments experienced decreases in expenses as a result of cost cutting measures in fiscal 2004. Expressed as a percentage of revenue, marketing expenses were 16% and 26% for the years ended April 30, 2004 and 2003, respectively.

Table of Contents

Research and Engineering Expenses. Our research and engineering expense by segment for 2004 and 2003 is summarized as follows:

	Year Ended April 30,		Dollar Change	Percent Change
	2004	2003		
Research and Engineering				
Waterjet:				
North America	\$ 4,082	\$ 4,332	\$ (250)	(6)%
Asia	295	278	17	6%
Other International	737	951	(214)	(23)%
Other	337	688	(351)	(51)%
Waterjet Total	5,451	6,249	(798)	(13)%
Avure:				
Food	1,583	2,523	(940)	(37)%
North America Press				%
International Press	3,617	4,729	(1,112)	(24)%
Avure Total	5,200	7,252	(2,052)	(28)%
Consolidated Total	\$ 10,651	\$ 13,501	\$ (2,850)	(21)%

Research and engineering expenses decreased \$2.8 million or 21% to \$10.7 million for the year ended April 30, 2004, as compared to the prior year's research and engineering expenses of \$13.5 million. Approximately \$2 million of this decrease was achieved in the Avure segments: \$9 million in Food and \$1.1 million in International Press. The remaining \$.8 million decrease in Waterjet is spread evenly throughout all segments within Waterjet except Asia, which was flat with the prior year. The reductions in all segments, relate to the timing of research and development work and the increased use of engineers on revenue generating projects, where costs are charged to Cost of Sales. Expressed as a percentage of revenue, research and engineering expenses were 6% and 9% for the years ended April 30, 2004 and 2003, respectively.

General and Administrative Expenses. Our general and administrative expense by segment for 2004 and 2003 is summarized as follows:

	Year Ended April 30,		Dollar Change	Percent Change
	2004	2003		
General and Administrative				
Waterjet:				
North America	\$ 12,767	\$ 10,835	\$ 1,932	18%
Asia	1,146	983	163	17%
Other International	3,064	3,614	(550)	(15)%
Other	1,842	2,324	(482)	(21)%
Waterjet Total	18,819	17,756	1,063	6%

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Avure:				
Food	1,245	1,522	(277)	(18)%
North America Press	601	620	(19)	(3)%
International Press	2,596	3,128	(532)	(17)%
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Avure Total	4,442	5,270	(828)	(16)%
	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Consolidated Total	\$ 23,261	\$ 23,026	\$ 235	1%
	<u> </u>	<u> </u>	<u> </u>	<u> </u>

General and administrative expenses increased \$235,000 or 1% to \$23.3 million for the year ended April 30, 2004, as compared to the prior year's general and administrative expenses of \$23.0 million. All segments experienced a decrease in general and administrative expense, except for the North America Waterjet segment,

Table of Contents

up \$1.9 million (18%) and the Asia Waterjet segment, up \$.2 million (17%). The decreases represent cost cutting measures put in place by management. The increase in North America Waterjet is attributable to higher costs of doing business as a public company following the enactment by Congress of the Sarbanes-Oxley Act of 2002 and include increased directors and officers liability insurance of \$.9 million as well as higher consulting costs for internal control work and other special projects of \$.2 million. In addition, we resumed the compensation of our Board members in fiscal 2004 and implemented a performance-based bonus plan for management which together amounted to an increase of \$2.9 million. These increases in the North America Waterjet segment were offset in part to general across the board cost reductions. The increase in Asia Waterjet is the addition of staff. Expressed as a percentage of revenue, general and administrative expenses were 13% and 16% for the years ended April 30, 2004 and 2003, respectively.

Restructuring and Impairment Charges. Our restructuring and impairment charges by segment for 2004 and 2003 is summarized as follows:

	Year Ending April 30, 2004	Year Ending April 30, 2003
	Restructuring	Impairment
Waterjet:		
North America	\$ 1,182	\$
Asia		
Other International	1,359	2,113
Other	89	5,032
Waterjet Total	2,630	7,145
Avure:		
Food		3,670
North America Press		
International Press	626	
Avure Total	626	3,670
Consolidated Total	\$ 3,256	\$ 10,815

	North America Waterjet		Other International Waterjet		Other Waterjet		International Press		Consolidated			
	Facility		Facility		Facility		Facility		Facility			
	Exit Costs	Other	Severance Benefits	Exit Costs	Other	Severance Benefits	Severance Benefits	Exit Costs	Severance Benefits	Exit Costs	Other	Total
Q1 restructuring charge	\$	\$	\$ 248	\$	\$	\$	\$	\$	\$ 248	\$	\$	\$ 248
Q1 cash payments			(128)						(128)			(128)
Balance, July 31, 2003			120						120			120
Q2 restructuring charge		178	(120)	105	302		201	191	81	296	480	857
Q2 cash payments		(178)			(47)							(225)
Q2 charge-offs					(255)							(255)
Balance, October 31, 2003				105			201	191	201	296		497

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Q3 restructuring charge	407	170	85	484	89		89	492	654	1,235	
Q3 cash payments	(270)	(160)	(14)			(121)	(121)	(284)	(160)	(565)	
Q3 charge-offs		(10)	(85)	(484)				(85)	(494)	(579)	
		<u> </u>	<u> </u>	<u> </u>				<u> </u>	<u> </u>	<u> </u>	
Balance, January 31, 2004	137		91		89	80	191	169	419	588	
Q4 restructuring charge	15	412	255			234		234	270	916	
Q4 cash payments	(13)	(126)	(13)		(89)	(70)		(159)	(26)	(311)	
Q4 charge-offs		(286)								(286)	
		<u> </u>								<u> </u>	
Balance, April 30, 2004	<u>\$ 139</u>	<u>\$</u>	<u>\$</u>	<u>\$ 333</u>	<u>\$</u>	<u>\$</u>	<u>\$ 244</u>	<u>\$ 191</u>	<u>\$ 244</u>	<u>\$ 663</u>	<u>\$ 907</u>

Table of Contents

Restructuring Charges. There were no restructuring charges in fiscal 2003. During the year ended April 30, 2004, we incurred \$3.3 million of restructuring-related costs, including severance, lease termination and inventory related charges, primarily in the U.S., Germany and Sweden. The most significant of this total being incurred in the North America Waterjet segment, \$1.2 million, Other International Waterjet, \$1.4 million and International Press, \$.6 million.

Financial Consulting Charges. During the year ended April 30, 2004, we incurred \$1.5 million of professional fees associated with the restructuring of our debt in July 2003. These costs were evaluated under EITF 98-14, *Debtors Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements*, and as they were either expenses related to potential Senior Credit Arrangements with lenders that did not occur, or they related to expenses associated with our subordinated debt and did not result in increase in the facility and accordingly they were expensed. No such costs were incurred for the year ended April 30, 2003.

Impairment Charges. There were no impairment charges in fiscal 2004. During fiscal 2003, we conducted a review of the carrying value of our goodwill. Statement of Financial Accounting Standard No. 142 (FAS 142), *Goodwill and Other Intangible Assets*, requires a company to perform impairment testing when certain triggering events affecting a business unit have taken place. The triggering events were the expectation of a sale or full or partial disposal of certain of our divisions and the continuing deterioration of the economic climate. Our review resulted in impairment charges of \$7.1 million during the quarter ended January 31, 2003, \$5 million was recorded in the Other segment and \$2.1 million was recorded in the Other International Waterjet segment. The impairment resulted primarily from continued weakness in the automotive industry, as well as weakness in our European operations. We also prepared an analysis of the fair value of the Company's reporting units for our required FAS 142 annual assessment. This assessment, performed as of April 30, 2003, revealed no further impairment. At April 30, 2003, we also conducted an impairment review of our long-lived assets in accordance with Statement of Financial Accounting Standard No. 144 (FAS 144), *Accounting for the Impairment or Disposal of Long-Lived Assets*. This review led to a \$3.7 million impairment charge related primarily to the carrying value of the depreciable assets of the Food segment.

Operating Income (Loss). Our operating income (loss) by segment for 2004 and 2003 is summarized as follows:

	<u>Year Ended April 30,</u>		<u>Dollar</u>	<u>Percent</u>
	<u>2004</u>	<u>2003</u>		
Operating income (loss)				
Waterjet:				
North America	\$ (4,390)	\$ (6,472)	\$ 2,082	32%
Asia	5,299	3,433	1,866	54%
Other International	(2,921)	(15,580)	12,659	81%
Other	335	(8,503)	8,838	NM
Waterjet Total	(1,677)	(27,122)	25,445	94%
Avure:				
Food	(2,887)	(16,458)	13,571	82%
North America Press	9	100	(91)	(91)%
International Press	2,672	(5,219)	7,891	NM
Avure Total	(206)	(21,577)	21,371	99%
Consolidated Total	\$ (1,883)	\$ (48,699)	\$ 46,816	96%

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

We recorded an operating loss of \$1.9 million for the year ended April 30, 2004, as compared to a loss of \$48.7 million in the prior year. All segments of our business except for North America Press recorded either increases in operating profit or a decrease in the operating loss as compared to fiscal 2003. The reasons for the changes in operating-profit or loss have been described in the paragraphs above addressing changes in sales, gross margin and operating expenses.

Table of Contents

Interest and Other Income (Expense), net. Fiscal 2004 interest expense increased \$1.3 million or 11% to \$13.2 million compared to the prior year of \$11.8 million due to increased amounts of amortization of fees from our credit facilities and a higher weighted average cost of capital from interest charged on the deferred and capitalized semi-annual interest payments to our subordinated lender. Included in Other Income, net is a \$2.6 million gain from the sale of our investment in WGI Heavy Minerals. In addition, the weaker dollar has positively impacted our foreign transactions and we have thus realized net currency gains of \$2.2 million, as well as unrealized currency gains of \$2.8 million in fiscal 2004. As the U.S. dollar remains weak, this has also caused other changes in our balance sheet, including an increase in our goodwill and intangible assets due to the translation from foreign currencies. Included in Other Income, net for the year ended April 30, 2003, are \$2.1 million of net realized foreign exchange transaction losses offset by \$5.3 million of unrealized currency gains. Below is the detail of Other Income (Expense), net.

	<u>Year Ended April 30,</u>	
	<u>2004</u>	<u>2003</u>
Net realized foreign exchange gains (losses)	\$ 2,155	\$ (2,089)
Net unrealized foreign exchange gains (losses)	2,827	5,307
Realized gain on sale of equity securities	2,618	
Write-off of investment and other assets		(35)
Minority Interest in joint venture	(35)	(79)
Other	252	(104)
Total	\$ 7,817	\$ 3,000

Income Taxes. We are providing for income taxes in jurisdictions where we have generated taxable income. During fiscal 2004, as a result of foreign asset collateral requirements and the amended credit agreements discussed in Note 9 to Consolidated Financial Statements, we were no longer able to permanently defer foreign earnings and recorded a \$1.9 million liability for withholding taxes payable on future repatriation of foreign earnings. We also recorded a U.S. tax liability of \$6.7 million on foreign earnings which we have decided to no longer permanently defer. The total \$6.7 million tax liability is offset by a release of the valuation allowance. In addition, we continue to assess our ability to realize our net deferred tax assets. Recognizing the continued losses generated during the quarter and in prior periods, we have determined it appropriate to continue to maintain a valuation allowance on our domestic net operating losses, certain foreign net operating losses and certain other deferred tax assets based on the expected reversal of both deferred tax assets and liabilities. As of April 30, 2004, we had approximately \$42.9 million of domestic net operating loss carryforwards to offset certain earnings for federal income tax purposes. All of these net operating loss carryforwards expire in fiscal 2023. Net operating loss carryforwards in foreign jurisdictions amount to \$35.6 million and do not expire. See Note 10 to Consolidated Financial Statements for discussion of tax components.

Discontinued Operations, Net of Tax. As of April 30, 2003, we held one of our service subsidiaries for sale and consequently showed its results of operations as discontinued operations for all periods presented. The sale of this subsidiary was consummated May 16, 2003 and resulted in cash proceeds of \$1.8 million and a gain of approximately \$650,000.

Net Loss. Our consolidated net loss for fiscal 2004 amounted to \$11.5 million, or \$.75 basic and diluted loss per share as compared to a net loss of \$70.0 million, or \$4.56 basic and diluted loss per share in the prior year.

The weighted average number of shares outstanding used for the calculation of basic and diluted loss per share is 15,415,000 for fiscal 2004 and 15,348,000 for fiscal 2003.

Fiscal 2003 Comprehensive Financial Review. During fiscal 2003, we revised our approach to receivable collection, inventory reduction and investigated other cash-generating initiatives in response to the continued decline in the economy and our highly leveraged position. We reviewed the carrying values of those assets that

Table of Contents

we expected to convert to cash in the short-term, as well as long-lived tangible and intangible assets and adjusted the carrying value of such assets to reflect their estimated current net realizable value. In addition, we conducted a review of potential liabilities. The total adjustments for the year ended April 30, 2003 are included in the Consolidated Statement of Operations. These adjustments, which are summarized below, were highly influenced by the economic environment our customers and we are facing.

We increased our allowance for doubtful accounts by \$4.1 million. This increase was based on extensive collection efforts and the results of a worldwide receivable-by-receivable review, including evaluation of the impact of current economic conditions, which had restricted customers' ability to pay their account balances.

We evaluated our ability to convert inventories, including evaluation and demonstration units, into cash in the short term by their sale or disposition. This evaluation led to a total adjustment of \$5.4 million to arrive at the estimated net realizable value of our inventories.

We conducted a detailed review of the carrying value of our goodwill in accordance with FAS 142. The triggering events were the expectation of sale or full or partial disposal of certain of our divisions, the continuing deterioration of the economic climate, and our operating losses. Our review resulted in impairment charges of \$7.1 million during the third quarter of fiscal 2003. The impairment resulted primarily from continued weakness in the automotive industry, as well as poor performance at our European operations. Our required annual FAS 142 review as of April 30, 2003 led to no further impairment charges.

We determined that no significant future services would be required of our former CEO. Therefore we accrued and charged to operations all remaining contractual fees and related benefits aggregating approximately \$1.1 million.

During fiscal 2003, we sold \$9.7 million of long-term notes receivable for \$8.6 million. This discount of \$1.1 million plus an additional accrual of \$0.1 million on potential future notes available for sale were recorded in Marketing Expense.

We accrued an additional \$1.5 million for potential losses related to several recourse/repurchase obligations on European sales. We have from time to time entered into recourse obligations with third party leasing companies. In response to continued concerns about the financial health of several customers, we revised our estimate of potential future exposure. Included in the \$1.5 million accrual was \$760,000 for the estimated loss on the repurchase and subsequent sale of a flex form press system, where we had a recourse obligation for a bankrupt customer. We sold this unit to an unrelated party in fiscal 2004.

We had deferred \$0.8 million in professional fees associated with previous ongoing strategic transactions, consisting of a planned equity offering and spin-off of Avure. We abandoned these plans and accordingly expensed all of these fees.

We reversed percentage of completion revenue previously recognized on three food systems (one customer) based on the customer's failure to fulfill its obligations under the contract terms. The total revenue reversed in the third quarter of fiscal 2003 was \$4.3 million with an associated gross margin of \$2.3 million. We received new orders for which we plan to deliver already-completed systems from inventory. Accordingly, these specific contracts did not qualify for percentage of completion accounting and the corresponding revenue was recognized upon delivery and acceptance in fiscal 2004.

We assessed our ability to realize our net deferred tax assets. Recognizing the magnitude of the losses generated during the fiscal year, we determined it appropriate to establish a valuation allowance for our net deferred tax assets, with the exception of our Swedish operations, amounting to \$12.7 million as well as discontinuing, in the near term, any future recognition of deferred tax assets resulting from losses.

Based upon our proposed strategy to downsize and streamline our operations and convert non-core or excess assets to cash, we adjusted various other asset values and reserves to appropriately reflect their net realizable value on a prospective basis, in accordance

with FAS 144. These adjustments totaled \$9.1 million for the year.

Table of Contents

Liquidity and Capital Resources

At April 30, 2005, approximately \$12.3 million of our cash and restricted cash was held by divisions outside the United States. The repatriation of offshore cash balances from certain divisions will trigger tax liabilities. In fiscal 2004, we recorded a \$1.9 million liability for withholding taxes on future repatriation of historical foreign earnings. In February 2005 and June 2004, we repatriated \$1.3 million and \$3.5 million, respectively, from certain foreign subsidiaries and we plan to continue repatriating additional funds in the future.

By April 30, 2005, we completed the execution of our restructuring plan, which resulted in total cash outlays of \$9 million (including amounts accrued as restructuring charges in accordance with generally accepted accounting principles). We have funded the restructuring plan from our cash from operations and foreign debt. The \$9 million outlay included completing the construction of our new \$5.2 million Taiwanese facility, to which we had committed in July 2000. The facility construction was financed via three unsecured lines of credit with Taiwanese banks. We then obtained a collateralized long-term credit facility and borrowed \$4.1 million on this facility in June 2004. We have used the proceeds to repay and reduce the senior credit facility by \$3.5 million. The benefits from our restructuring activities are beginning to be reflected in our operating results for the year ended April 30, 2005 and, we believe, should continue into fiscal 2006.

On March 21, 2005, in a Private Investment in Public Equity Transaction (PIPE Transaction), we sold 17,473,116 equity units at \$3.72 per unit for gross proceeds of \$65 million, and net proceeds of more than \$59 million. A unit consists of one share of our common stock and one warrant to buy 1/10th of a share of our common stock. Ten warrants give the holder the right to purchase one share of common stock for \$4.07. If the warrant holders opt to exercise their warrants, we would receive \$7.1 million in additional cash.

Under terms of PIPE Transaction, we were required to file an initial Form S-1 registration of the shares issued and issuable in the PIPE Transaction on or before May 20, 2005 (which we did) and are required to cause the Form S-1 to become effective on or before September 17, 2005. We are subject to liquidated damages of \$650,000 per month, if we fail to meet the September 17, 2005 date requirement. We have subsequently amended the Registration Rights Agreement to grant an extension until December 31, 2005 for the effective date of the registration of the shares and warrants issued in the PIPE transaction. Because the issuance price of the common stock of the PIPE Transaction was less than market value, we issued approximately 304,000 anti-dilution \$0.01 warrants to our lenders. These warrants have a Black-Scholes value of approximately \$1.7 million. Approximately \$1.5 million of this amount relates to warrants issued under subordinated debt agreements and \$222,000 relates to warrants issued under senior debt agreements. Proceeds of the PIPE were used to pay down existing debt, including all of the subordinated debt. Upon payoff of the subordinated debt, (on April 28, 2005) we also were required to charge to Interest Expense in the Consolidated Statement of Operations all remaining unamortized debt discount, which amounted to \$4.3 million, plus \$1.5 million related to the anti-dilution warrants issued to subordinated debt warrant holders prior to the PIPE. In addition, capitalized fees related to the Senior Agreement and anti-dilution warrants provided to our senior lenders were amortized to interest expense through July 8, 2008.

Our domestic senior credit agreement (Credit Agreement) is our primary source of external funding. At April 30, 2005, the balance outstanding on the Credit Agreement was \$9.7 million against a maximum borrowing of \$30 million. Our available credit at April 30, 2005, net of \$7.6 million in outstanding letters of credit, was \$12.7 million.

On July 28, 2004, we signed an amendment to the then current credit agreement (the Amendment). The Amendment provided for a revolving line of credit of up to \$42.7 million and an extension of the credit agreement through August 1, 2005. The commitment reduced to \$41.0 million at April 30, 2005. Interest rates under the Senior Credit Agreement were at Bank of America's prime rate in effect from time to time plus 4% and increased by one percentage point each quarter beginning November 1, 2004. The Amendment also required the issuance of 150,000 detachable \$.01 warrants to the senior lender as a fee and a quarterly commitment fee of $\frac{1}{2}$ of 1% (50 basis points) of the total commitment.

Table of Contents

We also amended our Subordinated Debt Agreement effective July 28, 2004. The subordinated lenders agreed to defer the semi-annual interest remittances due on October 31, 2004 and April 30, 2005, which total \$5.3 million. This deferred interest balance accrues additional interest at the rate of 15% per annum. The subordinated lenders also received 150,000 detachable \$.01 warrants to purchase common stock as an amendment fee.

On April 28, 2005 we entered into a new senior debt agreement (The April 28, 2005 Credit Agreement) with Bank of America N.A. and U.S. Bank N.A. The agreement provided a \$30 million commitment which was to expire August 1, 2005. This expiration date was consistent with our previous agreement. The April 28, 2005 Credit Agreement, however, gave us the ability to pay off our subordinated debt in its entirety, which we did on April 28, 2005. The April 28, 2005 Credit Agreement, including covenants, was very similar to the previous senior debt agreement except for the following provisions:

Required the complete pay-off of subordinated debt

The interest rate was reduced from prime + 6% to LIBOR + 2.5%

The annualized cost of Letters of Credit were reduced from 5% to 2.5% of the face amount

The total commitment increased to \$30 million, up from the prior debt agreement commitment level of \$25.1 million.

The April 28, 2005 Credit Agreement was collateralized by general liens on all of our assets. We were required to comply with certain covenants in the credit agreement, including restrictions on dividends and transactions with affiliates, limitations on additional indebtedness, capital expenditures, research and engineering expenses, and maintenance of EBITDA ratios and collateral values. We were in compliance with all covenants in the April 28, 2005 Credit Agreement as of April 30, 2005. In addition, the New Credit Agreement, similar to prior agreements, included a subjective acceleration clauses which permit the lenders to demand payment in the event of a material adverse change.

Effective July 8, 2005, we executed a new \$30 million, three year senior credit agreement with Bank of America N.A. and U.S. Bank N.A. This credit agreement expires July 8, 2008 and bears interest at the bank's prime rate (5.75% at April 30, 2005) or is linked to LIBOR plus a percentage depending on our leverage ratios, at our option. The agreement sets forth specific financial covenants to be attained on a quarterly basis, which we believe, based on our financial forecasts, are achievable.

We believe that our existing cash, cash from operations, and credit facilities at April 30, 2005 are adequate to fund our operations through April 30, 2006. If we fail to achieve our planned revenues, costs and working capital objectives, management believes it has the ability to curtail capital expenditures and reduce costs to levels that will be sufficient to enable us to meet our cash requirements and debt covenants through April 30, 2006.

With authorization from the Board of Directors in September 2004, we engaged the services of Danske Markets, Inc., which is working in Europe in cooperation with Close Associates to assist us in the sale of our General Press operations. These businesses are comprised of the North America Press and International Press segments. As these segments do not utilize ultrahigh-pressure water pumps, they are not considered core to our business, and it is our intent to divest ourselves of these operations. However, there can be no assurance we will find a suitable buyer at an acceptable price. If we do divest these businesses, it is anticipated that we will enter into a manufacturing agreement to provide the purchaser with the ultrahigh-pressure pump components and related spare parts for the Fresher Under Pressure business. These segments do not meet the

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

accounting criteria to be considered assets held for sale as of April 30, 2005 and accordingly the results of operations are shown as continuing operations and the related assets have not been reported as held for sale in our financial statements. On October 31, 2005, we completed the sale of the North America Press and International Press reportable segments, as well as the non ultrahigh-pressure portion of the Food reportable segment with the Gores Technology Group, LLC (Gores) for consideration of \$15.3 million, comprised of cash and notes. At closing,

Table of Contents

we also entered into a Supply Agreement with Gores whereby we have agreed to supply certain high pressure pump products on an exclusive basis to Gores.

Presented below is a summary of contractual obligations and other minimum commercial commitments at April 30, 2005, by due date. See Notes 4, 9 and 14 to April 30, 2005 Consolidated Financial Statements for additional information regarding foreign currency contracts, long-term debt, and lease obligations, respectively.

	Maturity by Fiscal Year						Total
	2006	2007	2008	2009	2010	Thereafter	
	(in thousands)						
Foreign currency contracts(1)	\$ 12,639	\$	\$	\$	\$	\$	\$ 12,639
Inventory purchases(2)	1,542						1,542
Operating leases	3,716	3,464	2,814	1,851	1,773	4,096	17,714
Other(3)	778	293	40	40	40		1,191
Long-term debt and notes payable(4)	3,649	1,978	10,505	832	855	1,328	19,147
Interest on long-term debt and notes payable(5)	668	705	657	170	54	37	2,291
Total	\$ 22,992	\$ 6,440	\$ 14,016	\$ 2,893	\$ 2,722	\$ 5,461	\$ 54,524

- (1) As these obligations were entered into as hedges, the majority of these obligations will be offset by losses/gains on the related assets, liabilities and transactions being hedged. As of April 30, 2005, the fair value of the transactions and related hedges amounts to a net loss of \$50,000 which is included in Accumulated Other Comprehensive Loss on the Consolidated Balance Sheet.
- (2) We have included inventory purchase commitments, which are legally binding and specify minimum purchase quantities. These purchase commitments do not exceed our projected requirements and are in the normal course of business. These commitments exclude open purchase orders.
- (3) These obligations include non-inventory vendor commitments, such as professional retainers and trade show commitments.
- (4) This table is reporting the contractual due dates of the long-term debt and notes payable balances.
- (5) Interest payments are estimated based on the outstanding debt balances as of April 30, 2005 using the then interest rate in effect through the contractual maturity of the debt instrument. These estimates may change over time as we opt to refinance our debt instruments. See note above.

Long-term debt, notes payable and lease commitments are expected to be met from working capital provided by operations and, as necessary, by other borrowings.

Our capital spending plans currently provide for outlays of approximately \$3 million in fiscal 2006, primarily related to information technology spending. It is expected that funds necessary for these expenditures will be generated internally and through available credit facilities. In fiscal 2005 and 2004, our investments in capital equipment were minimal as we were trying to conserve cash and were restricted by our debt agreements on the amount of capital spending we were allowed. Excluding spending on our Taiwan facility in 2004, our capital spending for fiscal 2005 and 2004 amounted to \$1.8 million and \$1.7 million, respectively. We are required to test our internal controls under Sarbanes-Oxley 404 for the year end April 2006. The external costs to achieve Sarbanes-Oxley compliance could exceed \$1.5 million.

Critical Accounting Estimates

The discussion and analysis of our 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 U.S. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of

Table of Contents

contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting estimates are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. We believe that our critical accounting estimates are limited to those described below. For a detailed discussion on the application of these estimates and our accounting policies, refer to Note 1 of the Consolidated Financial Statements.

Revenue Recognition

For standard systems and consumable and services sales, we recognize revenue in accordance with SEC Staff Accounting Bulletin No. 104 (SAB 104), Revenue Recognition in Financial Statements. SAB 104 requires that revenue can only be recognized when it is realized or realizable and earned. Revenue generally is realized or realizable and earned when all four of the following criteria have been met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services rendered; (3) the price is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criterion (4) is based on our judgments regarding the collectibility of those amounts. Should changes in conditions cause us to determine this criterion is not met for certain future transactions, revenue recognized for any reporting period could be adversely affected.

During the second quarter of fiscal 2004, we adopted EITF Issue No. 00-21 (EITF 00-21), Revenue Arrangements with Multiple Deliverables on a prospective basis. EITF 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of single or multiple products, services and/or rights to use assets. For standard systems, our multiple deliverables are: (1) the standard system and (2) the installation thereof. We recognize revenue upon shipment of the standard system at the fair value of that system. Installation revenue is recorded upon completion of the service. In some cases, systems are delivered with payment terms contingent on acceptance of installation. We will recognize revenue for those systems on installation acceptance.

For non-standard and long lead time systems, including the Avure operation, we recognize revenues using the percentage of completion method in accordance with Statement of Position 81-1 (SOP 81-1), Accounting for Performance of Construction-Type and Certain Production-Type Contracts. We use the cost to cost method, measuring the costs incurred on a project at a specified date, as compared to the estimated total cost of the project. Percentage of completion requires management to estimate costs to complete. Accordingly, modifications to estimates will impact percentage of completion revenues and associated gross margins. If, however, the time from order to install is less than three months, revenue is recognized under SAB 104. Shipping revenues and expenses are recorded in revenue and costs of goods sold, respectively.

Product Warranty Reserve

Our products are generally covered by a warranty up to 12 months. We accrue a reserve for estimated warranty costs at the time revenue is recognized. Our estimate of costs to service our warranty obligations is based on historical experience and expectation of future conditions. To the extent we experience increased warranty claim activity or increased costs associated with servicing those claims, our warranty accrual will increase resulting in decreased gross profit.

Valuation of Accounts Receivable

We use estimates in determining our allowance for bad debts that are based on our historical collection experience, current trends, credit policy and a percentage of our accounts receivable by aging category. In determining these percentages, we review historical write-offs in our receivables. In determining the appropriate reserve percentages, we also review current trends in the credit quality of our customers, as well as changes in our internal credit policies. If our estimate of our allowance is understated, operating income would be reduced.

Table of Contents

Valuation of Obsolete/Excess Inventory

We currently record a reserve for obsolete or excess inventory for parts and equipment that are no longer used due to design changes to our products or lack of customer demand. We regularly monitor our inventory levels and, if we identify an excess condition based on our usage and our financial policies, we record a corresponding reserve. If our estimate for obsolete or excess inventory is understated, gross margins would be reduced.

Valuation of Deferred Tax Assets

We review our deferred tax assets regularly to determine their realizability. When evidence exists that it is more likely than not that we will be unable to realize a deferred tax asset, we set up a valuation allowance against the asset based on our estimate of the amount which will likely not be realizable. Future utilization of deferred tax assets could result in recording of income tax benefits.

Impairment of Property and Equipment, Patents, Other Intangibles and Goodwill

We evaluate property and equipment, patents and other intangibles for potential impairment indicators when certain triggering events occur. Our judgments regarding the existence of impairment indicators are based on expected operational performance, market conditions, legal factors and future plans. If we conclude that a triggering event has occurred, we will compare the carrying values of the asset with the undiscounted cash flows expected to be derived from usage of the asset. If there is a shortfall and the fair value of the asset is less than its carrying value, we will record an impairment charge for the excess of carrying value over fair value. We estimate fair value by using a discounted cash flow model. Any resulting impairment charge could have a material adverse impact on our financial condition and results of operations. Many factors will ultimately influence the accuracy of these estimates.

We evaluate goodwill for potential impairment indicators as of our fiscal year-end and when certain triggering events occur. Our judgments regarding the existence of impairment indicators are based on expected operational performance, market conditions, legal factors, and future plans. Future events could cause us to conclude that impairment indicators exist and that goodwill should be evaluated for impairment prior to our fiscal year-end. Our impairment evaluation is based on comparing the fair value of the operating division with its associated carrying value and any shortfalls would require us to record an impairment charge for the difference between the carrying value and implied value of goodwill. We determine fair value by using a discounted cash flow model. Any resulting impairment charge could have a material adverse impact on our financial condition and results of operations. Expected future operational performance is based on estimates and management's judgment. Many factors will ultimately influence the accuracy of these estimates.

Legal Contingencies

At any time, we may be involved in certain legal proceedings. As of April 30, 2005, we have accrued our estimate of the probable costs for the resolution of these claims. This estimate has been developed in consultation with outside legal counsel and is based upon an analysis of potential outcomes, assuming a combination of litigation and settlement strategies. We do not believe these proceedings will have a material adverse effect on our consolidated financial position. However, it is possible that future results of operations or cash flows for any particular quarterly or annual period could be materially affected by changes in our assumptions, or the effectiveness of our strategies, related to these proceedings. See Legal Proceedings.

Recent Accounting Pronouncements

See Note 19 to the April 30, 2005 Consolidated Financial Statements included in this prospectus for recently issued accounting pronouncements.

Table of Contents

Quantitative and Qualitative Disclosures About Market Risk:

Market risk exists in our financial instruments related to an increase in interest rates, adverse changes in foreign exchange rates relative to the U.S. dollar, as well as financial risk management and derivatives. These exposures are related to our daily operations.

Interest Rate Exposure At April 30, 2005, we had \$19.1 million in interest bearing debt. Of this amount, \$5.7 million was fixed rate debt with an interest rate of less than 2.5% per annum. The remaining debt of \$13.4 million was at a variable interest rate, \$9.7 million at a rate of prime or 5.75% and the remainder at an interest rate of Swedish prime + 0.75% or less. See Note 9 to the Consolidated Financial Statements for additional contractual information on our debt obligations. Market risk is estimated as the potential for interest rates to increase 10% on the variable rate debt. A 10% increase in interest rates would result in an approximate additional annual charge to our pre-tax profits and cash flow of \$66,000. At April 30, 2005, we had no derivative instruments to offset the risk of interest rate changes. We may choose to use derivative instruments, such as interest rate swaps, to manage the risk associated with interest rate changes.

Foreign Currency Exchange Rate Risk We transact business in various foreign currencies, primarily the Canadian dollar, the Eurodollar, the Japanese yen, the New Taiwan dollar, and the Swedish Krona. As all of our foreign operations have functional currencies in other than the U.S. dollar, we translate the assets and liabilities of these operations into U.S. dollars at exchange rates in effect at the balance sheet date. Income and expense items are translated at the average exchange rates during the period. Aggregate net foreign exchange gains included in the determination of net loss amounted to \$531,000 for the year ended April 30, 2005. Based on the net position of foreign assets less liabilities, a near-term 10% appreciation or depreciation of the U.S. dollar in all currencies we operate could impact operating income by \$0.4 million and other income (expense) by \$2.8 million. Our financial position and cash flows could be similarly impacted. We have in the past, and may continue to use derivative instruments in the future, such as forward exchange rate contracts, to manage the risk associated with foreign currency exchange rate changes.

Table of Contents

BUSINESS

Overview

We design, develop, manufacture, market, install and service ultrahigh-pressure, or UHP, water pumps and UHP water management systems. Our core competency is our UHP water pumps. Our UHP water pumps pressurize water from 40,000 to over 100,000 pounds per square inch (psi) and are integrated with water delivery systems so that water can be used to cut or clean material or pressurize food. Our products include both standard and specialized waterjet cutting and cleaning systems. In addition to UHP water pumps and related systems, we provide non-UHP automation and articulation systems, primarily to the automotive industry.

Our mission is to provide the highest value product in the UHP water pump market. This requires our products to be of the highest reliability and provide our customers with a system which maximizes productivity and profitability. We are a developer of productivity technologies and we continually focus on customer support. Our brand promise is to provide reliability, superior value, service and technology through products based on UHP water pump technology. We will strive to continue to improve our customers' profitability through investment in the development of innovative products and services that expand our customers' markets and increase their productivity.

Our UHP technology has three broad applications: cutting, cleaning and food processing. In cutting and cleaning applications the ultrahigh-pressure created by our pumps is released through a small orifice to create a jet of water. In food processing we supply UHP pumps to Avure Technologies, Inc., a company we recently sold, to kill spoilage bacteria and pathogens in food products placed inside a pressure vessel.

The primary application of our UHP water pumps is cutting. In cutting applications, pressures from 50,000 to 87,000 psi, create a thin stream of water traveling at three or more times the speed of sound which can cut both metallic and nonmetallic materials for many industries, including aerospace, automotive, disposable products, food, glass, job shop, sign, metal cutting, marble, tile and other stone cutting, and paper slitting and trimming. Waterjet cutting is recognized as a more flexible alternative to traditional cutting methods such as lasers, saws or plasma. It is often faster, has greater versatility in the types of products it can cut and eliminates the need for secondary processing operations. We also manufacture a product line used in waterjet cleaning, where pressures in the range of 40,000 to 55,000 psi, are used in industrial cleaning, surface preparation, construction, and petro-chemical and oil field applications.

Products and Services

We provide UHP systems and related products and services to our target markets: aerospace, automotive, food, job shops, pulp and paper and surface preparation. We had, prior to the sale of Avure, divided our business into its two UHP operations: Waterjet and Avure, representing the applications of released pressure and contained pressure, respectively.

Waterjet:

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

The Waterjet operation is comprised of the following segments: North America Waterjet, Asia Waterjet, Other International Waterjet and Other. The Other segment includes the sales of systems for automotive and articulation for non UHP applications.

Systems

We offer a variety of UHP products, including both waterjet cutting and cleaning systems, as well as accessories and related robotic articulation equipment. UHP water pumps, as well as the related water management systems, are the core components of our technology. We utilize two different technologies to create the water pressure: intensifier and direct drive. In cutting applications a UHP pump pressurizes water up to

Table of Contents

87,000 psi and forces it through a small orifice, generating a high-velocity stream of water traveling in excess of 3,000 feet per second. In order to cut metallic and other hard materials, an abrasive substance, usually garnet, is added to the waterjet stream creating an abrasivejet. Abrasivejets cut without heat, cause no metallurgical changes, and leave a high-quality edge that usually requires no secondary operation. In addition to our intensifier pumps which pressurize water up to 87,000 psi, we offer our unique and patented direct drive pressure-compensated pumps which pressurize water up to 55,000 psi utilizing triplex piston technology.

A UHP system consists of a UHP intensifier or direct drive pump and one or more waterjet cutting or cleaning heads with the necessary robotics, motion control and automation systems. We have sold UHP waterjet cutting and cleaning systems worldwide. Our cutting systems may also combine waterjet with other applications such as conventional machining, pick and place handling, inspection, assembly, and other automated processes. Our waterjet systems are also used in industrial cleaning applications such as paint removal, surface preparation, factory and industrial cleaning, ship hull preparation, and heat exchanger cleaning.

Our sales are affected by worldwide economic changes. However, we believe that the productivity enhancing nature of our UHP technology and the diversity of our markets enable us to absorb cyclical downturns with less impact than conventional machine tool manufacturers, and we are confident that we can continue to gain market share in the machine cutting tool market. Waterjet systems represented 71% of waterjet revenues in fiscal 2005.

Consumable Parts and Services

Consumables represent parts used by the pump and cutting head during operation, such as seals, orifices and garnet. Every pump we sell will require consumables to operate, and the sale of consumables is a significant part of our revenues. Many of these consumable or spare parts are proprietary in nature and are patent protected. We also sell various tools and accessories which incorporate UHP technology, as well as aftermarket consumable parts and service for our products. Consumable parts and services represented 29% of waterjet revenues in fiscal 2005.

Marketing and Sales

We market and sell our products worldwide through our headquarters in Kent, Washington (a suburb of Seattle) and through subsidiaries, divisions and joint ventures located in Wixom, Michigan; Jeffersonville, Indiana; Birmingham, England; Bretten, Germany; Burlington and Windsor, Canada; Hsinchu, Taiwan; Shanghai and Beijing, China; Incheon, Korea; Sao Paulo, Brazil; Buenos Aires, Argentina; Lyon, France; Milan, Italy; Madrid, Spain; Yokohama, Nagoya and Tokyo, Japan. We sell directly to customers in North and South America, Europe, and Asia, and have distributors or agents covering most other countries. No single customer accounted for 10% or more of our revenues during any of the three years ended April 30, 2005.

In late fiscal 2004, we conducted an internal study of our installed waterjet cutting systems and the potential sale opportunities of the market. Based on the significant market potential relative to the installed base, we concluded that waterjet technology is in the early adoption phase of its product life cycle. To increase waterjet awareness, we have focused our marketing efforts on specific target industries, applications and markets. Marketing efforts include increased presence at regional tradeshows, increased advertising in print media and other product placement and demonstration/educational events as well as an increase in domestic sales representation, including distributors. To enhance the effectiveness of sales efforts, our marketing staff and sales force gather detailed information on the applications and requirements in targeted market segments. We also utilize telemarketing and the internet to generate sales leads in addition to lead generation through tradeshows and print media. This information is used to develop standardized and customized solutions using UHP and robotics technologies. We provide turnkey systems, including system design, specification, hardware and software integration, equipment testing and simulation, installation, start-up services,

technical training and service.

Table of Contents

We offer our spare parts and consumables through the internet at our Flowparts.com website and strive to ensure that we are able to ship a large number of parts within 24 hours to our customers.

Patents

We hold a large number of UHP technology and related systems patents. While we believe the patents we hold protect our intellectual property, we do not consider our business dependent on patent protection. In addition, we have over the years developed non-patented proprietary trade secrets and know-how in UHP applications, and in the manufacture of these systems, which we believe allows us to retain a technical lead over our competitors.

We believe the patents we hold and have in process, along with the proprietary application and manufacturing know-how, act as a barrier to entry for other competitors who may seek to provide UHP technology.

See [Legal Proceedings](#) below for a discussion of certain pending patent litigation.

Backlog

At April 30, 2005, our backlog was \$43.3 million compared to the April 30, 2004 backlog of \$25.5 million. Generally our products, exclusive of the aerospace product line, which account for \$21.2 million of the backlog, can be shipped within a four to 16 week period. The aerospace systems typically have lead times of six to 18 months. Our North American standard waterjet backlog increased \$6.2 million over the prior year to \$13.9 million. The changes in our backlog are not necessarily indicative of comparable variations in sales or earnings. The April 30, 2005 backlog represented 29% of our trailing twelve months sales. The unit sales price for most of our products and services is relatively high (typically ranging from tens of thousands to millions of dollars) and individual orders can involve the delivery of several hundred thousand dollars of products or services at one time. Furthermore, some items in backlog can be shipped more quickly than others, some have higher profit margins than others, and some may be cancelled by customers.

Competition Waterjet

Waterjet technology has been developed to provide manufacturers with an alternative to traditional cutting or cleaning methods, which utilize lasers, saws, knives, shears, plasma, routers, drills and abrasive blasting techniques. Many of the companies that provide these competing methods are larger and better funded than Flow. Within the manufacturing setting, several firms, including Flow, have developed tools for cleaning and cutting based on waterjet technology.

Waterjet cutting systems offer manufacturers many advantages over traditional cutting machines including an ability to cut in any direction, faster throughput times, minimal impact on the material being cut and a continuously expanding range of applications. These factors, in addition to the elimination of secondary processing in most circumstances, enhance the manufacturing productivity of our systems.

We believe increased market acceptance of waterjet cutting systems by the aerospace, automotive, and machining (job shop) industries will encourage other manufacturers, including those in other industries, to adopt waterjet solutions. We estimate the worldwide waterjet cutting systems market size at \$350 million and the waterjet cleaning systems market at \$335 million. The recent slowdown in many of the major world economies created a difficult operating environment for waterjet systems manufacturers, as new investments in infrastructure projects were curtailed and customers reduced capital expenditures. Low demand, coupled with price-based competition among waterjet manufacturers, caused many firms in the industry to restructure operations, lay off employees, and close plants.

Table of Contents

We believe we are the leader in the global waterjet cutting systems market with a market share estimated at more than 40%. In North America, together with another supplier, we have a combined market share of approximately 75%. The remaining 25% of the market is divided among 10 firms. The European market is also highly concentrated, with the top three companies controlling 50% of the market. We compete in the high-end and mid-tier segments of the waterjet cutting market.

In addition, we sell spare parts and consumables. While we believe our on-time delivery and internet parts ordering web site combine for the best all around value for our customers, we do face competition from numerous other companies who sell replacement parts for our machines. While they generally offer a lower price, we believe the quality of our parts, coupled with our service, makes us the value leader in spares and consumables.

Waterjet cleaning offers many advantages over other cleaning methods, such as the ability to remove difficult coatings or deposits from a surface without damaging such surface or adding potentially hazardous chemicals to the cleaning process. A UHP waterjet system is an environmentally-friendly answer to many difficult cleaning applications and can often be justified solely on the basis of hazardous material containment or reduction of secondary operations in the cleaning process.

We believe we are a major competitor in the ultrahigh-pressure (equal to or greater than 40,000 psi) segment of the waterjet cleaning systems market with an estimated global market share of 27%. We have a significant share of the market in North and South America and Asia. We also have an opportunity to build share and grow our business in Europe where waterjet cleaning had not previously been a market priority for us.

The automobile and aerospace industry and other industries that rely heavily on assembly-based manufacturing processes are primary consumers of robotics systems equipment and services. Using waterjet and other suitable technologies such as laser, robotics systems manufacturers provide custom engineered robotic systems designed for material separation and removal. The market for robotic systems is concentrated among a few companies in the U.S. and Europe.

Research and Engineering

We have devoted between 4% and 9% of revenues to research and engineering during each of the three years ended April 30, 2005. Research and engineering expenses were \$9.1 million, \$10.7 million, and \$13.5 million, in fiscal 2005, 2004 and 2003, respectively. While we will continue a robust research and engineering program to maintain our technological leadership position through development of new products and applications, as well as enhancement of our current product lines, a more focused effort has allowed us to decrease our research and engineering expenses as a percent of revenue to 4% for the fiscal year ended April 30, 2005.

Employees

As of December 1, 2005, we employed 656 full time and 38 part time personnel. We are not a party to any material collective bargaining agreements.

Legal Proceedings

At any time, we may be involved in certain legal proceedings. As of April 30, 2005, we have accrued our estimate of the probable costs for the resolution of these claims. This estimate has been developed in consultation with outside legal counsel and is based upon an analysis of potential outcomes, assuming a combination of litigation and settlement strategies. We do not believe these proceedings will have a material adverse effect on our consolidated financial position. However, it is possible that future results of operations or cash flows for any particular quarterly or annual period could be materially affected by changes in our assumptions, or the

Table of Contents

effectiveness of our strategies, related to these proceedings. See Notes 1 and 15 of Notes to the April 30, 2005 Consolidated Financial Statements for a description of our product liability claims and litigation.

Omax Corporation (Omax) filed suit against us on November 18, 2004. The case, *Omax Corporation v. Flow International Corporation*, United States District Court, Western Division at Seattle, Case No. CV04-2334, was filed in federal court in Seattle, Washington. The suit alleges that our products infringe Omax s Patent Nos. 5,508,596 entitled Motion Control with Precomputation and 5,892,345 entitled Motion Control for Quality in Jet Cutting. The suit also seeks to have our Patent No. 6,766,216 entitled Method and System for Automated Software Control of Waterjet Orientation Parameters declared invalid, unenforceable and not infringed. Omax manufactures waterjet equipment that competes with our equipment. Both the Omax and our patents are directed at the software that controls operation of the waterjet equipment. Although the suit seeks damages of over \$100 million, we believe Omax s claims are without merit and we intend not only to contest Omax s allegations of infringement but also to vigorously pursue our claims against Omax with regard to our own patent.

Table of Contents**INFORMATION CONCERNING DIRECTORS AND EXECUTIVE OFFICERS****Our Directors and Executive Officers**

The following table sets forth certain information about our directors and executive officers as of November 29, 2005.

<u>Name</u>	<u>Age</u>	<u>Position</u>
Stephen R. Light	59	President, Chief Executive Officer and Director
Douglas P. Fletcher	51	Chief Financial Officer
Thomas C. Johnson	53	Senior Vice President of Operations
Richard A. LeBlanc	50	Executive Vice President of Sales
John S. Leness	46	General Counsel and Corporate Secretary
Rick L. Nicholson	57	Vice President Human Resources
Felix M. Sciulli	54	Senior Vice President of Global Engineering and Research and Development
Ronald D. Barbaro	74	Director
Richard P. Fox	58	Director
Kathryn L. Munro	57	Chairman of the Board and Director
Arlen I. Prentice	68	Director
J. Michael Ribauda	63	Director
Kenneth M. Roberts	59	Director
Jan K. Ver Hagen	68	Director

Stephen R. Light (age 59) became President and Chief Executive Officer of the Company in January 2003. He was appointed to the Board in January of 2003 and his current term expires in 2006. Prior to joining the Company, from 2000 to 2002, Mr. Light was President and Chief Executive Officer of Omniquip Textron Group, Inc., a manufacturer of material handling equipment, aerial work platforms and hydraulic systems. From 1998 to 1999 he was President and Chief Executive Officer of Bucyrus International, Inc. From 1997 to 1998 he was Vice President and General Manager of Operations at P&H Mining Equipment Co., a subsidiary of Harnischfeger Industries; from 1986 to 1996 he served in various positions at Emerson Electric Company; from 1985 to 1986, he served as General Manager of North American Philips Mexican consumer electronics manufacturing business; and from 1968 to 1985 at General Electric Company. Mr. Light earned a B.S.M.E. in 1968 from Colorado State University.

Douglas P. Fletcher (age 51) joined the Company on August 16, 2005 as Interim Chief Financial Officer. He and was appointed Chief Financial Officer on October 5, 2005. He served as Chief Financial officer of GiftCertificates.com from August 2001 until July, 31, 2005. Prior to joining GiftCertificates.com, he served as the Chief Financial Officer at eCharge Corporation. Mr. Fletcher previously worked for Citigroup/Citibank from 1987 to 2000, where he served in senior management positions in the company's corporate finance, restructuring and equipment finance businesses. Mr. Fletcher has also worked in various financial capacities with International Paper and PricewaterhouseCoopers. Mr. Fletcher holds a bachelor's degree in Accounting and Finance from Ohio University.

Thomas C. Johnson (age 53) joined the Company in August 1996 as Vice President of Manufacturing. Mr. Johnson became Senior Vice President, Manufacturing Technology in October of 1999 and Senior Vice President of Operations in June of 2003. Prior to joining the Company, he was employed by the Kenworth Truck Company Division of PACCAR for sixteen years, serving as Plant Manager and before that as Assistant Plant Manager.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Richard A. LeBlanc (age 50) joined the Company in 1994 as Vice President of Sales. Mr. LeBlanc became Executive Vice President in August 1998. Prior to joining the Company, he was employed by the ASI Robotic Systems Division of Cargill Detroit Corporation for ten years, serving as Manager of Sales and Marketing and before that in direct sales.

Table of Contents

John S. Leness (age 46) joined the Company in June 1990 as its Corporate Counsel, became General Counsel in December 1990, and was appointed Assistant Secretary in January 1991 and Secretary in February 1991. From 1986 until joining the Company, Mr. Leness had been associated with the Perkins Coie law firm.

Rick L. Nicholson (age 57) joined the Company in 2005 as Vice President, Human Resources. From 2003 until he joined the Company, Mr. Nicholson had been a private consultant. From 2001 to 2003 he was the Chief Human Resources Executive at Milgard Manufacturing, Inc., a manufacturer of windows and patio doors, and from 1998 to 2001 he was Vice President of Human Resources at U.S. Marine Corporation a builder of boats. Prior to 1998 Mr. Nicholson was employed by Weyerhaeuser Company and Tektronix.

Felix M. Sciulli (age 54) joined the Company in October 1995 as Vice President of Engineering. Mr. Sciulli became Senior Vice President, Engineering and Research and Development in June 2000. Prior to joining the Company, he was with Equimeter, Inc., a division of BTR plc (acquired from Rockwell International Corporation), for six years as Director of Engineering and Research and Development. Mr. Sciulli also spent thirteen years with Rockwell in various engineering and research roles, and three years with Westinghouse Electric Corporation.

Ronald D. Barbaro (age 74) was the Chair and Chief Executive Officer, Ontario Lottery and Gaming Corporation from 1998-2003. Prior to this, he was President of The Prudential Insurance Company of America; responsible for worldwide operations (retired 1993). He was responsible for Prudential's Canadian operation from 1985 to 1990. Mr. Barbaro was elected to the Company's Board of Directors in 1995 and his current term expires in 2007. Mr. Barbaro currently chairs the Premier of Ontario's Economic Recovery Council and Chairman, Board of Trustees for The Brick Group Income Fund. He also serves on the boards of The Thomson Corporation International Group of Companies and TransGlobal Life Insurance Company (Alberta).

Richard P. Fox (age 58) has served as consultant and outside board member since 2001 to entrepreneurs and the financial services industry. Mr. Fox was appointed to the Company's Board of Directors in 2002 and his current term expires with the 2006 Annual Meeting. He was President and Chief Operating Officer of CyberSafe Corporation, responsible for the overall financial services and operations of the company. Prior to joining CyberSafe, Mr. Fox was Chief Financial Officer and a member of the Board of Directors of Wall Data where he was responsible for the company's finances, operations, and human resources activities. Mr. Fox spent 28 years at Ernst & Young, last serving as Managing Partner of the Seattle Office. He serves on the Board of Directors of Premera, a Blue Cross managed-care provider, aQuantive (NASDAQ: AQNT), an on line marketing company, as well as Shurgard Storage Centers, Inc. (NYSE: SHU), a real estate investment trust. In addition, he serves as Treasurer and is on the Board of Trustees of the Seattle Foundation and is on the Board of Visitors of the Fuqua School of Business, Duke University. Mr. Fox received a B.A. degree in Business Administration from Ohio University and an M.B.A. from Fuqua School of Business, Duke University. He is a Certified Public Accountant in Washington State.

Kathryn L. Munro (age 57) is the current Chairperson of the Board of Directors and is Principal of Bridge West, a technology investment company. She previously held a variety of senior management positions in both the commercial and retail areas of Seafirst Bank and Bank of America, most recently as Chief Executive for Bank of America's Southwest Banking Group. Ms. Munro began her banking career in 1980. She was elected to the Company's Board of Directors in 1996 and her current term expires in 2005. Ms. Munro currently serves on the corporate boards of Pinnacle West (NYSE: PNW) and Capitol Bancorp (NYSE: CBC). She also serves on the board of The Bank Administration Institute in Chicago and numerous community boards in Phoenix, including Valley of the Sun United Way and the national board of advisors for University of Arizona School of Business. Ms. Munro holds a B.S. degree from Auburn University and an M.B.A. from the University of Washington.

Table of Contents

Arlen I. Prentice (age 68) is Chairman and Chief Executive Officer of Kibble & Prentice, which provides insurance and financial consulting services. He has served as a director of the Company since 1993 and his current term expires in 2007. He founded Kibble & Prentice 32 years ago. Mr. Prentice serves as a director of Northland Telecommunications Corporation and is a past director of the Starbucks Coffee Corporation, a position he held for 19 years.

J. Michael Ribaldo (age 63) is Chairman and Chief Executive Officer of Surgical Synergies, Inc., a national company that develops, acquires and operates ambulatory surgery centers. Dr. Ribaldo was elected to the Company's Board of Directors in 1995, and his current term expires in 2007. Dr. Ribaldo graduated from Louisiana State University in 1963 and Louisiana State Medical School in 1967 with graduate medical school training at Emory University, Washington University and New York University. He received postgraduate training at Harvard Law School, Kellogg Business School and Stanford Graduate School of Business.

Kenneth M. Roberts (age 59) is President and Chief Investment Officer of Ken Roberts Investment Management, Inc., an investment advisory firm. Mr. Roberts is also President and Chief Executive Officer of Ken Roberts Financial Services, Inc. Mr. Roberts was appointed to the Company's Board of Directors in 1991 and his current term expires with the 2006 Annual Meeting. Mr. Roberts was, until November 1994, President and Chief Investment Officer of Ken Roberts Advisory Group, an investment advisory firm and subsidiary of the Spokane, Washington, office of Smith Barney Shearson, Inc. From 1981 to 1991, he was Vice President of Shearson Asset Management and Foster & Marshall Management, investment advisors, and President of Shearson Lehman Fundamental Value Fund, a registered investment company. From 1987 to 1991, Mr. Roberts was also a director of Shearson Lehman Fundamental Value Fund. Mr. Roberts currently serves on the Finance Advisory Board of Washington State University. He is also past President and Treasurer of the Spokane Chapter of the Seattle Society of Chartered Financial Analysts. Mr. Roberts received a B.A. from Whitworth College in 1968 and an M.B.A. from the Harvard Graduate School of Business in 1971.

Jan K. Ver Hagen (age 68) is the retired Chairman of the Board (non-executive) of Wolverine Tubing Corporation, a copper tubing manufacturer and processor of specialty heat transfer products, and continues to serve as Director and Chair of the Audit Committee of Wolverine. Mr. Ver Hagen was elected to the Company's Board of Directors in 2003, and his current term expires in 2005. He worked for Emerson Electric Co. from 1977 to 1994 including serving as Vice-Chairman and Director from 1987 to 1994. From 1994 to 1999 he was a director of United Dominion Industries, a multinational manufacturing group, and was President and Chief Operating Officer from 1994 to 1998. He returned to Emerson to serve as Senior Vice President from 1999 to 2002. He also serves as trustee of the Wisconsin Alumni Research Foundation. He received a B.S.M.E. in 1961 from the University of Wisconsin Madison.

The Board of Directors consists of a majority of independent directors as such term is defined under Rule 4200(a)(15) of the NASDAQ Stock Market Inc.'s Marketplace Rules. The Board of Directors has determined that Messrs. Barbaro, Fox, Munro, Roberts, Ribaldo, and Ver Hagen are independent directors.

Table of Contents

BOARD STRUCTURE, COMMITTEES AND COMPENSATION AND COMPOSITION

Currently, 9 individuals are serving as our directors. Our board of directors is divided into three classes of directors as provided in our articles of incorporation and bylaws and as set forth below.

Expiration

Class of Term Directors

I	2006 Richard P. Fox, Stephen R. Light, Kenneth M. Roberts
II	2007 Ronald D. Barbaro, Arlen I. Prentice, J. Michael Ribaud
III	2008 Kathryn L. Munro, Jan K. Ver Hagen

Directors for each class will be elected at the annual meeting of shareholders held in the year in which the term for that class expires and thereafter will serve for a term of three years.

Executive officers are appointed by the board of directors on an annual basis and serve until their successors have been duly elected and qualified. There are no family relationships among any of our directors or executive officers.

Board Committees

The Company has an Audit Committee, a Compensation and Plan Administrator Committee, a Mergers, Acquisitions and Dispositions Committee and a Nominating and Governance Committee. In addition to these standing committees, the Board, from time to time, may form ad hoc committees. During fiscal 2004, the Board appointed a Restructuring Committee which has reviewed matters related to the Company's capital structure. After fiscal 2005, the Board appointed a Strategic Scenario Planning Committee.

Audit Committee. The primary function of the Audit Committee is to assist the Board of Directors in its oversight of the integrity of financial information provided to shareholders and others, its review of the adequacy of the system of internal controls established by the Company and its monitoring of the audit process. In performing these functions, the Audit Committee reviews the Company's financial reporting process and internal controls, reviews and appraises the audit efforts of the Company's independent registered public accounting firm and internal auditor. The Audit Committee also provides open lines of communication between the directors, the independent registered public accounting firm, the internal auditors and the financial and senior management of the Company. The Audit Committee has adopted a charter (a copy of which is available at the Company's website at www.flowcorp.com), hereinafter "Charter," requiring, among other things, that members of the Committee be independent of Management, free of any relationship that would interfere with their independent judgment and have a minimum level of financial competency. The members of the Audit Committee are Richard P. Fox (Chair), Kathryn L. Munro, Kenneth M. Roberts, and Jan K. Ver Hagen, each of whom are all independent directors as defined under the NASDAQ's Marketplace Rules and each of whom are also experienced in financial matters. The members of the Audit Committee, in addition to the foregoing criteria, meet the additional criteria of SEC Rule 10A-3 that they neither (1) accept any direct compensation from the Company other than director and committee fees and pension or other deferred compensation for prior service, nor (2) are an affiliated person of the Company. The Board of Directors has determined that Richard P. Fox is an "audit committee financial expert" as defined in the rules of the Securities and Exchange Commission. The Audit Committee held eleven meetings in the fiscal year ended April 30, 2005.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Compensation and Plan Administrator Committee. The primary function of the Compensation and Plan Administrator Committee is to assist the Board of Directors to ensure that all officers and key management personnel of the Company and its subsidiaries are effectively compensated in terms of salary, supplemental compensation, and benefits which are internally equitable and externally competitive. The Committee establishes and maintains a competitive, fair, and equitable compensation and benefits policy designed to retain personnel, to stimulate their useful and profitable efforts on behalf of the Company, and to attract necessary additions to the staff with appropriate qualifications. The Committee also acts as Administrator of the Company's stock option plans, determining the terms, amounts and recipients of stock option grants. J. Michael Ribaldo (Chair), Richard P. Fox, Kathryn L. Munro, and Arlen I. Prentice (nonvoting) serve on the Committee. All members of the

Table of Contents

Committee are independent directors as defined under the NASDAQ's Marketplace Rules except Arlen I. Prentice, who is Chief Executive Officer of Kibble & Prentice, Inc., a company that, together with its wholly-owned subsidiary, provides insurance brokerage and employee benefits, administrative and consulting services to the Company. During fiscal 2005, premiums paid by the Company for insurance placed by Kibble & Prentice totaled \$2,152,833, and payments by the Company to Kibble & Prentice, Inc. and such subsidiary for commissions totaled \$227,539. Mr. Prentice does not vote on the Committee. There were six meetings of the Compensation and Plan Administrator Committee during the fiscal year ended April 30, 2005.

Mergers, Acquisitions and Dispositions Committee. The primary function of the Mergers, Acquisitions and Dispositions Committee is to assist the Board of Directors to review potential opportunities for acquisitions, mergers, dispositions, divestitures or similar transactions and to assist the Board of Directors in analyzing equity or debt financings or other capital raising opportunities. Kenneth M. Roberts (Chair), Ronald D. Barbaro, Arlen I. Prentice, Jan K. Ver Hagen, J. Michael Ribaudo, and Richard P. Fox serve on the Committee. There were four meetings of the Mergers, Acquisitions and Dispositions Committee during the fiscal year ended April 30, 2005.

Nominating and Governance Committee. The primary function of the Nominating and Governance Committee is to assist the Board of Directors in matters of Board organization and composition and to locate and recommend to the Board individuals to fill vacancies on the Board. Kathryn L. Munro (Chair), Ronald D. Barbaro, and Kenneth M. Roberts serve on the Committee, each of whom is an independent directors as defined under the NASDAQ's Marketplace Rules. The Nominating and Governance Committee met nine times during the fiscal year ended April 30, 2005.

Growth Committee. The Growth Committee was formed after the completion of fiscal 2005 to assist the Chief Executive Officer in the area of business strategy. The members of the Growth Committee are Ronald D. Barbaro (Chair), Stephen R. Light, Arlen I. Prentice, Kathryn L. Munro and Jan K. Ver Hagen.

Compensation Committee Interlocks and Insider Participation

No member of the board of directors or the compensation committee serves as a member of the board of directors or compensation committee of any entity that has one or more executive officers serving as a member of our board of directors or compensation committee.

Code of Business Conduct and Ethics

Our board of directors has adopted a code of business conduct and ethics applicable to our directors, executive officers, including our chief financial officer and other of our senior financial officers performing similar functions, and employees, in accordance with applicable rules and regulations of the SEC and the Nasdaq National Market.

Board Compensation

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

The Compensation and Plan Administrator Committee is charged with ensuring that the Company will be able to continue to attract and retain directors having the qualifications necessary to serve the interest of the Company's shareholders. To achieve this goal and based on a thorough review of director compensation at a peer group of 16 companies conducted by a nationally recognized independent compensation consulting firm, the Committee has adopted the following compensation program for Directors.

Directors who are not employees of the Company receive an annual retainer of \$20,000, payable quarterly, \$1,500 per meeting for attendance at Board meetings and \$1,000 per meeting for attendance at Committee meetings. The Company also reimburses directors for their travel expenses in connection with their attendance at Board and Committee meetings.

Table of Contents

In addition, Committee Chairs are paid an additional annual retainer of \$5,000 with the exception of the Audit Committee Chair who is paid an additional annual retainer of \$10,000, and the non-executive Chairperson of the Board who is paid an additional annual retainer of \$15,000.

Non-employee Directors will also receive annual grants of shares of common stock that are vested at the time of grant. The annual grants of shares of company stock will have a value equal to \$30,000. The grants will be made at each Annual Meeting of Shareholders, and the shares will be valued based on the average closing price over the twenty trading days preceding the Annual Meeting.

For Directors serving prior to 2003, the Company had adopted a post retirement policy providing that Directors may receive, if they agree to provide consultation services to the officers and directors of the Company (and execute a consultation agreement in that regard), annual amounts for a period equal to the director's years of service on the Board, up to a maximum of nine years. The annual amounts to be paid will equal the annual Director retainer in place at the time of his or her retirement. If a Director agrees to provide services, but does not subsequently provide such services, the Director will lose his or her eligibility to receive payments. This policy will not apply to newly-appointed directors.

Table of Contents**EXECUTIVE COMPENSATION****Summary Compensation Table**

The following table sets forth information for the years ended April 30, 2005, 2004 and 2003, with respect to the Chief Executive Officer and each of the four other highest paid executive officers of the Company whose aggregate cash compensation in fiscal 2005 exceeded \$100,000:

Name and Principal Position	Year	Annual Compensation			Long-Term Compensation		
		Salary	Bonus	Other Annual Compensation(1)	Restricted Stock Awards	Number of Stock Options	All Other Compensation(2)
Stephen R. Light(3) President and Chief Executive Officer	2005	\$ 480,008	\$ 421,414	\$ 184,679	\$ 350,053	21,250	\$ 0
	2004	450,008	264,061	181,438	181,000(4)	21,250	40,760
	2003	200,772	0	0	0	321,250	21,072
D. Patterson Adams, Jr. President and Chief Executive Officer, Avure Technologies, Incorporated	2005	\$ 250,016	\$ 124,925	\$ 57,575	\$ 0	0	\$ 104,859(5)
	2004	249,054	119,477	66,148	0	0	104,059(5)
	2003	250,016	0	0	0	0	111,946(5)
Thomas C. Johnson Senior Vice President of Operations	2005	\$ 190,008	\$ 99,785	\$ 56,253	\$ 0	0	\$ 58,629
	2004	190,008	83,620	57,445	39,000(6)	0	32,314
	2003	188,469	0	0	0	0	11,506
Richard A. LeBlanc Executive Vice President of Sales	2005	\$ 220,002	\$ 128,503	\$ 59,596	\$ 0	0	\$ 58,629
	2004	220,002	96,824	66,527	39,000(6)	0	32,690
	2003	215,043	30,856(7)	0	0	0	12,025
Stephen D. Reichenbach Chief Financial Officer(8)	2005	\$ 209,997	\$ 121,037	\$ 58,512	\$ 0	0	\$ 67,200
	2004	196,154	98,773	57,152	39,000(6)	0	6,600
	2003	180,003	0	0	0	0	11,385

- (1) Represents dollar value of shares of Company stock received in lieu of cash bonus.
- (2) Includes Company contributions to the Voluntary Pension and Salary Deferral Plan and the Flow International Corporation Executive Deferral Plan and amounts paid in connection with retention agreements.
- (3) Mr. Light joined the Company in December 2002 and became President and CEO on January 2, 2003.
- (4) Includes 200,000 restricted stock units granted in connection with a retention agreement and vesting December 31, 2006, and 20,000 shares granted pursuant to an employment agreement.
- (5) Includes reimbursement of moving expenses and interest paid on a relocation loan made to Mr. Adams when he joined the Company in August 2001.
- (6) Includes stock granted in connection with a retention agreement and vesting December 31, 2006.
- (7) Amounts paid based on sales commissions.
- (8) Mr. Reichenbach resigned effective August 8, 2005.

Table of Contents**Stock Option Grants in 2005****Option Grants Table****Fiscal 2005**

The following table sets forth certain information regarding options granted to the Company's Chief Executive Officer during the fiscal year ended April 30, 2005. No options were granted to the other four highest paid executives during fiscal 2005.

Individual Grants

Name	Number of Options Granted	Percent of Total Options Granted to Employees in Fiscal Year	Exercise Price (\$/Share)	Expiration Date	Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term (10 Years)	
					5%	10%
Stephen R. Light	21,250	100%	\$ 5.92	04/23/15	\$ 29,401	\$ 74,507

Aggregated Option Exercises in Fiscal 2005**and Fiscal Year-End Option Values**

The following table sets forth certain information regarding options exercised during the year ended April 30, 2005, by the Company's Chief Executive Officer and each of the individuals named in the Summary Compensation Table.

Name	Shares		Total Number of Unexercised Options at Fiscal Year-End		Value of Unexercised in-the-Money Options at Fiscal Year-End(1)	
	Acquired on	Value	Exercisable	Unexercisable	Exercisable	Unexercisable
	Exercise	Realized				
Stephen R. Light	0	0	140,207	123,543	\$ 352,489	\$ 233,861
D. Patterson Adams, Jr.	0	0	100,000	0	0	0
Thomas C. Johnson	0	0	55,000	0	0	0
Richard A. LeBlanc	0	0	156,000	0	0	0
Stephen D. Reichenbach	0	0	213,775	0	0	0

(1) Calculated using \$5.92, the closing price of the Company's Common Stock as reported by NASDAQ on April 30, 2005.

Stock Based Plans

Equity Compensation Plan Information

The following table presents the number of stock options and warrants that were and were not approved by our shareholders as of April 30, 2005.

<u>Plan category</u>	<u>(a)</u> Number of securities to be issued upon exercise of outstanding options, warrants and rights	<u>(b)</u> Weighted-average exercise price of outstanding options, warrants and rights	<u>(c)</u> Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by shareholders	2,034,546	\$ 9.20	1,368,218

Table of Contents

Compensation and Plan Administrator Committee Report

Introduction. The Compensation and Plan Administrator Committee of the Board of Directors (the Compensation Committee) establishes and directs the administration of all programs under which executive compensation is paid or awarded to the Company's executive officers. In addition, the Compensation Committee evaluates executive officer performance and assesses the overall effectiveness of the Company's executive compensation programs.

Total Compensation Philosophy. For fiscal 2006, with the assistance of an outside compensation consultant, the Compensation Committee conducted a comprehensive review of the Company's executive compensation programs. In conducting that review, the Committee adopted the following compensation philosophy, which it used as the basis for its review of the Company's programs:

Flow International will provide compensation and benefit programs that are competitive with relevant markets where we compete for employees, internally equitable, and consistent with our commitment to providing a work environment that promotes teamwork, outstanding performance, and corporate pride.

Base Salary Base salary opportunities should be competitive with relevant organizations with similar complexity, and internally consistent based upon each position's assigned responsibilities. Individual salary determinations will be made considering incumbent qualifications, experience and performance.

Short-Term Incentives Consistent with competitive practices, executive officers and other key management and technical positions should have a portion of targeted total compensation at risk, contingent upon meeting predefined corporate, business unit and individual goals. Flow International believes it is important that those who are directly involved in contributing to the achievement of our goals should have a meaningful portion of their total compensation opportunity tied to shared corporate objectives.

Long-Term Incentives Executive officers and other key management positions should have a meaningful portion of their competitive total compensation opportunity linked to high levels of sustained performance and increasing shareholder value.

Employee Benefits Flow International will assist employees in meeting their retirement income, health care, survivor income, disability income, time-off and other needs through competitive, cost-effective, company-sponsored programs that provide employees with reasonable flexibility in meeting their circumstances.

Decisions regarding total compensation program design, as well as individual pay decisions, will be made in the context of this Total Compensation Philosophy and our ability to pay, as defined by our financial success.

Elements of Executive Compensation. The elements of executive compensation during fiscal 2005 included base salary, an annual incentive program, a retention program, and retirement and other benefits. For fiscal 2006 the Committee adopted, subject to shareholder approval, a long term incentive program. While the elements of compensation described in this report are considered separately, the Compensation Committee takes into account the full compensation package afforded by the Company to each executive, including salary, incentive compensation, retirement and other benefits. In reviewing the individual performance of the executives, other than the Chief Executive Officer (CEO), the Compensation Committee takes into account the views of the CEO.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Base Salaries. Base salaries of the executive officers other than for the CEO had were determined by the Compensation Committee using the CEO's recommendations and data provided by the Committee's consultant. No adjustments to executive base salaries had been made for fiscal 2004 or 2005. The Committee made adjustments to individual executives' base salaries for fiscal 2006 based on competitive pay data and practices in the industrial and commercial machinery industry sector, proxy analysis of a group of peer companies and individual performance. The CEO's pay is set by contract and discussed below.

Table of Contents

Annual Incentive Plan. The Company's executive officers are eligible for bonuses under the Company's Annual Incentive Plan. The Annual Incentive Plan emphasizes the achievement of the Company's annual financial goals. For fiscal 2005 these goals were based on achievement of goals including revenue, operating profit and working capital as a percentage of revenue and individual and business unit goals, and bonuses were paid half in stock and half in cash. For fiscal 2006 these goals will be based on return on invested assets, revenue, operating profit and individual and business unit goals. Executives' target bonus levels have been set at percentages of base salary, ranging from fifteen to sixty percent, and the CEO's target bonus level set by his employment contract is at 60% of base salary; bonuses will range from zero to two times the target bonus, depending on target achievement. Payouts will be made half in stock and half in cash.

The Company exceeded its goals for fiscal 2005, and annual incentive payouts were made for the fiscal year at the maximum levels under the plan.

Long Term Incentive Plan. For fiscal 2006, the Company adopted, and the shareholders approved, a Long Term Incentive Plan. The purpose of the Long Term Incentive Plan is to provide stock incentives for executives who assist the Company in meeting the Company's long-term financial goals and to align the interests of executives with the Company's shareholders. The plan is also intended to provide performance based incentives beginning after the last awards are paid under the retention program described below. Under the plan, executives have the opportunity to receive shares of stock based on achievement of goals over a three year period. At the beginning of each three year performance period participating executives are assigned a target award, based on achievement of specific goals. At the end of the three year period the executive receives a number of shares, based on the Company's achievement of these goals. Awards may range from zero to two times the target number of shares. For the first three year period, ending with the end of fiscal 2008, the goals are based on the Company achieving a return on invested assets and a certain cumulative earnings per share over the preceding three year period. Goals for future three year periods, as well as target awards, will be set at the beginning of each three year period.

Retention Award. During fiscal year 2003, the Company began to implement a comprehensive restructuring program intended to return the Company to profitability. The Compensation Committee determined that during this implementation it was critical to ensure key executives remain employed at the Company and focused on the day-to-day operations to successfully turnaround the Company. As a result, the Compensation Committee adopted a retention program to achieve these goals. The program includes six executives including the CEO. The CEO's retention award is discussed below. Each participating executive who remains in the Company's employ is eligible to receive retention awards in both cash and restricted stock units. The cash retention awards began six months after the plan inception and provide for seven equal semi-annual increments. The executive must be employed at the payment date to receive the cash portion of the award. The restricted stock unit awards vest 42 months after plan inception. Each executive must remain a full-time employee for the entire 42-month period to vest in the restricted stock units. The retention program's final awards will be made in fiscal 2007, following which, executives will first become eligible to receive awards under the Long Term Incentive Program.

Chief Executive Officer Compensation. On November 25, 2002, Mr. Light entered into an employment agreement with the Company with a term ending on April 30, 2005 (the "Light Agreement"). The Light Agreement provides for automatic extensions beginning on May 1, 2003 (unless notice not to extend is given by either party) so that the remaining term shall always be two years. Under the terms of the Light Agreement, Mr. Light's annual base salary is \$450,000 and he is eligible for target annual performance bonuses equal to 60% of base salary. One-half of the bonus is payable in shares of common stock. Mr. Light's annual performance bonuses are based on the same factors as the executives' bonuses. The Board has established additional goals for the CEO. These include development of succession plans, development of a customer satisfaction survey and successful resolution of the Company's financing.

The Committee and Board of Directors reviewed Mr. Light's performance for fiscal 2005. They compared the Company's performance to the goals set for Mr. Light by the Board, concluding that he had exceeded the goals that had been set for him.

Table of Contents

Policy on Deductibility of Compensation. Section 162(m) of the Internal Revenue Code limits the Company's federal income tax deduction for compensation to its CEO and any of its four other highest paid executive officers to \$1 million. Qualified performance-based compensation is not subject to the \$1 million limitation, provided certain requirements of Section 162(m) are satisfied. These requirements include shareholder approval and periodic re-approval of the material terms of performance goals in plans such as the Company's 1995 Long-Term Incentive Plan. The Compensation Committee presently anticipates that the Company's executive compensation will either be below such levels or will be structured to qualify as performance-based compensation which is exempt from such limitation.

Conclusion. After its review of the total compensation program for the executives of the Company, the Compensation Committee believes that the executive compensation policies and practices it has adopted will serve the interests of the shareholders and the Company effectively. The Committee also believes that the various compensation programs offered are appropriately balanced to provide increased motivation for executive officers to contribute to the Company's overall future success, thereby increasing the value of the Company for the shareholders benefit. The Compensation Committee will continue to monitor the effectiveness of the Company's total compensation program to meet the ongoing needs of the Company.

This report is submitted by the members of the Compensation Committee.

COMPENSATION AND PLAN

ADMINISTRATOR COMMITTEE

J. Michael Ribaudo Chairman

Richard P. Fox

Sandra Rorem

Kathryn L. Munro

Table of Contents**MARKET INFORMATION**

The principal market for our common stock is the over-the-counter market. Our stock is traded on the NASDAQ National Market under the symbol FLOW. The range of high and low sales prices for our common stock for the first and second quarter of fiscal 2006 and for the third quarter of fiscal 2006 through December 8, 2005 and the four quarters for fiscal 2005 and 2004 is set forth in the following table.

	<u>Fiscal Year 2006</u>		<u>Fiscal Year 2005</u>		<u>Fiscal Year 2004</u>	
	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>	<u>High</u>	<u>Low</u>
First Quarter	\$ 7.83	\$ 5.87	\$ 3.66	\$ 2.15	\$ 1.94	\$ 1.13
Second Quarter	9.39	7.43	3.55	2.70	3.11	1.36
Third Quarter(1)	9.25	6.40	3.18	2.71	4.11	2.40
Fourth Quarter			6.60	2.85	3.74	2.20

(1) Prices for fiscal year 2006 reflect trading through December 8, 2005.

Director and Officer Indemnification

Article XII of the Articles of Incorporation of Flow International Corporation authorizes Flow International Corporation to indemnify any present or former director or officer to the fullest extent not prohibited under the WBCA, public policy or other applicable law. Chapter 23B.08.510 and .570 of the WBCA authorizes a corporation to indemnify its directors, officers, employees, or agents in terms sufficiently broad to permit such indemnification under certain circumstances for liabilities (including provisions permitting advances for expenses incurred) arising under the 1933 Act.

The directors and officers of Flow International Corporation are entitled to limited indemnification from the Selling Shareholders against any losses based upon the failure of the selling shareholder to comply with the prospectus delivery requirements under the federal securities laws or upon any untrue statement or alleged untrue statement or omission or alleged omission made in this Registration Statement and the Prospectus contained therein, as the same shall be amended or supplemented, made in reliance upon or in conformity with written information furnished to Flow International Corporation by such Selling Shareholder.

Table of Contents

STOCK OWNERSHIP OF MANAGEMENT AND PRINCIPAL SHAREHOLDERS

The following tables sets forth information as of December 6, 2005, with respect to each shareholder known by the Company to be the beneficial owner of more than five percent (5%) of any class of voting securities of the Company, each director, those executive officers listed in the Summary Compensation Table below and all directors and executive officers of the Company as a group. Currently, the Company's sole class of voting securities outstanding is Common Stock. Except as noted below, each person has sole voting and investment powers with respect to the shares shown. The address for each of the persons listed below is 23500 64th Avenue South, Kent, Washington 98032.

Except as otherwise indicated by footnote, and subject to applicable community property laws, we believe that the beneficial owners of the common stock listed below have sole voting power and investment power with respect to their shares. Beneficial ownership is determined in accordance with the rules of the SEC. The table below assumes the conversion of all of the outstanding shares of our convertible preferred stock into common stock, which will occur immediately prior to the completion of this offering.

The number of shares of common stock outstanding, on an as converted basis, used in calculating the percentage for each listed person or entity includes common stock underlying options or a warrant held by the person or entity that are exercisable within 60 days of December 6, 2005 or upon completion of this offering, but excludes common stock underlying options or warrants held by any other person or entity. Percentage of beneficial ownership is based as of December 6, 2005 and is on a non-diluted basis.

Table of Contents**STOCK OWNERSHIP OF MANAGEMENT**

Name and Position	Number of Shares	Percent of Outstanding Shares
Ronald D. Barbaro, Director	91,421(1)	0.3
Douglas P. Fletcher, Chief Financial Officer	1,680(2)	0.0
Richard P. Fox, Director	31,546	0.1
Thomas C. Johnson, Senior Vice President of Operations	87,784(3)	0.3
Richard A. LeBlanc, Executive Vice President of Sales	188,904(4)	0.5
John S. Leness, General Counsel and Corporate Secretary	186,381(5)	0.5
Stephen R. Light, President and Chief Executive Officer	483,251(6)	1.4
Kathryn L. Munro, Director	91,421(7)	0.3
Rick L. Nicholson, Vice President Human Resources	8,125(8)	0.01
Arlen I. Prentice, Director	227,500(9)	0.6
J. Michael Ribaud, Director	215,595(10)	0.6
Kenneth M. Roberts, Director	300,516(11)	0.9
Felix M. Sciulli, Senior Vice President of Global Engineering and Research and Development	92,955(12)	0.3
Jan K. VerHagen, Director	39,046	0.1
All directors and officers as a group (16 persons)	2,044,035(13)	6.0

- (1) Includes options exercisable and restricted shares vesting within 60 days for 59,875 shares of Company Common Stock.
- (2) Includes options exercisable and restricted shares vesting within 60 days for 840 shares of Company Common Stock.
- (3) Includes options exercisable and restricted shares vesting within 60 days for 55,000 shares of Company Common Stock.
- (4) Includes options exercisable and restricted shares vesting within 60 days for 151,000 shares of Company Common Stock.
- (5) Includes options exercisable and restricted shares vesting within 60 days for 151,000 shares of Company Common Stock.
- (6) Includes options exercisable and restricted shares vesting within 60 days for 181,873 shares of Company Common Stock.
- (7) Includes options exercisable and restricted shares vesting within 60 days for 59,875 shares of Company Common Stock.
- (8) Includes options exercisable and restricted shares vesting within 60 days for 1,250 shares of Company Common Stock.
- (9) Includes options exercisable and restricted shares vesting within 60 days for 59,875 shares of Company Common Stock.
- (10) Includes options exercisable and restricted shares vesting within 60 days for 59,875 shares of Company Common Stock.
- (11) Includes options exercisable and restricted shares vesting within 60 days for 59,875 shares of Company Common Stock.
- (12) Includes options exercisable and restricted shares vesting within 60 days for 63,000 shares of Company Common Stock.
- (13) Includes options exercisable and restricted shares vesting within 60 days for 961,123 shares of Company Common Stock.

Table of Contents**Stock Ownership of 5% Owners**

<u>Name and Address</u>	<u>Number of Shares</u>	<u>Percent of Outstanding Shares</u>
Pinnacle Fund LP(1) 4965 Preston Park Blvd. Suite 240 Plano, Texas 75093	2,200,000(2)	6.4%
Third Point LLC (f/k/a Third Point Management Company L.L.C.) and Daniel S. Loeb(1)(3) 360 Madison Ave. 24th Floor New York, New York 10017.	4,436,300(4)	12.9 %
Third Point Offshore Fund(1)(5) 360 Madison Ave. 24th Floor New York, New York 10017	3,014,220(6)	8.8%
JLF FUNDS 601 W. Main Avenue, Suite 600, Spokane, WA 99201	4,033,000	11.8%
ICM Asset Management, Inc. 601 W. Main Avenue Suite 600 Spokane, Washington 99201	1,647,150	4.8%

1 Based on filings made pursuant to Sections 13(g) of the Exchange Act.

2 Includes 200,000 shares issuable upon exercise of warrants.

3* Third Point LLC, a Delaware limited liability company (the Management Company) serves as investment manager or adviser to a variety of hedge funds and managed accounts (such funds and accounts, collectively, the Funds), with respect to shares of Common Stock directly beneficially owned by the Funds. Mr. Daniel S. Loeb is the managing member of the Management Company and controls its business activities, with respect to shares of Common Stock indirectly beneficially owned by Mr. Loeb by virtue of such position.

4* Includes 403,300 shares issuable upon exercise of warrants.

5* Shares are included in the totals for Third Point LLC.

6* Includes 274,020 shares issuable upon exercise of warrants.

Table of Contents**SELLING SHAREHOLDERS**

Set forth below is the name of each Selling Shareholder and the amount and percentage of Common Stock owned by each (including shares that can be acquired on the exercise of outstanding warrants) prior to the offering, the shares to be sold in the offering, and the amount and percentage of Common Stock to be owned by each (including shares that can be acquired on the exercise of outstanding warrants) after the offering. The footnotes provide information about persons who have investment voting power for the Selling Shareholders and about material transactions between the Selling Shareholders and the Company.

Selling Shareholders	Shares		Shares		
	Beneficially Owned		Beneficially Owned		
	Prior to the Offering(1)		After the Offering(1)		
	Number	Percent	Number	Percent	
J. Patterson McBaine(2)(3)	55,000	*	55,000	0	*
Gruber & McBaine International(2)(4)	126,500	*	126,500	0	*
Hamilton College(2)(4)	71,500	*	71,500	0	*
Donaghy Sales Inc.(2)(4)	33,000	*	33,000	0	*
Lagunitas Partners(2)(4)	561,000	1.6%	561,000	0	*
The Wallace Foundation(2)(4)	44,000	*	44,000	0	*
Jon D. Gruber and Linda W. Gruber(2)(4)	132,000	*	132,000	0	*
Lindsay Gruber Dunham(2)(4)	8,800	*	8,800	0	*
Jon Gruber Trustee J.W. Gruber Trust(2)(4)	8,800	*	8,800	0	*
Potomac Capital Partners(2)(5)	477,400	1.4%	477,400	0	*
Potomac Capital International(2)(5)	263,560	*	263,560	0	*
Pleiades Investment Partners(2)(5)	294,140	*	294,140	0	*
Crestview Capital Master LLC(2)(6)	591,397	1.7%	591,397	0	*
Presidio Partners(2)(7)	226,083	*	226,083	0	*
Brady Retirement Fund(2)(7)	49,206	*	49,206	0	*
Geary Partners(2)(7)	168,011	*	168,011	0	*
SRB Greenway Capital (QP) LP(2)(8)	238,658	*	238,658	0	*
SRB Greenway Capital LP(2)(8)	32,378	*	32,378	0	*
SRB Greenway Offshore Operating Fund(2)(8)	24,661	*	24,661	0	*
Westpark Capital(2)(9)	297,000	*	297,000	0	*
Pacific Asset Partners(2)(10)	147,849	*	147,849	0	*
BTG Investments(2)(11)	82,783	*	82,783	0	*
Third Point Partners Qualified LP(2)(12)	142,560	*	142,560	0	*
Third Point Partners(2)(12)	752,620	*	752,620	0	*
Third Point Offshore Fund(2)(12)	3,014,220	8.7%	3,014,220	0	*
Points West International Investments(2)(12)	526,900	1.5%	526,900	0	*
JLF Offshore Fund(2)(13)	2,642,200	7.7%	2,642,200	0	*
JLF Partners II(2)(13)	129,800	*	129,800	0	*
JLF Partners I(2)(13)	1,664,300	4.8%	1,664,300	0	*
The Pinnacle Fund(2)(14)	2,314,483	6.7%	2,200,000	114,483	*
Trustman c/o Arthur V Davis Foundation(2)(15)	23,980	*	23,980	0	*
Trustman c/o STI Classic Small Cap Growth Fund(2)(15)	2,016,400	5.8%	1,899,700	116,700	*
Trustman c/o TUA Troyal G Brooks(2)(15)	4,840	*	4,840	0	*
Trustman c/o TUA Sandra Brooks(2)(15)	1,980	*	1,980	0	*
Zeke, LP(2)(16)	1,183,600	3.4%	1,183,600	0	*
SF Capital Partners(2)(17)	1,100,000	3.2%	1,100,000	0	*
John Hancock Life Insurance Company(2)(18)	384,765	1.1%	384,765	0	*

Table of Contents

Selling Shareholders	Shares			Shares	
	Beneficially Owned			Beneficially Owned	
	Prior to the Offering(1)			After the Offering(1)	
	Number	Percent	Shares to be Sold	Number	Percent
John Hancock Variable Life Insurance Company(2)(18)(19)	27,479	*	27,479	0	*
Hare & Co., as nominee for Signature Four Limited(2)(18)(19)	13,744	*	13,744	0	*
Hare & Co., as nominee for Signature Five Limited(18)(19)	55,093	*	55,093	0	*
Bank of America Securities(20)(21)	909,325	2.0%	909,325	0	*
General Electric Capital Corporation(22)	81,527	*	81,527	0	*
<i>Total number of shares to be offered under this prospectus</i>			20,692,359		

* denotes less than 1%

- (1) Includes shares that may be acquired on the exercise of presently exercisable warrants
- (2) On March 21, 2005, we sold securities to each such person under a Securities Purchase Agreement and entered into a Registration Rights Agreement. The securities were units consisting of one share of common stock and a warrant to purchase one-tenth of a share at \$4.07 per share. Units were sold for \$3.72 per unit. Each purchaser under the Securities Purchase Agreement was an accredited investor as that term is defined in Regulation D under the Securities Act. In issuing the units, the Company relied on an exemption from registration under Section 4(2) and Rule 506 thereunder, each purchaser being accredited and provisions relating to limitations on the manner of sale and limitations on resale in Rule 506 being complied with. The sale of units was a private placement. Roth Capital Partners acted as placement agent in connection with the sale of units. The closing price of our stock on Nasdaq National Market on the day before the agreement between the Company and the Selling Shareholders relating to the PIPE Transaction was entered into \$3.70 per share. On the day that the agreement was entered into, the closing price was \$4.28 per share. The purchase price of the common stock component of a unit was \$3.70, representing a 13.6% discount from the closing price on the date the Securities Purchase Agreement was entered into. The exercise price of the warrants, \$4.07 per share, represents an 8.5% discount from the closing price on the date the Securities Purchase Agreement was entered into. The exercise price is a negotiated price. The number of shares listed above includes the shares issuable on the exercise of the warrants. Pursuant to the Registrant Rights Agreement, we agreed to file a registration statement on Form S-1 registering the resale of the shares of common stock issued and the shares issuable on exercise of the warrants and to keep the registration statement effective until the earlier of two years and the date that all the common shares may be sold by the investors pursuant to Rule 144 promulgated under the Securities Act of 1933. The Registration Rights Agreement also provides that if we do not register for resale the common shares by September 17, 2005, then upon such failure to register the shares, we must pay each of the investors a fee equal to 1% of the aggregate purchase price paid by each such investor pursuant to the Securities Purchase Agreement for the shares of common stock then held by each such investor, and for each month after such date that the common shares are not registered, we must additionally pay each of the investors a fee equal to 1% of the aggregate purchase price paid by each such investor pursuant to the Securities Purchase Agreement for the shares of common stock then held by each such investor. Pursuant to such agreement, we filed the registration statement of which this prospectus is a part with the Securities and Exchange Commission to register for resale the shares of common stock identified in this prospectus and owned by the selling stockholders.
- (3) J. Patterson McBaine is a natural person who has investment voting power for this Selling Shareholder.
- (4) Jon D. Gruber is a natural person who has investment voting power for this Selling Shareholder.
- (5) Kenneth Berkow is a natural person who has investment voting power for this Selling Shareholder.
- (6) Robert Hoyt is a natural person who has investment voting power for this Selling Shareholder.
- (7) William J. Brady is a natural person who has investment voting power for this Selling Shareholder.

Table of Contents

- (8) Steven R. Becker is a natural person who has investment voting power for this Selling Shareholder.
- (9) Patrick J. Brosnahan is a natural person who has investment voting power for this Selling Shareholder.
- (10) Robert M. Stafford is a natural person who has investment voting power for this Selling Shareholder.
- (11) Gordon J. Roth is a natural person who has investment voting power for this Selling Shareholder.
- (12) Daniel S. Loeb is a natural person who has investment voting power for this Selling Shareholder.
- (13) Jeff Feinberg is a natural person who has investment voting power for this Selling Shareholder.
- (14) Barry M. Kitt is a natural person who has investment voting power for this Selling Shareholder.
- (15) Mark Garfinkel is a natural person who has investment voting power for this Selling Shareholder.
- (16) Edward N. Antoian is a natural person who has investment voting power for this Selling Shareholder.
- (17) Michael A. Roth is a natural person who has investment voting power for this Selling Shareholder.
- (18) In May 2001, the Company signed a \$35 million subordinated debt agreement (the Hancock Agreement) with The John Hancock Life Insurance Company and affiliated entities, including John Hancock Variable Life Insurance Company, Signature Four Limited, and Signature Five Limited (collectively Hancock). The Hancock Agreement required semi-annual interest only payments at 13% (subsequently increased to 15%). The Agreement specified that the entire principal balance was due April 30, 2008, with a mandatory prepayment of \$17,500,000 due on April 30, 2007. There were amendments in 2003 and 2004 to capitalize certain interest payments. At the time the Hancock Agreement was executed, the Company also issued 867,891 warrants to purchase Flow common stock at \$.01 per share to Hancock. In July 2004, the Company issued an additional 150,000 warrants to purchase Flow common stock at \$.01 per share to Hancock, in connection with an amendment of the Hancock Agreement. Hancock sold its interest in the loans and a portion of the warrants to Bank of America Securities in December, 2004. The loan was paid off in full in the amount of \$40,736,770.31 on April 28, 2005. If the warrants had been exercised on the date of Securities Purchase Agreement relating to the PIPE transaction was entered into, the purchase price would have represented a discount from current market price if approximately 99.5%.
- (19) Lorn C. Davis is a natural person who has investment voting power for this Selling Shareholder.
- (20) Kirk B. Wortman is a natural person who has investment voting power for this Selling Shareholder.
- (21) In 2001, the Company entered into a credit agreement with Bank of America, N.A. and other lenders (the Senior Credit Agreement). The Senior Credit Agreement, as amended provided for a revolving line of credit of up to \$42,736,100 and a final maturity date of August 1, 2005. Interest rates under the Senior Credit Agreement were at the Bank of America s prime rate in effect from time to time plus 4% and increased by one percentage point each quarter beginning November 1, 2004. The credit agreement as amended also required a quarterly commitment fee of 1/2 of 1% (50 basis points) of the total commitment, and issuance of 150,000 detachable \$.01 warrants as a fee. The Company also paid an annual letter of credit fee equal to 5% of the amount available to be drawn under each outstanding letter of credit. In 2004, the lenders other than Bank of America transferred their interests in the loan to Bank of America, N.A., and to General Electric Capital Corporation along with 150,000 warrants. On April 28, 2005 the Senior Credit Agreement was paid off and replaced with a \$30 million credit agreement with Bank of America N.A. and U.S. Bank National Association. This new short-term facility has the same expiration date as the previous facility and similar terms, except that the interest rate has been decreased from prime rate plus 6% to LIBOR plus 2.5% and the commitment is for \$30 million. This new facility, however, allowed the Company to payoff its outstanding subordinated debt, which the Company did on April 28, 2005. If the warrants had been exercised on the date of Securities Purchase Agreement relating to the PIPE transaction was entered into, the purchase price would have represented a discount from current market price if approximately 99.5%.
- (22) Andrew Giangrave is a natural person who has investment voting power for this Selling Shareholder.

The number of selling shareholder warrants to which footnotes (18) (21) and (22) apply have also been adjusted upon closing of the PIPE pursuant to the anti-dilution provisions of those warrants.

Table of Contents

CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS

Arlen I. Prentice is Chief Executive Officer of Kibble & Prentice, Inc., a company that, together with its wholly owned subsidiary, provides insurance brokerage and employee benefits, administrative and consulting services to the Company. During fiscal 2005 and through December 8, 2005, payments by the Company to Kibble & Prentice, Inc. and such subsidiary for such services totaled \$2,566,541. Such payments were for various categories of insurance and included both the brokerage commissions and the premiums that Kibble passes on to the underwriter. Mr. Prentice abstains from participating in matters where he may have a conflict of interest.

Certain of the Selling Shareholders hold more than 5% of our common stock. Since such persons acquired more than 5% of our common stock from us, there have been no transactions between the company and any such persons. For information about the terms under which they acquired such shares, see Selling Shareholders, page 83.

Table of Contents

DESCRIPTION OF CAPITAL STOCK

General

The Company's current Certificate of Incorporation provides for the authorization of 49,000,000 shares of Common Stock, plus 1,000,000 shares reserved for the issuance of shares of preferred stock with a per value of \$0.01 per share. As of April 30, 2005, based on the number of shares of Common Stock currently outstanding and the number of shares eligible for issuance under all of the Company's stock option plans and outstanding warrants, there were 39,017,439 shares of Common Stock either outstanding or reserved, leaving 9,982,561 authorized, but unissued, and unreserved shares of Common Stock available for other corporate purposes or opportunities.

Common Stock

The holders of our common stock are entitled to one vote per share on all matters submitted to a vote at a meeting of shareholders, except as otherwise required by law and subject to the rights of any preferred stock we may issue in the future. The holders of our common stock are generally entitled to vote on amendments to our articles of incorporation, except for the designation of a series of preferred stock out of our authorized preferred stock. The Company's Board of Directors is classified into three classes, which are staggered and each of which serves a three year term. There are no cumulative voting rights for the election of our directors, which means that the holders of a majority of the outstanding shares of our common stock will be entitled to elect all of our directors. Subject to preferences that may be applicable to any outstanding preferred stock, the holders of our common stock are entitled to receive such dividends, if any, as may be declared by our board of directors out of funds legally available for dividends. In the event of liquidation, dissolution or winding up of us, the holders of our common stock are entitled to share rateably in all assets remaining after payment of or provision for our liabilities, subject to prior rights of preferred stock, if any, then outstanding. Our common stock has no pre-emptive or conversion rights or other subscription rights. There are no redemption or sinking fund provisions applicable to the common stock. All outstanding shares of our common stock are fully paid and nonassessable.

The Company has only one class of capital stock outstanding entitled to be voted at the Annual Meeting, Common Stock with voting rights.

Preferred Stock

Pursuant to our articles of incorporation, our board of directors has the authority, without action by our shareholders, to issue up to 1,000,000 shares of preferred stock. The board of directors may issue this stock from time to time in one or more series and may fix the rights, preferences, privileges and restrictions of each series of preferred stock. Some of the rights and preferences that our board of directors may designate include dividend rights, conversion rights, voting rights, terms of redemption, liquidation preferences and sinking fund terms. The board of directors may determine the number of shares constituting any series and the designation of such series. Any or all of the rights and preferences selected by our board of directors for any series of preferred stock may be greater than the rights of the common stock. The issuance of preferred stock could adversely affect, among other things, the voting power of holders of common stock and the likelihood that shareholders will receive dividend payments and payments upon our liquidation, dissolution or winding up.

Antitakeover Effects of Washington Law and Certain Provisions of Our Articles of Incorporation and Our Bylaws

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Washington RCW 23B.19. Washington law imposes restrictions on certain transactions between a corporation and certain significant shareholders. Chapter 23B.19 of the WBCA prohibits a target corporation, with certain exceptions, from engaging in certain significant business transactions with a person or group of persons that beneficially owns 10% or more of the voting securities of the target corporation (an acquiring person) for a period of five years after the acquisition of the securities, unless the transaction of securities is

Table of Contents

approved by a majority of the members of the target corporation's board of directors prior to the time of acquisition. Such prohibited transactions include, among other things, a merger or consolidation with, disposition of assets to, or issuance or redemption of stock to or from, the acquiring person; termination of 5% or more of the employees of the target corporation as a result of the acquiring person's acquisition of 10% or more of the shares; or allowing the acquiring person to receive any disproportionate benefit as a shareholder.

After the five-year period, a significant business transaction may occur, as long as it complies with certain fair price provisions of the statute. A corporation may not opt out of this statute. This provision may have the effect of delaying, deterring or preventing a change in control of us.

Vote Required for Merger. Our Articles of Incorporation require the affirmative approval of a merger, share exchange or sale of substantially all of the Corporation's assets by 2/3 of the Corporation's shares entitled to vote, or if separate voting groups is required then by not less than a majority of all of the votes entitled to be cast by that voting group.

Issuance of preferred stock. As noted above, our board of directors, without shareholder approval, has the authority under our articles of incorporation to issue preferred stock with rights superior to the rights of the holders of common stock. As a result, preferred stock could be issued quickly and easily, could adversely affect the rights of holders of common stock. The preferred stock could be issued with terms calculated to delay or prevent a change in control or to make removal of management more difficult, if, for example, our board of directors designated and issued a series of preferred stock in an amount that sufficiently increased the number of outstanding shares to overcome a vote by the holders of our common stock or with rights and preferences that included special voting rights to veto a change in control, merger or similar transaction.

Preferred Share Rights Purchase Plan. On June 7, 1990 the Board of Directors of the Company adopted a Preferred Share Rights Purchase Plan, which Plan was amended and restated as of September 1, 1999. Pursuant to the Plan a Preferred Share Purchase Right (a "Right") is attached to each share of Company common stock. The Rights will be exercisable only if a person or group acquires 10% or more of the Company's common stock or announces a tender offer, the consummation of which would result in ownership by a person or group of 10% or more of the common stock. Each Right entitles shareholders to buy one one-hundredth of a share of Series B Junior Participating Preferred Stock (the "Series B Preferred Shares") of the Company at a price of \$45. If the Company is acquired in a merger or other business combination transaction, each Right will entitle its holder to purchase a number of the acquiring company's common shares having a value equal to twice the exercise price of the Right. If a person or group acquires 10% or more of the Company's outstanding common stock, each Right will entitle its holder (other than such person or members of such group) to receive, upon exercise, a number of the Company's common shares having a value equal to two times the exercise price of the Right. Following the acquisition by a person or group of 10% or more of the Company's common stock and prior to an acquisition of 50% or more of such common stock, the Board of Directors may exchange each Right (other than Rights owned by such person or group) for one share of common stock or for one one-hundredth of a Series B Preferred Share. Prior to the acquisition by a person or group of 10% of the Company's common stock, the Rights are redeemable, at the option of the Board, for \$.0001 per Right. The Rights expire on September 1, 2009. The Rights do not have voting or dividend rights, and until they become exercisable, have no dilutive effect on the earnings of the Company.

Effective October 29, 2003, Flow International Corporation amended its Preferred Share Purchase Rights Plan and the Rights issued pursuant to the Plan. The amendment modifies the definition of "Acquiring Person" to exclude certain persons who inadvertently acquire in excess of 10% of the outstanding common shares if such person enters into a standstill agreement in form and substance satisfactory to the Company and agrees to divest a sufficient number of shares of Common Stock so that such Person would no longer be an Acquiring Person within no more than one year from the date of such agreement.

The amended terms of the Rights are set forth in the Amendment No. 1 dated as of October 29, 2003 between Flow International Corporation and Mellon Investor Services LLC to the Amended and Restated Rights Agreement dated as of September 1, 1999 between Flow International

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Corporation and Mellon Investor Services LLC. The Amended and Restated Rights Agreement is otherwise unchanged.

Table of Contents

PLAN OF DISTRIBUTION

The Selling Stockholders and any of their pledgees, donees, transferees, assignees and successors-in-interest may, from time to time, sell any or all of their shares of Common Stock on any stock exchange, market or trading facility on which the shares are traded or in private transactions. These sales may be at fixed or negotiated prices. The Selling Stockholders may use any one or more of the following methods when selling shares:

ordinary brokerage transactions and transactions in which the broker-dealer solicits Investors;

block trades in which the broker-dealer will attempt to sell the shares as agent but may position and resell a portion of the block as principal to facilitate the transaction;

purchases by a broker-dealer as principal and resale by the broker-dealer for its account;

an exchange distribution in accordance with the rules of the applicable exchange;

privately negotiated transactions;

to cover short sales made after the date that this Registration Statement is declared effective by the Commission;

broker-dealers may agree with the Selling Stockholders to sell a specified number of such shares at a stipulated price per share;

a combination of any such methods of sale; and

any other method permitted pursuant to applicable law.

The Selling Stockholders may also sell shares under Rule 144 under the Securities Act, if available, rather than under this prospectus. Rule 144 governs resale of restricted securities for the account of any person (other than us), and restricted and unrestricted securities for the account of an affiliate of ours. Restricted securities generally include any securities acquired directly or indirectly from us or our affiliates, which were not issued or sold in connection with a public offering registered under the Securities Act. An affiliate of ours is any person who directly or indirectly controls us, is controlled by us, or is under common control with us. Our affiliates may include our directors, executive officers, and persons directly or indirectly owning 10% or more of our outstanding common stock. Under Rule 144 unregistered resales of our restricted common stock cannot be made until the restricted common stock has been held for one year from the later of its acquisition from us or an affiliate of ours. Thereafter, restricted shares of our common stock may be resold without registration subject to requirements of Rule 144 regarding volume limitation, aggregation, broker transaction, notice filing and publicly available information about us. Resales of our restricted and unrestricted common stock by our affiliates are subject to these requirements. The volume limitations provide that a person (or persons who must aggregate their sales) cannot, within any three-month period, sell more than the greater of one percent of the then outstanding shares, or the average weekly reported trading volume during the four calendar weeks preceding each such sale. A non-affiliate may resell restricted common stock, which has been held for two years free of the requirements of Rule 144 mentioned above.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Broker-dealers engaged by the Selling Stockholders may arrange for other brokers-dealers to participate in sales. Broker-dealers may receive commissions or discounts from the Selling Stockholders (or, if any broker-dealer acts as agent for the purchaser of shares, from the purchaser) in amounts to be negotiated. The Selling Stockholders do not expect these commissions and discounts to exceed what is customary in the types of transactions involved.

The Selling Stockholders may from time to time pledge or grant a security interest in some or all of the Shares owned by them and, if they default in the performance of their secured obligations, the pledgees or secured parties may offer and sell shares of Common Stock from time to time under this prospectus, or under an amendment to this prospectus under Rule 424(b)(3) or other applicable provision of the Securities Act of 1933 amending the list of selling stockholders to include the pledgee, transferee or other successors in interest as selling stockholders under this prospectus.

Table of Contents

To the extent required under the Securities Act, a prospectus supplement accompanying this prospectus, or, if appropriate, a post-effective amendment to this registration statement will be filed, disclosing the name of any underwriters or broker-dealers, the number of shares of common stock involved, the price at which the common stock is to be sold, the commissions paid or discounts or concessions allowed to such underwriters or broker-dealers, where applicable, that such broker-dealers did not conduct any investigation to verify the information set out or incorporated by reference in this prospectus and other facts material to the transaction. Any prospectus supplement, and, if necessary, a post-effective amendment to the registration statement of which this prospectus is a part will be filed with the SEC to reflect the disclosure of additional information with respect to the distribution of the common shares covered by this prospectus. In addition, upon the Company being notified in writing by a Selling Stockholder that a donee or pledgee intends to sell more than 500 shares of Common Stock, a supplement to this prospectus will be filed in accordance with applicable securities law. The Company's undertaking to file a supplement in this circumstance is based on its understanding of disclosure obligations relating to sales of securities made pursuant to a registration statement and is not related to any contractual agreement or other understanding or arrangement with a Selling Shareholder or any other person. The 500 share threshold does not limit the Company's obligation to file a prospectus supplement or post-effective amendment to disclose a fundamental change in the information set forth in the registration statement or to include material information with respect to the plan of distribution or any other material change to such information.

The Selling Stockholders also may transfer the shares of Common Stock in other circumstances, in which case the transferees, pledgees or other successors in interest will be the selling beneficial owners for purposes of this prospectus.

The Selling Stockholders and any broker-dealers or agents that are involved in selling the shares may be deemed to be underwriters within the meaning of the Securities Act in connection with such sales. In such event, any commissions received by such broker-dealers or agents and any profit on the resale of the shares purchased by them may be deemed to be underwriting commissions or discounts under the Securities Act. Discounts, concessions, commissions and similar selling expenses, if any, that can be attributed to the sale of Securities will be paid by the Selling Stockholder and/or the purchasers. To our knowledge, the only Selling Stockholder that is a registered broker-dealer is Bank of America Securities. Bank of America Securities is an underwriter within the meaning of the Securities Act of 1933. If a selling stockholder is deemed to be an underwriter, the selling stockholder may be subject to certain statutory liabilities including, but not limited to Sections 11, 12 and 17 of the Securities Act and Rule 10b-5 under the Exchange Act. Selling stockholders who are deemed underwriters within the meaning of the Securities Act will be subject to the prospectus delivery requirements of the Securities Act.

The Company has advised each Selling Stockholder that it may not use shares registered on this Registration Statement to cover short sales of Common Stock made prior to the date on which this Registration Statement shall have been declared effective by the Commission. If a Selling Stockholder uses this prospectus for any sale of the Common Stock, it will be subject to the prospectus delivery requirements of the Securities Act. The Selling Stockholders will be responsible to comply with the applicable provisions of the Securities Act and Exchange Act, and the rules and regulations thereunder promulgated, including, without limitation, Regulation M, as applicable to such Selling Stockholders in connection with resales of their respective shares under this Registration Statement.

The Company is required to pay all fees and expenses incident to the registration of the shares, but the Company will not receive any proceeds from the sale of the Common Stock. The Company has agreed to indemnify the Selling Stockholders against certain losses, claims, damages and liabilities, including liabilities under the Securities Act.

In order to comply with the securities laws of some states, if applicable, the common stock may be sold in these jurisdictions only through registered or licensed brokers or dealers. In addition, in some states the common stock may not be sold unless it has been registered or qualified for sale or an exemption from registration or qualification requirements is available and is complied with.

Table of Contents

The Selling Shareholders may indemnify any broker-dealer that participates in transactions involving the sale of the shares against certain liabilities, including liabilities arising under the Securities Act.

We have agreed to indemnify the Selling Stockholders against liabilities, including liabilities under the Securities Act and state securities laws, relating to the registration of the shares offered by this prospectus.

LEGAL MATTERS

Preston Gates & Ellis LLP, Seattle, Washington, will pass upon the validity of the common stock offered hereby. Partners of Preston Gates & Ellis LLP hold an aggregate of 3,300 shares of our common stock.

EXPERTS

The consolidated financial statements as of April 30, 2005 and 2004, and for each of the three years in the period ended April 30, 2005 included in this prospectus have been so included in reliance on the report (which includes an explanatory paragraph relating to the Company's restatement of its financial statements as described in Note 2 to the financial statements) of PricewaterhouseCoopers LLP, an independent registered public accounting firm, given on the authority of said firm as experts in auditing and accounting.

WHERE YOU CAN FIND MORE INFORMATION

We have filed with the SEC a registration statement on Form S-1 under the Securities Act with respect to the common stock registered pursuant to this offering. This prospectus does not contain all of the information set forth in the registration statement. For further information with respect to Flow International Corporation and the common stock offered in this offering, we refer you to the registration statement and to the attached exhibits and schedules. Statements made in this prospectus concerning the contents of any document referred to in this prospectus are not necessarily complete. With respect to each such document filed as an exhibit to the registration statement, we refer you to the exhibit for a more complete description of the matter involved.

You may inspect our registration statement and the attached exhibits and schedules without charge at the public reference facilities maintained by the SEC at 450 Fifth Street, NW, Washington, DC 20549. You may obtain copies of all or any part of our registration statement from the SEC upon payment of prescribed fees. You may obtain information on the operation of the public reference room by calling the SEC at 1-800-SEC-0330.

Our SEC filings, including the registration statement and the exhibits filed with the registration statement, are also available from the SEC's website at www.sec.gov, which contains reports, proxy and information statements and other information regarding issuers that file electronically with the SEC.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

You can obtain a copy of any of our filings, at no cost, by writing to or telephoning us at:

Flow International Corporation

Attn: Corporate Secretary

23500 64th Avenue South

Kent, Washington 98032

(253) 850-3500

Table of Contents

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE QUARTER ENDED JULY 31, 2005 (Unaudited)

<u>Condensed Consolidated Balance Sheets - July 31, 2005 and April 30, 2005</u>	F-1
<u>Condensed Consolidated Statements of Operations - Three Months Ended July 31, 2005 and 2004</u>	F-2
<u>Condensed Consolidated Statements of Cash Flows - Three Months Ended July 31, 2005 and 2004</u>	F-3
<u>Condensed Consolidated Statements of Shareholders' Equity (Deficit) and Comprehensive Loss - Three Months Ended July 31, 2005 and 2004</u>	F-4
<u>Notes to Condensed Consolidated Financial Statements</u>	F-5

CONSOLIDATED FINANCIAL STATEMENTS

FOR THE YEAR ENDED APRIL 30, 2005

<u>Report of Independent Registered Public Accounting Firm</u>	F-17
<u>Consolidated Balance Sheets at April 30, 2005 and 2004</u>	F-18
<u>Consolidated Statements of Operations for each of the three years in the period ended April 30, 2005</u>	F-19
<u>Consolidated Statements of Cash Flows for each of the three years in the period ended April 30, 2005</u>	F-20
<u>Consolidated Statements of Shareholders' (Deficit) Equity and Comprehensive Loss for each of the three years in the period ended April 30, 2005</u>	F-21
<u>Notes to Consolidated Financial Statements</u>	F-22
<i>Financial Statement Schedule</i>	
<u>Schedule II Valuation and Qualifying Accounts</u>	F-51

Table of Contents**FLOW INTERNATIONAL CORPORATION****CONDENSED CONSOLIDATED BALANCE SHEETS****(Unaudited; in thousands, except share amounts)**

	July 31, 2005	April 30, 2005
		(restated)
Current Assets:		
Cash and Cash Equivalents	\$ 15,219	\$ 12,976
Restricted Cash	2,527	469
Receivables, Net	28,047	38,325
Inventories, Net	26,034	24,218
Deferred Income Taxes		
Prepaid Expenses	6,487	6,046
Other Current Assets	2,052	2,632
	<u>80,366</u>	<u>84,666</u>
Total Current Assets	80,366	84,666
Property and Equipment, Net	12,227	12,634
Intangible Assets, Net	13,600	14,644
Goodwill	2,764	2,764
Deferred Income Taxes	1,527	1,532
Other Assets	2,028	2,227
	<u>\$ 112,512</u>	<u>\$ 118,467</u>
	<u>\$ 112,512</u>	<u>\$ 118,467</u>
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities:		
Notes Payable	\$ 3,841	\$ 3,531
Current Portion of Long-Term Obligations	475	9,912
Accounts Payable	14,606	20,842
Accrued Payroll and Related Liabilities	7,265	8,819
Taxes Payable and Other Accrued Taxes	2,452	2,291
Deferred Income Taxes	839	609
Deferred Revenue	2,995	4,646
Customer Deposits	14,509	10,606
Warrant Obligation	7,374	6,696
Other Accrued Liabilities	11,513	10,481
	<u>65,869</u>	<u>78,433</u>
Total Current Liabilities	65,869	78,433
Long-Term Obligations	13,301	5,704
Other Long-Term Liabilities	2,986	3,219
	<u>82,156</u>	<u>87,356</u>
Total Liabilities	82,156	87,356
Commitments and Contingencies		
Minority Interest	2,178	2,401
	<u>2,178</u>	<u>2,401</u>
Shareholders' Equity:		

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Series A 8% Convertible Preferred Stock \$.01 par value, 1,000,000 shares authorized, none issued		
Common Stock \$.01 par value, 49,000,000 shares authorized, 34,592,148 shares outstanding at July 31, 2005 and 33,495,479 shares outstanding at April 30, 2005	346	335
Capital in Excess of Par	114,022	112,512
Accumulated Deficit	(80,559)	(80,581)
Accumulated Other Comprehensive Loss		
Cumulative Translation Adjustment, net of income tax of \$0	(5,194)	(3,506)
Unrealized Loss on Cash Flow Hedges, net of income tax of \$170 and \$19	(437)	(50)
	<u> </u>	<u> </u>
Total Shareholders' Equity	28,178	28,710
	<u> </u>	<u> </u>
	\$ 112,512	\$ 118,467
	<u> </u>	<u> </u>

See Accompanying Notes to Condensed Consolidated Financial Statements

F-1

Table of Contents**FLOW INTERNATIONAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS****(Unaudited; in thousands, except per share data)**

	Three Months Ended July 31,	
	2005	2004
Revenues	\$ 49,729	\$ 48,982
Cost of Sales	29,106	31,087
Gross Margin	20,623	17,895
Expenses:		
Sales and Marketing	8,545	7,309
Research and Engineering	2,691	2,604
General and Administrative	7,366	5,728
Restructuring	98	
Financial Consulting		623
	18,700	16,264
Operating Income	1,923	1,631
Interest Expense, Net	(798)	(3,095)
Other Expense, Net	(226)	(170)
Income (Loss) Before Provision for Income Taxes	899	(1,634)
Provision for Income Taxes	(877)	(706)
Net Income (Loss)	\$ 22	\$ (2,340)
Net Income (Loss) Per Share:		
Basic	\$ 0.00	\$ (.15)
Diluted	\$ 0.00	\$ (.15)
Weighted Average Shares Used in Computing Basic and Diluted Net Income (Loss) Per Share		
Basic	34,299	15,686
Diluted	36,012	15,686

See Accompanying Notes to Condensed Consolidated Financial Statements

Table of Contents**FLOW INTERNATIONAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS****(Unaudited; in thousands)**

	Three Months Ended July 31,	
	2005	2004 (restated)
Cash Flows from Operating Activities:		
Net Income (Loss)	\$ 22	\$ (2,340)
Adjustments to Reconcile Net Income (Loss) to Cash Provided by Operating Activities:		
Depreciation and Amortization	1,165	1,322
Foreign Currency (Gains) Losses	(349)	660
Amortization of Debt Discount		257
Fair Value Adjustment on Warrants Issued	678	
Stock Compensation	712	359
Other Non-Cash Items	71	6
Changes in Operating Assets and Liabilities:		
Receivables	9,700	(274)
Inventories	(2,203)	(740)
Other Operating Assets	(1,188)	(1,488)
Customer Deposits	4,118	3,001
Accounts Payable	(5,861)	2,614
Deferred Revenue	(1,630)	(14)
Other Operating Liabilities	537	(2,203)
Cash Provided by Operating Activities	5,772	1,160
Cash Flows from Investing Activities:		
Expenditures for Property and Equipment	(519)	(329)
Restricted Cash	(2,137)	(184)
Other	(59)	58
Cash Used in Investing Activities	(2,715)	(455)
Cash Flows from Financing Activities:		
Borrowings (Repayments) under Line of Credit Agreements, Net	542	(2,082)
Payments on Senior Credit Agreement	(17,759)	(13,173)
Borrowings on Senior Credit Agreement	16,049	8,620
Payments of Long-Term Obligations	(39)	(18)
Borrowings on Long-Term Obligations		4,108
Other	9	
Cash Used In Financing Activities	(1,198)	(2,545)
Effect of Changes in Exchange Rates on Cash	384	(538)

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Increase (Decrease) in Cash and Cash Equivalents	2,243	(2,378)
Cash and Cash Equivalents at Beginning of Period	12,976	11,734
	<u> </u>	<u> </u>
Cash and Cash Equivalents at End of Period	\$ 15,219	\$ 9,356
	<u> </u>	<u> </u>
<i>Supplemental Disclosure of Noncash Financing Activity</i>		
Issuance of warrants to lenders	\$	\$ 960
	<u> </u>	<u> </u>
Issuance of compensatory common stock on executive incentive compensation plan	\$ 799	\$ 680
	<u> </u>	<u> </u>

See Accompanying Notes to Condensed Consolidated Financial Statements

F-3

Table of Contents**FLOW INTERNATIONAL CORPORATION****CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS EQUITY (DEFICIT)****AND COMPREHENSIVE LOSS**

(Unaudited, in thousands)

	Common Stock		Capital In Excess of Par	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Loss	Total Shareholders Equity (Deficit)
	Shares	Par Value				
Balances, April 30, 2004	15,510	\$ 156	\$ 54,686	\$ (59,965)	\$ (4,429)	\$ (9,552)
Components of Comprehensive Loss:						
Net Loss				(2,340)		(2,340)
Unrealized Loss on Cash Flow Hedges, Net of Income Tax of \$9					(24)	(24)
Cumulative Translation Adjustment, Net of Income Tax of \$0					(161)	(161)
Total Comprehensive Loss						(2,525)
Issuance of Warrants			960			960
Stock Compensation	366	3	1,037			1,040
Balances, July 31, 2004	15,876	\$ 159	\$ 56,683	\$ (62,305)	\$ (4,614)	\$ (10,077)
Balances, April 30, 2005	33,495	\$ 335	\$ 112,512	\$ (80,581)	\$ (3,556)	\$ 28,710
Components of Comprehensive Loss:						
Net Income				22		22
Unrealized Loss on Cash Flow Hedges, Net of Income Tax of \$155					(398)	(398)
Reclassification Adjustment for Settlement of Cash Flow Hedges, net of income tax of \$4					11	11
Cumulative Translation Adjustment, Net of Income Tax of \$0					(1,688)	(1,688)
Total Comprehensive Loss						(2,053)
Exercise of Warrants	908	9				9
Stock Compensation	189	2	1,510			1,512
Balances, July 31, 2005	34,592	\$ 346	\$ 114,022	\$ (80,559)	\$ (5,631)	\$ 28,178

See Accompanying Notes to Condensed Consolidated Financial Statements

F-4

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

For the Three Months Ended July 31, 2005

(Unaudited)

1. Basis of Presentation

In the opinion of the management of Flow International Corporation (the Company), the accompanying unaudited condensed consolidated financial statements contain all adjustments, consisting of normal recurring items and accruals necessary to fairly present the financial position, results of operations and cash flows of the Company. These interim financial statements do not include all information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States, and should be read in conjunction with the April 30, 2005 consolidated financial statements included in the Company's Annual Report filed with the Securities and Exchange Commission on Form 10-K/A (Amendment No. 1) as filed with the SEC on November 23, 2005. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of the Company's financial statements. Actual results may differ from these estimates under different assumptions or conditions. Operating results for the three months ended July 31, 2005 may not be indicative of future results.

2. Restatement

As reported in the Company's April 30, 2005 Form 10-K/A, the Company has identified errors in the Consolidated Financial Statements related to the impairment of goodwill, the valuation of anti-dilution warrants, additional costs incurred on percentage-of-completion contracts and the presentation of percentage-of-completion related balances on the Consolidated Balance Sheet, the computation of stock compensation expense, the allocation of the valuation allowance to deferred tax asset and liability balances, the recording of straight-line rent expense, and the classification of technical service expenses. The Company restated its Consolidated Balance Sheet as of April 30, 2005 as described in the Form 10-K/A.

The Company has also determined that there was an error in the Condensed Consolidated Statement of Cash Flows for the three months ended July 31, 2004 related to one of the items above. Specifically, the Company noted inconsistencies between its divisions in the balance sheet presentation of accounts receivable and cash receipts relating to contracts accounted for using the percentage-of-completion method. The Company has, therefore, adjusted its financial statements to reflect a consistent presentation and comply with the provisions of SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts. The effect of this error on these amounts included in the determination of cash provided by operating activities on the Consolidated Statement of Cash Flows for three months ended July 31, 2004 was to decrease the cash flow from changes in Receivables and to increase the cash flow from changes in Customer Deposits by \$3.1 million. Total cash flows from operating, investing and financing activities were not impacted by the restatement.

3. Liquidity

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

On July 8, 2005, the Company executed a new \$30 million, three year senior credit agreement with Bank of America N.A. and U.S. Bank N.A. This credit agreement expires July 8, 2008 and bears interest at the bank's prime rate (6.25% at July 31, 2005) or is linked to LIBOR plus a percentage depending on the Company's leverage ratios, at the Company's option. The agreement sets forth specific financial covenants to be attained on a quarterly basis, which we believe, based on our financial forecasts, are achievable.

The Company's domestic senior credit agreement (Credit Agreement) is its primary source of external funding. At July 31, 2005, the balance outstanding on the Credit Agreement was \$8.0 million against a maximum

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

available borrowing of \$30 million. The available credit at July 31, 2005, net of \$6.4 million in outstanding letters of credit, was \$15.6 million.

We believe that our existing cash, cash from operations, and credit facilities at July 31, 2005 are adequate to fund our operations through April 30, 2006. If we fail to achieve our planned revenues, costs and working capital objectives, management believes it has the ability to curtail capital expenditures and reduce costs to levels that will be sufficient to enable us to meet our cash requirements and debt covenants through April 30, 2006. The Company was in compliance with all covenants as of July 31, 2005.

4. Restructuring and Financial Consulting

In fiscal 2005, the Company completed the execution of a plan intended to return it to profitability through reductions in headcount, consolidation of facilities and operations, and closure or divestiture of selected operations.

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The following table summarizes accrued restructuring activity (in thousands):

	North America Waterjet	Other International Waterjet	Other Waterjet	Food	International Press	Consolidated					
	Facility Exit Costs	Exit Costs	Severance Benefits	Other	Severance Benefits	Facility Exit Costs	Severance Benefits	Facility Exit Costs	Other	Total	
Balance, April 30, 2004	139	333			244	191	244	663		907	
Q1 restructuring charge											
Q1 cash payments	(9)	(4)			(68)	(3)	(68)	(16)		(84)	
Balance, July 31, 2004	130	329			176	188	176	647		823	
Q2 restructuring charge											
Q2 cash payments	(9)	(4)			(64)	(3)	(64)	(16)		(80)	
Balance, October 31, 2004	121	325			112	185	112	631		743	
Q3 restructuring charge				120	119		120	119		239	
Q3 cash payments	(9)	(10)		(17)	(39)	(39)	(3)	(56)	(61)	(117)	
Balance, January 31, 2005	112	315		103	80	73	182	176	689	865	
Q4 restructuring charge											
Q4 cash payments	(9)	(31)		(50)	(17)	(39)	(3)	(89)	(60)	(149)	
Balance, April 30, 2005	\$ 103	\$ 284	\$	\$	\$ 53	\$ 63	\$ 34	\$ 179	\$ 87	\$ 629	\$ 716
Q1 restructuring charge			74	24				74	24	98	
Q1 cash payments	(9)	(30)	(74)	(49)	(17)	(34)	(3)	(157)	(59)	(216)	
Q1 charge-offs				(24)					(24)	(24)	
Balance, July 31, 2005	\$ 94	\$ 254	\$	\$ 4	\$ 46	\$	\$ 176	\$ 4	\$ 570	\$ 574	

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

During the three months ended July 31, 2005, the Company announced the closing and relocation of its Wixom, Michigan facility to its Burlington, Ontario facility and terminated 13 employees. In connection with this restructuring, the Company recorded severance benefits of \$74,000 which were paid in the quarter and also wrote off \$24,000 of inventory with no future value. The Company anticipates future restructuring charges related to its lease during the second quarter of fiscal 2006 of approximately \$300,000.

The remaining accrued severance costs in the Food Segment of \$4,000 as of July 31, 2005 will be paid over the next quarter and the remaining accrued facility exit costs for all segments of \$570,000, which consist of long-term lease commitments, net of expected sublease income, will be paid primarily over the next several years.

5. Net Income (Loss) Per Share and Stock-Based Compensation

Basic net income (loss) per share represents net income (loss) available to common shareholders divided by the weighted average number of shares outstanding during the period. Diluted net income (loss) per share represents net income (loss) available to common shareholders divided by the weighted average number of shares outstanding including the potentially dilutive impact of stock options and warrants, where appropriate. Potential common share equivalents of stock options and warrants are computed by the treasury stock method and are included in the denominator for computation of earnings per share if such equivalents are dilutive.

The following table sets forth the computation of basic and diluted net income (loss) per share for the three months ended July 31, 2005 and 2004:

	Three Months Ended July 31,	
	2005	2004
Numerator:		
Net income (loss)	\$ 22	\$ (2,340)
Denominator:		
Denominator for basic net income (loss) per share weighted average shares	34,299	15,686
Dilutive potential common shares from employee stock options	83	
Dilutive potential common shares from warrants	1,630	
Denominator for diluted net income (loss) per share weighted average shares and assumed conversions	36,012	15,686

Basic and diluted net income (loss) per share	\$ 0.00	\$ (0.15)
---	---------	-----------

The dilutive potential common shares from employee stock options exclude 1,675,490 options which were out of the money at July 31, 2005. The effect of all 2,087,579 stock options and 1,160,000 warrants at July 31, 2004 have been excluded from the diluted weighted average share denominator for the three months ended July 31, 2004, as their effect would be anti-dilutive.

The Company has engaged an independent third party in a Consulting Agreement effective March 1, 2003 to provide executive coaching and organizational services. In partial consideration for such services, the Company issued 19,097 unregistered shares of common stock, valued at \$50,000 which was expensed during the three months ended July 31, 2004.

On July 28, 2004, in connection with the execution of amendments to its senior credit agreement, the Company issued to the senior lenders 150,000 detachable warrants to purchase common stock at \$.01 per share

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

as a fee. The 150,000 warrants were valued at \$480,000 and were amortized to interest expense during the period from August 1, 2004 through July 31, 2005 which was the maturity date of the amended senior credit agreement. Also, in connection with the July 28, 2004 amendment of its subordinated debt agreement, the Company issued to the subordinated lender 150,000 detachable warrants to purchase common stock at \$.01 per share as a fee. All of these warrants were fully vested. The 150,000 warrants were valued at \$480,000 and were amortized to interest expense during the period from August 1, 2004 through the original term of the subordinated debt. In conjunction with the payoff of the subordinated debt on April 28, 2005, the Company recorded charges of \$2.0 million which represented the remaining unamortized fees. The issuance of shares and warrants was exempt from registration under Section 4(2) of the Securities Act of 1933 because these were not transactions involving a public offering.

The following table illustrates the effect on net income (loss) and net income (loss) per share if the Company had applied the fair value recognition provisions of Financial Accounting Standards No. 123 (FAS 123), Accounting for Stock Based Compensation to stock-based employee compensation. Based on the Company's current NOL position, there are no tax effects related to the stock-based compensation items below.

	Three Months Ended July 31,	
	2005	2004
	(in thousands, except per share data)	
Net income (loss), as reported	\$ 22	\$ (2,340)
Add: Employee stock-based compensation under APB 25 included in net loss, net of related tax effects	712	309
Deduct: Total employee stock-based compensation expense determined under fair value based method for all awards, net of tax related effects	(731)	(334)
Pro forma net income (loss)	\$ 3	\$ (2,365)
Net income (loss) per share basic and diluted:		
As reported	\$.00	\$ (.15)
Pro forma	\$.00	\$ (.15)

To determine compensation expense under FAS 123, the Company used the following assumptions:

	Fiscal 2006	Fiscal 2005
Risk-free interest rates	4.01%	4.34%

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

	Five years	Six years
Expected lives		
Expected dividend yields	0%	0%
Expected volatility	62.8%	62.0%

During the three months ended July 31, 2005 and 2004, the Company recorded total employee non-cash compensation expense of \$712,000 and \$309,000, respectively, related to various compensatory arrangements which provide common stock or restricted stock units, rather than options, to the Board of Directors and executive management.

F-9

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The table below presents the expense components related to the various common stock arrangements for the three months ended July 31, 2005 and 2004. Please refer to the Company's Amended Annual Report on Form 10-K/A for a further discussion of compensatory arrangements.

	Three Months Ended July 31,	
	2005	2004
Accrual for annual compensatory stock award to Board members	\$ 60	\$ 60
Executive employment and retention contracts	652	249
Employee and Director Total	712	309
Stock granted in consideration of third party services rendered		50
	\$ 712	\$ 359

6. Segment Information

The Company has identified seven reportable segments. Four segments, North America Waterjet, Asia Waterjet, Other International Waterjet and Other (together known as Waterjet), utilize the Company's released pressure technology. The remaining three segments, Food, North America Press and International Press (together known as Avure), utilize the Company's contained pressure technology. The Waterjet operation includes cutting and cleaning operations, which are focused on providing total solutions for the aerospace, automotive, job shop, surface preparation and paper industries. The Avure operation includes the Fresher Under Pressure food processing technology, as well as the isostatic and flexform press (General Press) operations. The Fresher Under Pressure technology provides food safety and quality enhancement solutions for food producers, while the General Press business manufactures systems which produce and strengthen advanced materials for the aerospace, automotive and medical industries. Segment operating results are measured by the Company's Chief Executive Officer based on operating income (loss). The accounting policies of the segments are the same as those described in the Summary of Significant Accounting Policies included in the Company's April 30, 2005 Amended Annual Report filed with the Securities and Exchange Commission on Form 10-K/A.

A summary of operations by reportable segment is as follows:

**Three Months Ended
July 31,**

	<u>2005</u>	<u>2004</u>
	(in thousands)	
Sales		
North America Waterjet	\$ 22,927	\$ 15,900
Asia Waterjet	5,768	6,351
Other International Waterjet	8,453	7,136
Other*	4,838	8,912
Food	2,337	3,868
North America Press	2,117	2,593
International Press	3,289	4,222
	<u>\$ 49,729</u>	<u>\$ 48,982</u>

F-10

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

	Three Months Ended July 31,	
	2005	2004
Operating Income (Loss)		
North America Waterjet	\$ 427	\$ (446)
Asia Waterjet	1,345	1,664
Other International Waterjet	283	(397)
Other*	71	101
Food	320	(37)
North America Press	38	(3)
International Press	(601)	638
Eliminations	40	111
	\$ 1,923	\$ 1,631

* The Other segment is comprised of divisions which do not make primary use of the Company's ultrahigh-pressure water pump technology. These divisions provide automation and robotic system solutions to the automotive market.

7. Restricted Cash

The Company maintains amounts which are restricted in a separate bank account to provide customer performance guarantees as well as vendor guarantees. At July 31, 2005 and April 30, 2005, the Company had \$2,581,000 and \$526,000 of cash pledged on such guarantees of which \$2,527,000 and \$469,000 have restrictions which will lift within the next twelve months, respectively. The remaining restricted cash balances have been reported in Other Assets on the Condensed Consolidated Balance Sheets.

8. Receivables

Receivables consist of the following:

July 31, 2005	April 30, 2005
----------------------	-----------------------

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

	(in thousands)	
		(restated)
Trade Accounts Receivable	\$ 29,041	\$ 37,157
Unbilled Revenues	2,691	5,027
	<u>31,732</u>	<u>42,184</u>
Less Allowance for Doubtful Accounts	(3,685)	(3,859)
	<u>\$ 28,047</u>	<u>\$ 38,325</u>

F-11

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)****9. Inventories**

Inventories consist of the following:

	<u>July 31, 2005</u>	<u>April 30, 2005</u>
	(in thousands)	
Raw Materials and Parts	\$ 14,277	\$ 15,500
Work in Process	7,950	4,799
Finished Goods	6,623	6,852
	<u>28,850</u>	<u>27,151</u>
Less Provision for Slow-Moving and Obsolete Inventories	(2,816)	(2,933)
	<u>\$ 26,034</u>	<u>\$ 24,218</u>

10. Income Taxes

For the three months ended July 31, 2005 and 2004, the tax provision consists of current expense related to operations in foreign jurisdictions which are profitable and without loss carryforwards. In addition, certain operations in jurisdictions (principally Germany) reported net operating losses for which no benefit was recognized as it is more likely than not that such benefit will not be realized.

Due to a history of losses and uncertainty of future earnings, the Company continues to provide a full valuation allowance against its net operating losses and other net deferred tax assets, arising in all tax jurisdictions except Sweden because the realization of such assets is not more likely than not. The domestic net operating losses can be carried forward 20 years to offset domestic profits in future periods and expire from fiscal 2022 through fiscal 2024 and other foreign net operating losses do not have an expiration date.

In fiscal 2004, the Company determined it was no longer able to permanently defer foreign earnings and recorded a \$1.9 million liability for withholding taxes payable on future repatriation of foreign earnings. The Company has continued to record liabilities for withholding taxes on earnings of these foreign operations. During the three months ended July 31, 2005, the Company repatriated \$1.4 million from certain foreign subsidiaries and plans to continue to repatriate additional earnings in the future.

11. Notes Payable and Long-Term Obligations

	<u>July 31, 2005</u>	<u>April 30, 2005</u>
Long Term Obligations:		
Senior Credit Agreement	\$ 7,986	\$ 9,695
Term Loans Payable	5,790	5,921
	<u>13,776</u>	<u>15,616</u>
Less Current Portion	(475)	(9,912)
	<u>\$ 13,301</u>	<u>\$ 5,704</u>
Notes Payable	<u>\$ 3,841</u>	<u>\$ 3,531</u>

F-12

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

On July 8, 2005, the Company signed a new three year credit agreement (Agreement). The Company expensed \$489,000 of fees during the three months ended July 31, 2005 related to the prior credit agreement. The Agreement provides for a revolving line of credit of up to \$30 million with a maturity date of August 1, 2008 and is collateralized by a general lien on all of the Company's assets. Interest rates under the Agreement are at LIBOR plus a percentage depending on leverage ratios or at the Bank of America's prime rate in effect from time to time, at the Company's option. LIBOR and the prime rate at July 31, 2005 were 3.52% and 6.25%, respectively. The rate in effect on the balance outstanding at July 31, 2005 was 6.25%. The Agreement requires compliance with funded debt, tangible net worth and liquidity ratios. The Company also pays an annual letter of credit fee equal to 2.5% of the amount drawn under each outstanding letter of credit. The annual letter of credit fee is payable quarterly in arrears. In addition, the Agreement, similar to prior agreements, includes a subjective acceleration clause which permits the lenders to demand payment in the event of a material adverse change.

The Company makes use of its credit facility to fund its operations during the course of the year. In the three months ended July 31, 2005, the Company borrowed an aggregate of \$16.0 million on the prior and current credit facility while repaying \$17.8 million. As of July 31, 2005, the Company had \$15.6 million of domestic unused line of credit, net of \$6.4 million in outstanding letters of credit and \$8.0 million in outstanding borrowings.

The Company was in compliance with all covenants as of July 31, 2005 and for the quarter then ended.

The Company has five unsecured credit facilities in Taiwan with a commitment totaling 268 million New Taiwanese Dollars (US\$8.4 million at July 31, 2005), bearing interest at rates ranging from 1.8% to 2.82% per annum. The credit facilities have maturities between 12 and 36 months and can be extended for like periods, as needed, at the bank's option. At July 31, 2005, the balance outstanding under these credit facilities amounts to US\$2.4 million, \$1.1 million of which is shown under Notes Payable while the remaining \$1.3 million is classified under Term Loans Payable.

The Company has also obtained a seven-year collateralized long-term loan, expiring in 2011, in the amount of 145 million New Taiwanese Dollars (US\$4.5 million at July 31, 2005) bearing interest at an annual rate of 2.85%. The loan is collateralized by the Company's recently completed manufacturing facility in Taiwan. In June 2004, the Company borrowed \$4.1 million against this facility and repatriated \$3.5 million to the U.S. to reduce amounts outstanding under the senior credit facility. The balance of \$4.4 million at July 31, 2005 is included in Term Loans Payable.

The Company has a credit facility in Sweden totaling 25 million Swedish Krona (US\$3.2 million at July 31, 2005), which is collateralized by trade receivable and inventories of the Company's Swedish subsidiary and which bears interest at the Swedish prime rate plus 0.75% (or 3.4% at July 31, 2005). At July 31, 2005, the balance outstanding amounts to US\$2.8 million and is included in Notes Payable. The line expires annually on December 31 and is renewable in yearly increments at the bank's option.

12. Warranty Obligations

The Company's estimated obligations for warranty are accrued concurrently with the revenue recognized. The Company makes provisions for its warranty obligations based upon historical costs incurred for such obligations adjusted, as necessary, for current conditions and factors. Due to the significant uncertainties and judgments involved in estimating the Company's warranty obligations, including changing product designs and specifications, the ultimate amount incurred for warranty costs could change in the near term from the current estimate.

F-13

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)****(Unaudited)**

The following table shows the fiscal 2006 year-to-date activity for the Company's warranty accrual:

	(in thousands)
Accrued warranty balance as of April 30, 2005	\$ 1,710
Accruals for warranties on fiscal 2006 year-to-date sales	329
Warranty labor and materials provided fiscal 2006 year-to-date	(514)
	<hr/>
Accrued warranty balance as of July 31, 2005	\$ 1,525
	<hr/>

13. Foreign Currency

The Company's subsidiaries have adopted the local currency of the country in which they operate as the functional currency. All assets and liabilities of these foreign subsidiaries are translated at year-end rates. Income and expense accounts of the foreign subsidiaries are translated at the average rates in effect during the year. Assets and liabilities (including inter-company accounts that are transactional in nature) of the Company which are denominated in currencies other than the functional currency of the entity are translated based on current exchange rates and gains or losses are included in the Consolidated Statement of Operations.

The following table shows the amount of net realized and unrealized foreign exchange gains (losses) included in Other Income (Expense), net, in the accompanying Consolidated Statements of Operations:

	Three Months Ended July 31,	
	2005	2004
	<hr/>	<hr/>
	(in thousands)	
Realized Foreign Exchange Gains, Net	\$ 129	\$ 527
Unrealized Foreign Exchange Gains (Losses), Net	372	(660)
	<hr/>	<hr/>
	\$ 501	\$ (133)
	<hr/>	<hr/>

14. Commitments and Contingencies

At any time, the Company may be involved in certain legal proceedings in addition to the Omax matter described below. As of July 31, 2005, the Company has accrued its estimate of the probable costs for the resolution of these claims. This estimate has been developed in consultation with legal counsel and is based upon an analysis of potential outcomes, assuming a combination of litigation and settlement strategies. The Company does not believe these proceedings will have a material adverse effect on its consolidated financial position. However, it is possible that future results of operations or cash flows for any particular quarterly or annual period could be materially affected by changes in the Company's assumptions, or the effectiveness of its strategies, related to these proceedings.

On November 18, 2004, Omax Corporation (Omax) filed suit against the Company alleging that the Company's products infringe on Omax's patents. The suit also seeks to have a specific patent held by the Company declared invalid. The Company asserts that it does not infringe Omax's patents and Omax's patents are invalid and unenforceable. In its counterclaim, the Company seeks damages from Omax for violation of antitrust laws and injunctive relief and damages for infringement of the Company's patent. The trial date has been set for September 2006. Although the Omax suit seeks damages of over \$100 million, the Company believes Omax's claims are without merit and intends not only to contest Omax's allegations of infringement but also to

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

vigorously pursue its claims with regard to its own patent. Accordingly, the Company has not provided any loss contingency accrual related to the Omax lawsuit as of July 31, 2005. The Company will incur legal expenses as part of this lawsuit and will expense them as incurred. While an exact amount of legal fees is not known at this time, the total fees are expected to be more than \$1 million over the next year to two years.

15. New Accounting Pronouncements

During October 2004, the FASB ratified the consensus reached by the EITF with respect to EITF Issue No. 04-10, Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds (EITF 04-10), which clarifies the guidance in paragraph 19 of FAS No. 131, Disclosures about Segments of an Enterprise and Related Information (FAS No. 131). According to EITF 04-10, operating segments that do not meet the quantitative thresholds can be aggregated under paragraph 19 only if aggregation is consistent with the objective and basic principle of FAS No. 131, the segments have similar economic characteristics, and the segments share a majority of the aggregation criteria listed in items (a)-(e) in paragraph 17 of FAS No. 131. The FASB staff is currently working on a FASB Staff Position (FSP) to provide guidance in determining whether two or more operating segments have similar economic characteristics. The effective date of EITF 04-10 has been delayed in order to coincide with the effective date of the anticipated FSP, with early application is permitted. The adoption of EITF 04-10 is not expected to have an impact on the Company's Consolidated Financial Statements.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, Inventory Costs—an Amendment of ARB No. 43, Chapter 4. This statement clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and spoilage, requiring these items be recognized as current-period charges. In addition, this statement requires that allocation of fixed production overheads to the costs of conversion be based on the normal capacity of the production facilities. The provisions of this statement are effective for inventory costs incurred during fiscal years beginning after June 15, 2005 and will become effective for the Company beginning in May 2006. The full impact that the adoption of this statement will have on the Company's financial position and results of operations has not yet been determined.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 153, Exchanges of Nonmonetary Assets (FAS 153), which eliminates the exception for nonmonetary exchanges of similar productive assets and replaces it with a general exception for exchanges of nonmonetary assets that do not have commercial substance. FAS 153 will be effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company does not believe the adoption of FAS 153 will have a material impact on its financial statements.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123R, Share-Based Payment (Revised 2004). This statement addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for the company's equity instruments or liabilities that are based on the fair value of the company's equity securities or may be settled by the issuance of these securities. SFAS 123R eliminates the ability to account for share-based compensation using APB 25 and generally requires that such transactions be accounted for using a fair value method. The provisions of this statement are effective for financial statements issued for the first interim period following the Company's fiscal year that begins on or after June 15, 2005 and will become effective for the Company beginning with the first quarter of the fiscal 2007 year. The Company has not yet determined which transition method it will use to adopt SFAS 123R. The

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

full impact that the adoption of this statement will have on the Company's financial position and results of operations will be determined by share-based payments granted in future periods.

F-15

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

In March 2005, the FASB issued FASB Staff Position (FSP) FIN 46(R)-5, Implicit Variable Interests Under FIN 46(R). FSP FIN 46(R)-5 states that a reporting entity should consider whether it holds an implicit variable interest in a variable interest entity (VIE) or in a potential VIE. If the aggregate of the explicit and implicit variable interests held by the reporting entity and its related parties would, if held by a single party, identify that party as the primary beneficiary, the party within the group most closely associated with the VIE should be deemed the primary beneficiary. The guidance of FSP FIN 46(R)-5 is effective for the reporting period beginning after March 3, 2005. The Company adopted FSP FIN 46(R)-5 during the three months ended July 31, 2005 without a material impact on its Consolidated Financial Statements.

In March 2005, the FASB also issued FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47). FIN 47 clarifies that an entity must record a liability for a conditional asset retirement obligation if the fair value of the obligation can be reasonably estimated. FIN 47 is effective no later than the end of fiscal years ending after December 15, 2005. The Company does not expect the adoption of FIN 47 to have a material effect on its Consolidated Financial Statements.

16. Subsequent Events

On August 26, 2005, the Company entered into a Purchase Agreement (the Purchase Agreement) with Barton Mines Company (Barton) to give Barton exclusive rights to sell abrasive to the Company's customers for \$2.5 million in cash at closing, future annual payments of \$250,000 for the next three years based on achievement of system sales targets and royalty payments for systems sold over the next 10 years.

On October 31, 2005, the Company completed the sale of the North America Press and International Press reportable segments, as well as the non ultrahigh-pressure portion of the Food reportable segment with the Gores Technology Group, LLC (Gores) for estimated net proceeds of \$14.0 million, comprised of cash and notes. An \$8.0 million 8% note is due 90 days subsequent to the closing of the transaction while the other \$2.0 million 6% note is due in three years. At closing, the Company also entered into a Supply Agreement with Gores whereby it has agreed to supply certain high pressure pump products on an exclusive basis to Gores. These segments do not meet the accounting criteria to be considered assets held for sale as of July 31, 2005 and accordingly the results of operations are shown as continuing operations and the related assets have not been reported as held for sale in our financial statements.

Table of Contents

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

To the Board of Directors and Shareholders of

Flow International Corporation

In our opinion, the consolidated financial statements listed in the accompanying index present fairly, in all material respects, the financial position of Flow International Corporation (the Company) and its subsidiaries at April 30, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended April 30, 2005, in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and financial statement schedule based on our audits. We conducted our audits of these statements in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As further described in Note 1, the Company adopted the provisions of EITF 00-21 Revenue Arrangements with Multiple Deliverables effective August 1, 2003 and the provisions of FIN 46R Consolidation of Variable Interest Entities effective February 1, 2004.

As discussed in Note 2, the Company has restated its consolidated balance sheet at April 30, 2004 and its consolidated financial statements as of and for the year ended April 30, 2005.

/s/ PRICEWATERHOUSECOOPERS LLP

Seattle, Washington

July 29, 2005, except for Note 2 and Note 21, as to which the date is November 21, 2005

F-17

Table of Contents

FLOW INTERNATIONAL CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands, except share amounts)

	April 30,	
	2005	2004
	(restated)	(restated)
ASSETS:		
Current Assets:		
Cash and Cash Equivalents	\$ 12,976	\$ 11,734
Restricted Cash	469	1,101
Receivables, net	38,325	39,006
Inventories, net	24,218	26,384
Deferred Income Taxes		1,025
Prepaid Expenses	6,064	3,630
Other Current Assets	2,632	1,932
	<u>84,666</u>	<u>84,812</u>
Total Current Assets	84,666	84,812
Property and Equipment, net	12,634	14,200
Intangible Assets, net	14,644	14,251
Goodwill	2,764	11,260
Deferred Income Taxes	1,532	
Other Assets	2,227	4,749
	<u>\$ 118,467</u>	<u>\$ 129,272</u>
	<u>\$ 118,467</u>	<u>\$ 129,272</u>
LIABILITIES AND SHAREHOLDERS (DEFICIT) EQUITY:		
Current Liabilities:		
Notes Payable	\$ 3,531	\$ 8,687
Current Portion of Long-Term Obligations	9,912	40,040
Accounts Payable	20,842	15,123
Accrued Payroll and Related Liabilities	8,819	7,734
Taxes Payable and Other Accrued Taxes	2,291	4,212
Deferred Income Taxes	609	
Deferred Revenue	4,646	3,028
Customer Deposits	10,606	4,327
Warrant Obligation	6,696	
Other Accrued Liabilities	10,481	10,666
	<u>78,433</u>	<u>93,817</u>
Total Current Liabilities	78,433	93,817
Long-Term Obligations, net	5,704	38,081
Deferred Income Taxes		55
Other Long-Term Liabilities	3,129	4,511
	<u>87,356</u>	<u>136,464</u>
	<u>87,356</u>	<u>136,464</u>

Commitments and Contingencies		
Minority Interest	2,401	2,360
Shareholders' Equity (Deficit):		
Series A 8% Convertible Preferred Stock \$.01 par value, 1,000,000 shares authorized, none issued		
Common Stock \$.01 par value, 49,000,000 shares authorized, 33,495,479 shares outstanding at April 30, 2005 15,509,853 shares outstanding at April 30, 2004	335	156
Capital in Excess of Par	112,512	54,686
Accumulated Deficit	(80,581)	(59,965)
Accumulated Other Comprehensive Loss:		
Cumulative Translation Adjustment, net of income tax of \$0	(3,506)	(4,684)
Unrealized (Loss) Gain on Cash Flow Hedges, net of income tax of \$19 and (\$99)	(50)	255
Total Shareholders' Equity (Deficit)	28,710	(9,552)
	\$ 118,467	\$ 129,272

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

Table of Contents**FLOW INTERNATIONAL CORPORATION****CONSOLIDATED STATEMENTS OF OPERATIONS****(In thousands, except per share amounts)**

	Year Ended April 30,		
	2005		
	(restated)	2004	2003
Sales	\$ 219,365	\$ 177,609	\$ 144,115
Cost of Sales	138,536	112,382	108,074
Gross Margin	80,460	65,227	36,041
Operating Expenses:			
Marketing	32,657	28,422	37,398
Research and Engineering	9,067	10,651	13,501
General and Administrative	26,988	23,261	23,026
Restructuring Charges	239	3,256	
Financial Consulting Charges	623	1,520	
Impairment Charges	9,064		10,815
	78,638	67,110	84,740
Operating (Loss) Income	1,822	(1,883)	(48,699)
Interest Expense	(20,559)	(13,171)	(11,848)
Interest Income	157	386	686
Other Income (Expense), net	302	7,817	3,000
Loss Before Provision for Income Taxes	(18,278)	(6,851)	(56,861)
Provision for Income Taxes	(2,338)	(5,197)	(12,603)
Loss Before Discontinued Operations	(20,616)	(12,048)	(69,464)
Discontinued Operations, Net of Tax		526	(523)
Net Loss	\$ (20,616)	\$ (11,522)	\$ (69,987)
Loss Per Share			
Basic and Diluted			
Loss Before Discontinued Operations	\$ (1.16)	\$ (.78)	\$ (4.53)
Discontinued Operations, Net of Tax		.03	(.03)
Net Loss	\$ (1.16)	\$ (.75)	\$ (4.56)

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

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

F-19

Table of Contents**FLOW INTERNATIONAL CORPORATION****CONSOLIDATED STATEMENTS OF CASH FLOWS****(In thousands)**

	Year Ended April 30,		
	2005		
	(restated)	2004	2003
Cash Flows from Operating Activities:			
Net Loss	\$ (20,616)	\$ (11,522)	\$ (69,987)
Adjustments to Reconcile Net Loss to Cash Provided by Operating Activities:			
Depreciation and Amortization	5,109	6,167	10,112
Deferred Income Taxes	(198)	646	11,208
Minority Interest	41	35	79
Gain on Sale of Equity Securities		(2,618)	
Gain on Sale of Discontinued Operations		(650)	
Write-off of Capitalized Bank Fees and Debt Discount	6,815		
Fair Value Adjustment on Warrants Issued	274		
Provision for Losses on Trade Accounts Receivable			4,072
Provision for Slow Moving and Obsolete Inventory			2,554
Tax Effect of Exercised Stock Options			49
Stock Compensation	1,585	763	235
Impairment Charges	9,064		10,815
Loss on Disposal and Write-Down of Operating Assets		1,613	8,052
Foreign Currency (Gains) Losses	(1,443)	(2,791)	(5,420)
Amortization of Debt Discount	1,112	907	801
Other	124		
Changes in Operating Assets and Liabilities:			
Receivables	2,094	(8,886)	28,578
Inventories	3,048	14,199	6,231
Prepaid Expenses	(2,745)	(300)	4,710
Other Current Assets	(238)	2,435	(2,088)
Other Long-Term Assets	1,268	981	4,578
Accounts Payable	5,255	2,366	(1,725)
Accrued Payroll and Related Liabilities	1,607	3,028	(711)
Deferred Revenue	1,491	(2,059)	584
Customer Deposits	6,024	5,418	(4,096)
Other Accrued Liabilities and Other Accrued Taxes	4,085	1,979	3,186
Other Long-Term Liabilities	(1,676)	526	(1,561)
Cash Provided by Operating Activities	22,080	12,237	10,256
Cash Flows From Investing Activities:			
Expenditures For Property and Equipment	(1,762)	(5,863)	(4,671)
Proceeds from Sale of Equity Securities		3,275	
Proceeds from Sale of Discontinued Operations		1,837	
Proceeds from Sale of Property and Equipment	783		2,176
Restricted Cash	1,758	(2,156)	
Other	31	500	
Cash Provided by (Used in) Investing Activities	810	(2,407)	(2,495)

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Cash Flows from Financing Activities:

Borrowings (Repayments) Under Notes Payable, net	(5,633)	3,697	3,753
Payments on Senior Credit Agreement	(82,607)	(46,530)	(51,998)
Borrowings on Senior Credit Agreement	52,321	30,087	53,250
Payments of Long-Term Obligations	(49,023)	(1,054)	(4,877)
Borrowings on Long-Term Obligations	4,079	1,200	
Proceeds from Issuance Of Common Stock and Warrants	59,287		428
Proceeds from Exercise of Options	107		
	<u> </u>	<u> </u>	<u> </u>
Cash (Used in) Provided by Financing Activities	(21,469)	(12,600)	556
	<u> </u>	<u> </u>	<u> </u>
Effect of Exchange Rate Changes	(179)	(541)	(392)
	<u> </u>	<u> </u>	<u> </u>
(Decrease) Increase in Cash And Cash Equivalents	1,242	(3,311)	7,925
Cash and Cash Equivalents at Beginning of Period	11,734	15,045	7,120
	<u> </u>	<u> </u>	<u> </u>
Cash and Cash Equivalents at End of Period	\$ 12,976	\$ 11,734	\$ 15,045
	<u> </u>	<u> </u>	<u> </u>

Supplemental Disclosures of Cash Flow Information

Cash Paid during the Year for:

Interest	\$ 9,810	\$ 7,472	\$ 8,161
Income Taxes	2,970	2,940	2,179

Supplemental Disclosures of Noncash Financing Activity

Capitalization of Interest on Long-Term Obligations	\$ 7,061	\$ 7,875	\$
Capital Lease Obligations	167		

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

Table of Contents

FLOW INTERNATIONAL CORPORATION

**CONSOLIDATED STATEMENTS OF SHAREHOLDERS (DEFICIT) EQUITY
AND COMPREHENSIVE LOSS**

(In thousands)

	Common Stock		Capital In Excess of Par	Retained Earnings (Accumulated Deficit)	Accumulated Other Comprehensive Loss	Total Shareholders Equity (Deficit)
	Shares	Par Value				
Balances, April 30, 2002	15,282	\$ 153	\$ 53,214	\$ 21,544	\$ (3,857)	\$ 71,054
Components of Comprehensive Loss:						
Net Loss				(69,987)		(69,987)
Unrealized Gain on Equity Securities Available for Sale, Net of Income Tax of \$417					809	809
Unrealized Gain on Cash Flow Hedges, Net of Income Tax of \$29					73	73
Reclassification Adjustment for Settlement of Cash Flow Hedges, net of income tax of \$21					(53)	(53)
Cumulative Translation Adjustment, Net of Income Tax of \$0					2,264	2,264
Total Comprehensive Loss						(66,894)
Exercise of Stock Options	77	1	427			428
Stock Compensation			284			284
Balances, April 30, 2003	15,359	154	53,925	(48,443)	(764)	4,872
Components of Comprehensive Loss:						
Net Loss				(11,522)		(11,522)
Reclassification Adjustment for Sale of Equity Securities, Net of Income Tax of \$0					(809)	(809)
Unrealized Gain on Cash Flow Hedges, Net of Income Tax of \$277					713	713
Reclassification Adjustment for Settlement of Cash Flow Hedges, net of income tax of \$23					58	58
Cumulative Translation Adjustment, Net of Income Tax of \$0					(3,627)	(3,627)
Total Comprehensive Loss						(15,187)
Stock Compensation	151	2	761			763
Balances, April 30, 2004	15,510	156	54,686	(59,965)	(4,429)	(9,552)
Components of Comprehensive Loss:						
Net Loss (restated)				(20,616)		(20,616)
Unrealized Gain on Cash Flow Hedges, Net of Income Tax of \$133					(343)	(343)
Reclassification Adjustment for Settlement of Cash Flow Hedges, net of income tax of \$15					38	38

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Cumulative Translation Adjustment, Net of Income Tax of \$0					1,178	1,178
Total Comprehensive Loss						(19,743)
Issuance of Common Stock	17,473	175	52,690			52,865
Issuance of Warrants (restated)			2,690			2,690
Stock Compensation (restated)	512	4	2,446			2,450
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>
Balances, April 30, 2005 (restated)	33,495	\$ 335	\$ 111,715	\$ (80,581)	\$ (3,556)	\$ 28,710
	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>	<u> </u>

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

F-21

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the three years ended April 30, 2005

(All tabular dollar amounts in thousands, except per share and option amounts)

Note 1 The Company and Summary of Significant Accounting Policies:

Operations and Segments

Flow International Corporation (Flow or the Company) designs, develops manufactures, markets, installs and services ultrahigh-pressure (UHP) water pumps and UHP water management systems. Flow s core competency is UHP water pumps. Flow s UHP water pumps pressurize water from 40,000 to over 100,000 pounds per square inch (psi) and are integrated with water delivery systems so that water can be used to cut or clean material or pressurize food. Flow s products include both standard and specialized waterjet cutting and cleaning systems together with the Fresher Under Pressure® food processing technology. In addition to UHP water systems, the Company provides automation and articulation systems and isostatic and flexform press systems. The Company provides technologically-advanced, environmentally-sound solutions to the manufacturing, industrial, marine cleaning and food markets.

The Company uses seven reportable segments to analyze its operations. Four segments, North America Waterjet, Asia Waterjet, Other International Waterjet and Other (together known as Waterjet), utilize the Company s released pressure technology. The remaining three segments, Food, North America Press and International Press (together known as Avure), utilize the Company s contained pressure technology. The Waterjet operation includes cutting and cleaning operations, which are focused on providing total solutions for the aerospace, automotive, job shop, surface preparation and paper industries. The Avure operation includes the Fresher Under Pressure food processing technology, as well as the isostatic and flexform press (General Press) operations. The Fresher Under Pressure technology provides food safety and quality enhancement solutions for food producers, while the General Press business manufactures systems which produce and strengthen advanced materials for the aerospace, automotive and medical industries. Equipment is designed, developed, and manufactured at the Company s principal facilities in Kent, Washington, and at manufacturing facilities in Burlington, Canada; Columbus, Ohio; Hsinchu, Taiwan; Jeffersonville, Indiana; Wixom, Michigan and Västerås, Sweden. The Company markets its products to customers worldwide through its principal offices in Kent and its support offices in Argentina, Brazil, Canada, China, France, Germany, Italy, Japan, Korea, Spain, Sweden, Switzerland, Taiwan, and the United Kingdom.

Principles of Consolidation

The Consolidated Financial Statements include the accounts of Flow International Corporation and its majority-owned subsidiaries. There are properly no investments in affiliate companies in which the Company accounts for under either the equity or cost method. All significant intercompany transactions and accounts have been eliminated.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

In January 2003, the FASB issued Interpretation No. 46 (FIN 46), Consolidation of Variable Interest Entities, as revised in December 2003 by FIN 46R. The new rule requires that companies consolidate a variable interest entity (VIE) if the company is subject to a majority of the risk of loss from the VIE s activities, or is entitled to receive a majority of the entity s residual returns or both. Based upon the Company s analysis, the Company is associated with one VIE, Flow Autoclave, and has determined that it is the primary beneficiary and should, therefore, continue to include the VIE in its consolidated financial statements. Flow Autoclave is a joint venture with an unrelated third party and is involved with the domestic sales of the Company s general press technology. Flow Autoclave s sales to third party customers were less than 8% of the Company s consolidated sales for the years ended April 30, 2005, 2004 and 2003. None of Flow Autoclave s assets are collateralized on behalf of its obligations and the general creditors of Flow Autoclave do not have any recourse to the Company. The Company includes income or expense associated with the minority interest in its joint venture as part of

F-22

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Other Income (Expense), net in the accompanying Consolidated Statements of Operations. The implementation of FIN 46R in the fourth fiscal quarter of 2004 had no effect on the consolidated financial statements.

Liquidity

The Company has incurred losses during fiscal 2005, 2004 and 2003. The Company has been able to satisfy its needs for working capital and capital expenditures, due in part to its ability to access adequate financing arrangements. The Company expects that operations will continue, with the realization of assets and discharge of current liabilities in the ordinary course of business. Compliance with future debt covenants requires the Company to meet its operating projections, which include achieving certain revenues, costs, consistent operating margins, and working capital targets.

The Company believes that its existing cash and credit facilities at April 30, 2005 are adequate to fund its operations through April 30, 2006. If the Company fails to achieve its planned revenues, costs and working capital objectives, management believes it has the ability to curtail capital expenditures and reduce costs to levels that will be sufficient to enable the Company to meet its cash requirements and debt covenants through April 30, 2006.

Revenue Recognition

The Company recognizes revenue in accordance with SEC Staff Accounting Bulletin No. 104 (SAB 104), Revenue Recognition in Financial Statements. SAB 104 requires that revenue can only be recognized when it is realized or realizable and earned. Revenue generally is realized or realizable and earned when all four of the following criteria have been met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services rendered; (3) the price is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criterion (4) is based on the Company's judgment regarding the collectibility of those amounts. Should changes in conditions cause us to determine this criterion is not met for future transactions, revenue recognized for any reporting period could be adversely affected.

During the second quarter of fiscal 2004, the Company adopted EITF Issue No. 00-21 (EITF 00-21), Revenue Arrangements with Multiple Deliverables on a prospective basis. EITF 00-21, which was subsequently included in SAB 104, provides guidance on how to account for arrangements that involve the delivery or performance of single or multiple products, services and/or rights to use assets. For standard systems, the Company's multiple deliverables are: (1) the standard system and (2) the installation thereof. If payment is contingent upon system installation and the system installation does not occur prior to a period end, the system revenue recognized is the lesser of the cash received or the estimated relative fair value of the system. The adoption of EITF 00-21 did not have a significant effect on the consolidated financial statements. Revenue for consumables is recognized at the time of shipment. System sales are substantiated by signed customer contracts which quote a fixed price. Revenue related to the installation portion of a system sale is recognized when the service has been rendered. Collectibility of accounts is reasonably assured at the time of sale.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

For non-standard and long lead time systems, including the Avure operation, the Company recognizes revenues using the percentage of completion method in accordance with Statement of Position 81-1 (SOP 81-1), Accounting for Performance of Construction-Type and Certain Production-Type Contracts. Typical lead times for non-standard systems can range from six to 18 months. The Company uses the cost to cost method, measuring the costs incurred on a project at a specified date, as compared to the estimated total cost of the project. As manufacturing costs are incurred, a corresponding amount of unbilled revenue is recorded. The balance is reclassified to trade accounts receivable when a milestone is achieved and a customer billing is issued. The balance of trade accounts receivables and unbilled revenues will therefore vary based on the timing of completion on non-standard systems as well as the timing of the related billings to the respective customers.

F-23

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Shipping revenues and expenses are recorded in revenue and costs of goods sold, respectively.

Cost of Sales

Cost of sales includes direct and indirect costs associated with the manufacture, installation and service of its systems and consumable parts sales. Direct costs include material and labor, while indirect costs include, but are not limited to, inbound freight charges, purchasing and receiving costs, inspection costs, warehousing costs, internal transfer costs and other costs of our distribution network.

Cash Equivalents and Restricted Cash

The Company considers highly liquid short-term investments with original or remaining maturities from the date of purchase of three months or less, if any, to be cash equivalents. The Company's cash consists of demand deposits in large financial institutions. At times, balances may exceed federally insured limits.

The Company may, at times, pledge cash as security for customer or other commitments. These amounts are shown separately on the Consolidated Balance Sheet and classified based on the expiration of the underlying commitment.

Inventories

Inventories are stated at the lower of cost, determined by using the first-in, first-out method, or market. Costs included in inventories consist of materials, labor and manufacturing overhead, which are related to the purchase or production of inventories.

Property and Equipment

Property and equipment are stated at the lower of cost or net realizable value. Additions, leasehold improvements and major replacements are capitalized. When assets are sold, retired or otherwise disposed of, the cost and accumulated depreciation are removed from the accounts and any resulting gain or loss is reflected in the statement of operations. Depreciation for financial reporting purposes is provided using the straight-line method over the estimated useful lives of the assets, which range from three to eleven years for machinery and equipment; three to nine years for furniture and fixtures and 19 years for buildings. Leasehold improvements are amortized over the shorter of the related lease term,

or the life of the asset. Expenditures for maintenance and repairs are charged to expense as incurred.

Intangible Assets and Goodwill

Effective May 1, 2001, the Company adopted Statement of Financial Accounting Standards No. 141 (FAS 141), Business Combinations and Statement of Financial Accounting Standards No. 142 (FAS 142), Goodwill and Other Intangible Assets. FAS 141 requires that all business combinations be accounted for under the purchase method only and that certain acquired intangibles in a business combination be recognized as assets separate from goodwill. In accordance with FAS 142, the Company amortizes identified definite-lived intangible assets over their expected useful lives and does not amortize goodwill. At least once per year, the Company will compare the fair value of its reporting units, and, if necessary, the implied fair value of goodwill, with the corresponding carrying values. If necessary, the Company will record an impairment charge for any shortfall. The Company determines the fair value of its reporting units using a discounted cash flow model. If certain criteria are satisfied, the Company may also carry forward the fair value estimate from the prior year. In

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

accordance with FAS 142, the Company conducted its annual impairment review of goodwill at April 30, 2005, which did not result in any impairment charges.

Intangible assets consist of acquired and internally developed patents and are amortized on a straight-line basis over the shorter of fifteen years, or the estimated remaining life of the patent. The total carrying amount of intangible assets was \$27,998,000 and \$26,100,000 at April 30, 2005 and 2004, respectively. Accumulated amortization was \$13,354,000 and \$11,849,000 at April 30, 2005 and 2004, respectively.

Aggregate amortization expense for the year ended April 30, 2005, 2004 and 2003 amounted to \$1,505,000, \$1,439,000, and \$1,611,000, respectively. The estimated annual amortization expense is \$1,300,000 for each year through April 30, 2009.

During fiscal 2003, the Company conducted an interim detailed review of the carrying value of its goodwill. FAS 142 requires a company to perform impairment testing when certain triggering events affecting a business unit have occurred. The triggering events were the expectation of sale or full or partial disposal of certain Flow divisions and the continuing deterioration of the economic climate. The Company's review resulted in impairment charges of \$7.1 million during the quarter ended January 31, 2003. The impairment resulted primarily from continued weakness in the automotive industry, as well as poor performance at the Company's European operations. The fair value of those reporting units and the estimated fair value of goodwill was estimated using the expected present value of future cash flows.

Impairment of Long-Lived Assets

In accordance with Statement of Financial Accounting Standard No. 144 (FAS 144), Accounting for the Impairment or Disposal of Long-Lived Assets, the Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amounts of assets may not be recoverable. The carrying value of long-lived assets is assessed for impairment by evaluating operating performance and future undiscounted cash flows of the underlying assets. If the sum of the expected future net cash flows of an asset, is less than its carrying value, an impairment measurement is required. Impairment charges are recorded to the extent that an asset's carrying value exceeds fair value. Accordingly, actual results could vary significantly from such estimates. The Company's review resulted in no impairment charges during the years ended April 30, 2005 and 2004 and charges of \$3.7 million during the year ended April 30, 2003.

Fair Value of Financial Instruments

The carrying amount of all financial instruments on the balance sheet as of April 30, 2005 and 2004 approximates fair value. The carrying value of variable-rate long-term obligations and notes payable approximates the fair value because interest rates reflect current market conditions.

Concentration of Credit Risk

In countries or industries where the Company is exposed to significant credit risk, sufficient collateral, including cash deposits and/or letters of credit, is required prior to the completion of a transaction. The Company does not believe there is a material credit risk beyond that provided for in the consolidated financial statements in the ordinary course of business. The Company makes use of foreign exchange contracts to cover some transactions denominated in foreign currencies, and does not believe there is an associated material credit or financial statement risk.

F-25

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Warranty Liability

Products are warranted to be free from material defects for a period of one year from the date of installation. Warranty obligations are limited to the repair or replacement of products. The Company's warranty accrual is reviewed quarterly by management for adequacy based upon recent shipments and historical warranty experience. Credit is issued for product returns upon receipt of the returned goods, or, if material, at the time of notification and approval.

Product Liability

The Company is obligated under terms of its product liability insurance contracts to pay all costs up to deductible amounts. These costs are reported in general and administrative expenses and include insurance, investigation and legal defense costs.

Income Taxes

The Company accounts for income taxes under the asset and liability method, which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the carrying amounts and the tax bases of assets and liabilities. If it is more likely than not that some portion of a deferred tax asset will not be realized, a valuation allowance is recorded.

Foreign Currency Translation

The Company's subsidiaries have adopted the local currency of the country in which they operate as the functional currency. All assets and liabilities of these foreign subsidiaries are translated at year-end rates. Income and expense accounts of the foreign subsidiaries are translated at the average rates in effect during the year. Adjustments resulting from the translation of the investments in Flow Asia, Flow Automation, Flow Europe, Foracon, Flow Japan, Flow South America, and Avure AB financial statements are recorded in the Accumulated Other Comprehensive Loss account in the Shareholders' Equity (Deficit) section of the accompanying Consolidated Balance Sheets.

Assets and liabilities (including inter-company accounts that are transactional in nature) of the Company which are denominated in currencies other than the functional currency of the entity are translated based on current exchange rates and gains or losses are included in the Consolidated Statement of Operations. For the years ended April 30, 2005, 2004 and 2003, a net realized and unrealized foreign exchange gain of \$531,000, \$5.0 million, and \$3.2 million, respectively, is included in Other Income (Expense), net, in the accompanying Consolidated Statements of Operations.

Other Income (Expense)

Other Income (Expense), net consists of the following:

	Year Ended April 30,		
	2005		
	(restated)	2004	2003
	<u> </u>	<u> </u>	<u> </u>
Net realized foreign exchange gains (losses)	\$ 1,359	\$ 2,155	\$ (2,089)
Net unrealized foreign exchange (losses) gains	(827)	2,827	5,307
Realized gain on sale of equity securities		2,618	
Write-off of investment and other assets			(35)
Minority interest in joint venture	(40)	(35)	(79)
Other	(190)	252	(104)
	<u> </u>	<u> </u>	<u> </u>
Total	\$ (302)	\$ 7,817	\$ 3,000
	<u> </u>	<u> </u>	<u> </u>

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Basic and Diluted Loss Per Share

Basic loss per share represents net loss available to common shareholders divided by the weighted average number of shares outstanding during the period. Diluted loss per share represents net loss available to common shareholders divided by the weighted average number of shares outstanding including the potentially dilutive impact of stock options, where appropriate. Common stock equivalents include stock options and warrants. Potential common share equivalents of stock options and warrants are computed by the treasury stock method and are included in the denominator for computation of earnings per share if such equivalents are dilutive.

The following table sets forth the computation of basic and diluted loss per share for the years ended April 30, 2005, 2004 and 2003:

	Year Ended April 30,		
	2005	2004	2003
	(restated)		
Numerator:			
Net loss	\$ (20,616)	\$ (11,522)	\$ (69,987)
Denominator:			
Denominator for basic loss per share weighted average shares	17,748	15,415	15,348
Dilutive potential common shares from employee stock options			
Dilutive potential common shares from warrants			
Denominator for diluted loss per share weighted average shares and assumed conversions	17,748	15,415	15,348
Basic and diluted loss earnings per share	\$ (1.16)	\$ (0.75)	\$ (4.56)

There were 2,034,546, 2,089,412 and 2,500,682 of potentially dilutive common shares from employee stock options and 3,219,245, 860,000 and 860,000 of potentially dilutive shares from warrants which have been excluded from the diluted weighted average share denominator for fiscal 2005, 2004 and 2003, respectively, as their effect would be anti-dilutive.

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Stock-Based Compensation

At April 30, 2005, the Company has three stock-based employee compensation plans, which are described more fully in Note 11. The Company accounts for those plans under the recognition and measurement provisions of APB Opinion No. 25, Accounting for Stock Issued to Employees, and related interpretations. No stock-based employee compensation cost is reflected in the Company's net loss to the extent options granted under those plans have an exercise price equal to the market value of the underlying common stock on the date of grant. Awards under the Company's plans typically vest over two years. The cost related to stock-based employee compensation included in the determination of net loss for the three years ended April 30, 2005 is less than that which would have been recognized if the fair value based method had been applied to all awards since the original effective date of Financial Accounting Standards No. 123 (FAS 123), Accounting for Stock Based Compensation. The following table illustrates the effect on net loss and loss per share if the fair value based method had been applied to all outstanding and unvested awards in each period:

	Year Ended April 30,		
	2005	2004	2003
	(restated)		
Net loss, as reported	\$ (20,616)	\$ (11,522)	\$ (69,987)
Add: Stock compensation included in net loss, net of related tax effects	1,046	504	155
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of tax related effects	1,090	(878)	(414)
Pro forma net loss	\$ (20,660)	\$ (11,896)	\$ (70,246)
Loss per share - basic and diluted:			
As reported	\$ (1.16)	\$ (0.75)	\$ (4.56)
Pro forma	\$ (1.16)	\$ (0.77)	\$ (4.58)

Use of Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S. requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosures 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 from those estimates. Significant estimates that are susceptible to significant change in the near term are the percentage of completion estimates and the adequacy of the allowance for obsolete inventory, warranty obligations, doubtful accounts receivable, and deferred tax assets.

Note 2 Restatement:

The Company has identified errors in the Consolidated Financial Statements related to the impairment of goodwill, the valuation of anti-dilution warrants, additional costs incurred on percentage-of-completion contracts and the presentation of percentage-of-completion related balances on the Consolidated Balance Sheet, the computation of stock compensation expense, the allocation of the valuation allowance to deferred tax asset and liability balances, the recording of straight-line rent expense, and the classification of technical service expenses.

The Company has reviewed its goodwill impairment analysis under Statement of Financial Accounting Standards No. 142 (FAS 142), Goodwill and Other Intangible Assets and concluded that its original determination that there was no impairment as of April 30, 2005 was incorrect. The Company had originally concluded that it was appropriate to carry-forward its valuation analysis from April 30, 2003 to April 30, 2005, because management believed there was a less than remote possibility that an updated

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

analysis would result in a valuation of the reporting units' goodwill being less than book value. Prior to the original filing of its Form 10-K, the Company had discussions with a potential buyer and had received an indication of intent to purchase three of its reporting segments for a value that was less than the related carrying value, thus indicating that using the April 30, 2003 analysis was no longer appropriate. The Company has prepared an updated valuation analysis on an individual reporting unit basis using the expected offer price which resulted in the determination that the goodwill for the International Press and North America Press reportable segments was fully impaired as of April 30, 2005. Accordingly, the restated financial statements reflect in the Consolidated Statement of Operations for the year ended April 30, 2005 an impairment charge and reduction in net income of \$8.7 million and in the Consolidated Balance Sheet as of April 30, 2005 a reduction of \$9.1 million in Goodwill and \$383,000 reduction in Minority Interest. Upon consummation of the sale of the North America and International Press reportable segments as well as the non ultrahigh-pressure portion of the Food reportable segment on October 31, 2005, as discussed in Note 21 to the Consolidated Financial Statements, the Company expects to realize a gain on the disposition of this asset group.

The Company assessed the valuation of anti-dilution warrants issued on March 21, 2005 to its senior and subordinated lenders and concluded that it had computed the value of these warrants using the stock price as of an incorrect date. On March 21, 2005, the Company issued approximately 304,000 anti-dilution warrants to its existing senior and subordinated lenders in conjunction with the closing of a Private Investment in Public Equity (PIPE) transaction. In valuing these warrants under the Black-Scholes method, the Company used the fair market value of the stock of \$3.70 which was equivalent to the stock price on the day the PIPE transaction was entered into. This yielded a valuation of \$1.1 million. The expense associated with the warrants was written off to interest expense as the underlying debt was paid off. The Company subsequently realized that it should have used the fair market value of the stock on the date the PIPE transaction closed of \$5.70 as this was the date the Company became obligated to issue the anti-dilution warrants and the number of warrants to be issued was determined. This higher stock price yielded a valuation of \$1.7 million for the warrants, a difference of \$608,000. This change in valuation increased the amount charged to Interest Expense for the year ended April 30, 2005 by \$564,000 while increasing Prepaid Expenses by \$44,000 and Capital In Excess of Par by \$608,000 in the Consolidated Balance Sheet as of April 30, 2005.

The Company determined that its Cost of Sales in the Consolidated Statement of Operations was understated for several loss contracts accounted for using the percentage-of-completion method as the estimates for cost to complete were not updated prior to the issuance of the Company's financial statements. The Company has accrued an additional \$261,000 in costs in Cost of Sales in its Consolidated Statement of Operations for the year ended April 30, 2005 and in Other Accrued Liabilities on the Consolidated Balance Sheet as of April 30, 2005. In addition, the Company noted inconsistencies between its divisions in the balance sheet presentation of accounts receivable and cash receipts relating to contracts accounted for using the percentage-of-completion method. The Company has, therefore, adjusted its Consolidated Balance Sheet to reflect a consistent presentation and comply with the provisions of SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts. The effect of these adjustments was to decrease Receivables, net and Customer Deposits by \$4.5 million and \$5.9 million as of April 30, 2005 and 2004, respectively.

The Company also concluded that its computation of compensation expense for performance based equity awards was recorded on a quarter-by-quarter basis only, rather than on a year-to-date true-up basis, thereby understating the compensation amount. In addition, the Company did not record a stock award for services rendered. These corrections increased General & Administrative Expense by \$189,000 in the Consolidated Statement of Operations for the year ended April 30, 2005 and Capital In Excess of Par in the Consolidated Balance Sheet as of April 30, 2005.

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company noted that its deferred tax valuation allowance had been inappropriately classified in its Consolidated Balance Sheet. Specifically, Financial Accounting Standard No. 109 (FAS 109), Accounting for Income Taxes , provides that the valuation allowance for a particular tax jurisdiction shall be allocated between current and noncurrent deferred tax assets on a pro rata basis, rather than against noncurrent then current deferred tax assets. Consequently, the Company has revised its Consolidated Balance Sheet to reflect the proper allocation of the valuation allowance between current and noncurrent deferred tax balances. This adjustment reduced current deferred tax assets by \$923,000 and increased current deferred tax liability and noncurrent deferred tax assets by \$609,000 and \$1.5 million as of April 30, 2005, respectively. The reclassification as of April 30, 2004 increased current deferred tax assets and increased non-current deferred tax liabilities by \$55,000.

Further, the Company determined that it had not consistently applied Statement of Financial Accounting Standard No. 13 (FAS 13), Accounting for Leases , to leases with rent escalation clauses. As a result, the Company increased Cost of Sales by \$108,000 and General & Administrative Expenses by \$16,000 in the Consolidated Statement of Operations for the year ended April 30, 2005 to properly reflect rent on a straight-line basis. Other Accrued Liabilities and Other Long-Term Liabilities in the Consolidated Balance Sheet as of April 30, 2005 increased by \$31,000 and \$93,000, respectively, to reflect the corresponding deferred rent liability.

Lastly, the Company reviewed the classification of its technical services expenses for North America Waterjet for the year ended April 30, 2005 and concluded that these expenses, amounting to \$625,000, were improperly included as Research & Engineering Expenses. The Company has reclassified such expenses into Marketing Expenses consistent with prior period presentation in the Consolidated Statement of Operations.

Amounts included in the determination of cash provided by operating activities on the Consolidated Statement of Cash flows for the years ended April 30, 2005 and 2004 have been restated to reflect the errors identified above. Total cash flows from operating, investing and financing activities were not impacted by the restatement.

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following items in the Consolidated Statements of Operations and Consolidated Balance Sheets have been restated as follows:

	<u>Year ended April 30, 2005</u>	
	<u>As previously reported</u>	<u>Restated</u>
<i>Consolidated Statement of Operations</i>		
Cost of Sales	138,536	138,905
Gross Margin	80,829	80,460
Marketing Expenses	32,032	32,657
Research & Engineering Expenses	9,692	9,067
General & Administrative Expenses	26,783	26,988
Impairment Charge		9,064
Operating Income	11,460	1,822
Interest Expense	(19,995)	(20,559)
Other (Expense) Income, net	(81)	302
Net Loss	(10,797)	(20,616)
Net Loss per Share:		
Basic and Diluted		
Net Loss	(.61)	(1.16)

	<u>As of April 30, 2005</u>		<u>As of April 30, 2004</u>	
	<u>As previously reported</u>	<u>Restated</u>	<u>As previously reported</u>	<u>Restated</u>
<i>Consolidated Balance Sheets:</i>				
Receivables, net	42,781	38,325	44,860	39,006
Deferred Income Taxes	861		970	1,025
Prepaid Expenses	6,064	6,046	*	*
Total Current Assets	90,001	84,666	90,611	84,812
Goodwill	11,828	2,764	*	*
Deferred Income Taxes		1,532	*	*
Total Assets	131,334	118,467	135,071	129,272
Customer Deposits	15,062	10,606	10,181	4,327
Deferred Income Tax Liability		609		55
Other Accrued Liabilities	10,189	10,481	*	*
Total Current Liabilities	81,988	78,433	99,671	93,817
Other Long-Term Liabilities	3,126	3,219	*	*
Total Liabilities	90,818	87,356	142,263	136,464
Minority Interest	2,784	2,401	*	*
Capital In Excess of Par	111,715	112,512	*	*

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Accumulated Deficit	(70,762)	(80,581)	*	*
Total Shareholders' Equity	37,732	28,710	*	*
Total Liabilities and Shareholders' Equity	131,334	118,467	135,071	129,272

* The restatements described above did not result in a restatement of this line item in this fiscal year in the Company's previously reported financial statements.

F-31

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Note 3 Private Investment in Public Equity*

On March 21, 2005, in a Private Investment in Equity Securities Transaction (PIPE Transaction), the Company sold 17,473,118 equity units at \$3.72 per unit for gross proceeds of \$65 million, and net proceeds of \$59.3 million. A unit consists of one share of the Company's common stock and one warrant to buy 1/10th of a share of common stock. Ten warrants give the holder the right to purchase one share of common stock for \$4.07. Proceeds of the PIPE were used to pay down existing debt of \$59.3 million, including all of the subordinated debt. Under terms of the PIPE Transaction, the Company is required to file an initial Form S-1 registration of the shares issued and issuable in the PIPE Transaction on or before May 20, 2005, which it completed on May 20, 2005, and is required to cause the Form S-1 to go effective on or before September 17, 2005. The Company is subject to cash penalties of \$650,000 per month, if it fails to meet this date requirement. Under the terms of warrants previously issued to the senior and subordinated lenders, the Company is obligated to issue additional warrants if shares of common stock are issued for prices less than market price. Because the issuance price of the common stock of the PIPE Transaction was less than market value, the Company issued approximately 304,000 anti-dilution \$0.01 warrants to its lenders. These warrants have a Black-Scholes value of approximately \$1.7 million. The majority of the charges resulting from the issuance of the additional 304,042 warrants, \$1.6 million, were charged to interest expense in the fourth quarter of fiscal 2005 as the underlying debt associated with these warrants was retired in the fourth quarter of fiscal 2005. The remainder, \$126,000 has been capitalized and is being amortized to interest expense through August 1, 2005.

Under EITF 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock (EITF 00-19), the fair value of the warrants issued under the PIPE Transaction have been reported initially as a liability due to the requirement to net-cash settle the transaction until the Company's Form S-1 is declared effective. The reason for this treatment is that there are cash payment penalties of 1% of the gross proceeds per month (\$650,000) should this Form S-1 not be declared effective prior to September 17, 2005. Upon effectiveness of the Form S-1, these amounts will be reclassified into Capital in Excess of Par in the Equity section of the Consolidated Balance Sheet. The warrants have been valued at \$6.4 million using the Black-Scholes method. The assumptions utilized in computing the fair value of the warrants were as follows: expected life of 3 years, estimated volatility of 63% and a risk free interest rate of 4.34%. The shares have been valued at \$52.9 million, or the difference between the net proceeds and the value of the warrants. The warrants are considered a derivative financial instrument and will be marked to fair value quarterly until the Form S-1 is declared effective. Any changes in fair value of the warrants will be recorded through the Consolidated Statement of Operations as Other Income (Loss), net. The Company expensed \$274,000 in the fourth quarter of fiscal 2005 associated with the fair value adjustment of the warrants. There was no fair value adjustment in any other periods presented.

Note 4 Warranty Obligations:

The Company's obligations for warranty are accrued concurrently with the revenue recognized. The Company makes provisions for its warranty obligations based upon historical costs incurred for such obligations adjusted, as necessary, for current conditions and factors. Due to the significant uncertainties and judgments involved in estimating the Company's warranty obligations, including changing product designs and specifications, the ultimate amount incurred for warranty costs could change in the near term from the current estimate.

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The following table shows the fiscal 2005 and 2004 activity for the Company's warranty accrual:

Accrued warranty balance as of April 30, 2003	\$ 1,073
Accruals for warranties on fiscal 2004 sales	1,258
Warranty labor and materials provided in fiscal 2004	(1,127)
	<hr/>
Accrued warranty balance as of April 30, 2004	1,204
Accruals for warranties on fiscal 2005 sales	1,507
Warranty labor and materials provided in fiscal 2005	(1,001)
	<hr/>
Accrued warranty balance as of April 30, 2005	<u>\$ 1,710</u>

Note 5 Derivative Financial Instruments:

The Company follows Statement of Financial Accounting Standards No. 133 (FAS 133), Accounting for Derivative Instruments and Hedging Activities, which establishes accounting and reporting standards for derivative instruments, including certain derivative instruments embedded in other contracts for hedging activities. All derivatives, whether designated in hedging relationships or not, are required to be recorded on the balance sheet at fair value. If the derivative is designated as a fair value hedge, the changes in the fair value of the derivative and of the hedged item attributable to the hedged risk are recognized in earnings. If the derivative is designated as a cash flow hedge, the effective portions of changes in the fair value of the derivative are recorded in other comprehensive income (OCI) and are recognized in the statement of operations when the hedged item affects earnings. Ineffective portions of changes in the fair value of cash flow hedges are recognized in earnings.

The Company uses derivative instruments to manage exposures to foreign currency risks. The Company's objective for holding derivatives is to minimize foreign currency fluctuation risks using the most effective methods to eliminate or reduce the impacts of these exposures. The Company does not enter into speculative hedges. Counterparties to the Company's derivative financial instruments are credit worthy major financial institutions. The Company has not experienced any losses due to counterparty default.

Certain forecasted transactions and assets are exposed to foreign currency risk. The Company monitors its foreign currency exposures regularly to maximize the overall effectiveness of its foreign currency hedge positions. The currency hedged is the Swedish Krona. As of April 30, 2005, the Company had \$69,000 of net pre-tax unrealized losses on foreign currency cash flow hedges all of which is expected to be realized into earnings over the next 12 months when the associated transactions are recorded as revenue. The actual amounts realized will vary based on future changes in foreign currency rates. The fair value of the forward exchange contracts is estimated by obtaining market rates from selected financial institutions.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

The total notional amount of the forward exchange contracts at April 30, 2005 is \$12.6 million and these expire at various times through April 2006.

Hedge ineffectiveness, determined in accordance with FAS 133, had no impact on earnings for the years ended April 30, 2005, 2004 and 2003. No fair value hedges or cash flow hedges were derecognized or discontinued for the years ended April 30, 2005, 2004 and 2003.

Derivative gains and losses included in Other Comprehensive Loss (OCL) are reclassified into earnings each period as the related transactions are recognized into earnings. During the three years ended April 30, 2005, the amount transferred from OCL to Other Income (Expense), net, was \$43,000.

F-33

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Note 6 Investments and Related Party Transactions:*

In January 2004, the Company sold its investment in marketable securities of WGI Heavy Minerals for \$3.3 million and realized a gain of \$2.6 million on the transaction which is reflected in Other Income (Expense), net on the Consolidated Statement of Operations for the year ended April 30, 2004. All proceeds were used to pay down outstanding borrowings and permanently reduce the available borrowing capacity of the senior credit facility. In addition, the Company relinquished its seat on the Board of Directors of WGI Heavy Minerals. This investment was originally made to secure a long-term relationship with the Company's supplier of its high quality garnet. Garnet is sold by the Company as a consumable used in abrasivejet cutting. All transactions with WGI Heavy Minerals were conducted on an arms-length basis at the then current market prices for garnet.

Arlen I. Prentice, a director, is Chief Executive Officer of Kibble & Prentice, Inc., a company that, together with its wholly owned subsidiary, provides insurance brokerage and employee benefits, administrative and consulting services to the Company. Payments by the Company to Kibble & Prentice, Inc. and such subsidiary for such services have totaled \$1.0 million, \$2.4 million and \$2.1 million for the fiscal years ended April 2005, 2004 and 2003, respectively. Such payments were for various categories of insurance and included both the brokerage commissions and the premiums that Kibble & Prentice, Inc. passes on to the underwriter. Mr. Prentice abstains from participating in the approval of matters where he may have a conflict of interest.

Note 7 Receivables:

Receivables are recorded at the invoiced amount and most do not bear interest. For certain customers, the Company accepts an interest-bearing note receivable as payment. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses on existing receivables. The Company determines the allowance based on historical write-off experience and current economic data. The allowance for doubtful accounts is reviewed quarterly. Past due balances over 90 days and over a specified amount are reviewed individually for collectibility. All other balances are reviewed on a pooled basis by type of receivable. Account balances are charged against the allowance when the Company determines that it is probable the receivable will not be recovered. For notes receivable, the Company monitors the customers payment performance when evaluating the collectibility of the note, as well as whether or not to continue accruing interest income. The Company does not have any off-balance-sheet credit exposure related to our customers.

Receivables consist of the following:

<u>April 30,</u>	
2005	2004
(restated)	(restated)

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Trade Accounts Receivable	\$ 37,157	\$ 27,649
Unbilled Revenues	5,027	16,134
	<u>42,184</u>	<u>43,783</u>
Less Allowance for Doubtful Accounts	3,859	4,777
	<u>\$ 38,325</u>	<u>\$ 39,006</u>

Unbilled revenues do not contain any amounts which are expected to be collected after one year.

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Note 8 Inventories:*

Inventories consist of the following:

	<u>April 30,</u>	
	<u>2005</u>	<u>2004</u>
Raw Materials and Parts	\$ 15,500	\$ 14,849
Work in Process	4,799	6,223
Finished Goods	6,852	7,811
	<u>27,151</u>	<u>28,883</u>
Less Provision for Slow-Moving and Obsolete Inventories	2,933	2,499
	<u>\$ 24,218</u>	<u>\$ 26,384</u>

Note 9 Property and Equipment:

Property and Equipment are as follows:

	<u>April 30,</u>	
	<u>2005</u>	<u>2004</u>
Land and Buildings	\$ 6,211	\$ 5,881
Machinery and Equipment	34,442	34,368
Furniture and Fixtures	4,576	4,839
Leasehold Improvements	7,827	7,531
Construction in Progress	241	362
	<u>53,297</u>	<u>52,981</u>
Less Accumulated Depreciation and Amortization	40,663	38,781

	\$ 12,634	\$ 14,200
	<u> </u>	<u> </u>

The Company did not capitalize any interest for the year ended April 30, 2005 while, for the years ended April 30, 2004 and 2003, it capitalized interest of \$8,000 and \$115,000 respectively.

In accordance with FAS 144, the Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate the carrying amounts of assets may not be recoverable. The carrying value of long-lived assets are assessed for impairment by evaluating future operating performance and expected undiscounted cash flows of the underlying assets. Adjustments are made if the estimated fair value is less than carrying value. Accordingly, actual results could vary significantly from such estimates. The Company's review resulted in no impairment charges during the years ended April 30, 2005 and 2004 and charges of \$3.7 million during the quarter ended April 30, 2003 related to the Avure operation.

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Note 10 Long-Term Obligations, Notes Payable and Liquidity:*

Long-term obligations are as follows:

	April 30,	
	2005	2004
Subordinated Debt	\$	\$ 41,875
Less Original Issue Discount on Subordinated Debt		(5,070)
Net Subordinated Debt		36,805
Credit Agreement	9,695	39,980
Term Loans Payable	5,921	1,336
	15,616	78,121
Less Current Portion	(9,912)	(40,040)
	\$ 5,704	\$ 38,081
Notes Payable	\$ 3,531	\$ 8,687

On April 28, 2005 the Company entered into a Senior Credit Agreement with Bank of America N.A. and U.S. Bank N.A. (the April Agreement). The April Agreement provided a \$30 million commitment expiring August 1, 2005. This expiration date is consistent with the agreement it replaced. The April Agreement gave the Company the ability to pay off its subordinated debt in its entirety, which it did on April 28, 2005. In addition, the April Agreement, similar to prior agreements, included a subjective acceleration clauses which permit the lenders to demand payment in the event of a material adverse change. This new senior debt agreement was similar to the previous senior credit agreement except for the following provisions:

Required the complete pay-off of subordinated debt

The interest rate was reduced from prime + 6% to LIBOR + 2.5%

The annualized cost of Letters of Credit was reduced from 5% to 2.5% of the face amount

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

The total commitment increased to \$30 million, up from the Senior Credit Agreement commitment level of \$25.1 million.

Prior to the April Agreement, we had amended our senior facility on July 28, 2004 which provided for a revolving line of credit of up to \$42.7 million and an extension of the then existing credit agreement through August 1, 2005. The commitment reduced to \$25.1 million at April 30, 2005 as a result of the PIPE. Interest rates under the credit facility are at the Bank of America's prime rate in effect from time to time plus 4% and increase by one percentage point each quarter beginning November 1, 2004. The prime rate at April 30, 2005 was 5.75%. The Amendment also required a quarterly commitment fee of $\frac{1}{2}$ of 1% (50 basis points) of the total commitment, and issuance of 150,000 detachable \$.01 warrants as a fee.

On July 8, 2005, the Company signed a new three year credit agreement (Agreement). The Agreement provides for a revolving line of credit of up to \$30.0 million with a maturity date of August 1, 2008 and is collateralized by a general lien on all of the Company's assets. Interest rates under the Agreement are at LIBOR plus and at the Bank of America's prime rate in effect from time to time. LIBOR and the prime rate at April 30, 2005 were 2.6% and 5.75%, respectively. The Agreement requires compliance with funded debt, tangible net worth and liquidity ratios. The Company also pays an annual letter of credit fee equal to 2.5% of the amount available to be drawn under each outstanding letter of credit. The annual letter of credit fee is payable quarterly in arrears. In addition, the New Credit Agreement, similar to prior agreements, includes a subjective acceleration clauses which permit the lenders to demand payment in the event of a material adverse change.

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company makes use of its credit facility to fund its operations during the course of the year. In fiscal 2005, the Company borrowed an aggregate of \$52.3 million on the credit facility while repaying \$82.6 million. In fiscal 2004 and 2003, the Company borrowed an aggregate of \$30.0 million and \$53.2 million, respectively, on the credit facility while repaying \$46.5 million and \$52.0 million, respectively. As of April 30, 2005, the Company had \$12.7 million of domestic unused line of credit. The process whereby the Company's current excess cash receipts directly reduce the outstanding senior credit facility balance combined with material adverse change language discussed below, results in the balance outstanding being classified as a current liability.

In May 2001, the Company signed a \$35 million subordinated debt agreement with The John Hancock Life Insurance Company and affiliated entities (Hancock). The agreement as previously amended requires semi-annual interest only payments at 15% and two equal principal payments due on April 30, 2007, and April 30, 2008. In addition, the Company issued 859,523 warrants to purchase Flow common stock at \$.01 per share to Hancock. The value of the warrants relative to the total value of the transaction was 21% or \$7.3 million which was recorded to Capital in Excess of Par. Accordingly, the value assigned to the warrants results in a discount to the carrying value of the Long-Term Obligations in the accompanying Consolidated Balance Sheets. The debt discount is amortized over the term of the debt by the effective interest method and the fully vested warrants expire on April 30, 2008. As of April 30, 2003, Hancock had agreed to defer required semi-annual interest payments, beginning with April 30, 2003, until April 30, 2004, which total \$6.9 million. On July 28, 2004, Hancock amended the agreement to continue to defer interest through April 30, 2005, which totals an additional \$5.3 million. All deferred and capitalized payments accrue interest at the rate of 15%.

On April 28, 2005, the Company repaid all principal, deferred interest as well as accrued interest, totaling \$48.9 million. In conjunction with the pay-off, the Company wrote off the remaining unamortized debt discount of \$4.3 million to Interest Expense, net in fiscal 2005.

The Company was in compliance with all covenants during fiscal 2005.

The Company has been able to satisfy its needs for working capital and capital expenditures, due in part to its ability to access adequate financing arrangements. The Company expects that operations will continue, with the realization of assets and discharge of liabilities in the ordinary course of business. Compliance with amended future debt covenants for the credit agreement requires the Company to meet its operating projections, which include achieving certain revenues and consistent operating margins. If the Company is unable to comply with its debt covenants and the Company's lenders are unwilling to waive or amend the debt covenants, amounts owed under the Company's credit agreement would become current, and the Company would be required to seek alternative financing.

The Company has five unsecured credit facilities in Taiwan with a commitment totaling 268 million New Taiwanese Dollars (US \$8.5 million at April 30, 2005), bearing interest at rates ranging from 1.8% to 2.77% per annum. The credit facilities have maturities between 12 and 36 months and can be extended for like periods, as needed, at the bank's option. At April 30, 2005, the balance outstanding under these credit facilities amounts to US\$2.4 million, \$1.1 million of which is shown under Notes Payable while the remaining \$1.3 million is classified under Term Loans Payable.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

The Company has also obtained a seven-year collateralized long-term loan, expiring in 2011, in the amount of 145 million New Taiwanese Dollars (US\$4.6 million at January 31, 2005) bearing interest at an annual rate of 2.75%. The loan is collateralized by the Company's recently completed manufacturing facility. In June 2004, the Company borrowed \$4.1 million against this facility and repatriated \$3.5 million to the U.S. to reduce amount outstanding under the senior credit facility. The balance of \$4.4 million at April 30, 2005 is included in Term Loans Payable.

F-37

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

Notes Payable also include borrowings under a \$3.5 million (25 million Swedish Krona) Avure AB line of credit which is collateralized by trade accounts receivable and inventory, at an interest rate of Swedish prime (3.4% at April 30, 2005) plus 0.75%. The line of credit expires annually on December 31 and is renewable in yearly increments at the bank's option. As of April 30, 2005, Avure AB has borrowed approximately \$2.5 million under this line of credit and has approximately \$1.0 million available under this credit facility.

Principal payments under all debt obligations for the next four years are as follows: \$3,649,000 in 2006, \$1,978,000 in 2007, \$10,505,000 in 2008, \$832,000 in 2009, \$855,000 in 2010 and \$1,328,000 thereafter. The 2006 amount differs from the current portion presented on the Consolidated Balance Sheet at April 30, 2005 because of the current classification of the Credit Agreement.

Note 11 Income Taxes:

The components of consolidated (loss) income before income taxes and the provision for income taxes are as follows:

	Year Ended April 30,		
	2005		
	(restated)	2004	2003
(Loss) Income Before Provision (Benefit) for Income Taxes:			
Domestic	\$ (22,247)	\$ (16,910)	\$ (35,166)
Foreign	3,969	10,059	(21,695)
Total	\$ (18,278)	\$ (6,851)	\$ (56,861)

The provision for income taxes comprises:

	Year Ended April 30,		
	2005	2004	2003
Current:			
Domestic	\$	\$ 121	\$

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

State and Local	41	87	68
Foreign	2,168	4,343	1,327
	<u> </u>	<u> </u>	<u> </u>
Total	2,209	4,551	1,395
Deferred	129	646	11,208
	<u> </u>	<u> </u>	<u> </u>
Total	\$ 2,238	\$ 5,197	\$ 12,603
	<u> </u>	<u> </u>	<u> </u>

F-38

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

Net deferred tax assets (liabilities) comprise the following:

	April 30, 2005	April 30, 2004
	(restated)	(restated)
	<u> </u>	<u> </u>
Current:		
Accounts receivable allowances	\$ 320	\$ 331
Inventory capitalization	164	103
Obsolete inventory	602	613
Vacation accrual	237	262
Net operating loss carryover	923	537
Unrealized gain		433
Business tax credits	423	193
	<u> </u>	<u> </u>
Current Deferred Tax Assets	2,669	2,472
Unrealized loss	(1,639)	
Valuation allowance	(1,639)	(1,447)
	<u> </u>	<u> </u>
Total Current Deferred Taxes	(609)	1,025
	<u> </u>	<u> </u>
Long-Term:		
Fixed assets		520
Net operating loss carryover	32,836	19,369
Goodwill	393	554
State and foreign taxes	127	
AMT credits	564	564
Unrealized loss		
All other	877	1,909
	<u> </u>	<u> </u>
Long-Term Deferred Tax Asset	34,797	22,916
Fixed assets	(58)	
State and foreign taxes		(491)
Valuation allowance	(33,207)	(22,480)
	<u> </u>	<u> </u>
Total Long-Term Deferred Taxes	1,532	(55)
	<u> </u>	<u> </u>
Total Net Deferred Tax Assets	\$ 923	\$ 970
	<u> </u>	<u> </u>

A reconciliation of income taxes at the federal statutory rate to the provision (benefit) for income taxes is as follows:

	Year Ended April 30,		
	2005	2004	2003
	<u> </u>	<u> </u>	<u> </u>
Income taxes at federal statutory rate	(34.0)%	(34.0)%	(34.0)%
Extra territorial income exclusion			(0.3)
Foreign tax rate differences	(2.4)	6.2	1.7
Change in valuation allowances	36.1	(28.2)	47.5
State and local tax rate differences	0.1	0.8	0.1
Original issue discount amortization	(4.7)	5.0	0.5
Non deductible meals	0.1	0.6	0.1
Foreign earnings not previously subject to U.S. tax		93.3	
Foreign withholding taxes	1.2	26.9	
Minimum tax		1.8	
Impairment charge	16.2		
Other	0.2	3.7	6.6
	<u> </u>	<u> </u>	<u> </u>
Income tax provision	12.8%	75.9%	22.2%
	<u> </u>	<u> </u>	<u> </u>

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

As of April 30, 2005, the Company had approximately \$70.7 million of domestic net operating loss carryforwards to offset certain earnings for federal income tax purposes. These net operating loss carryforwards expire between fiscal 2022 and fiscal 2024. Net operating loss carryforwards in foreign jurisdictions amount to \$28.2 million and do not expire.

Since 2003, the Company has provided a full valuation allowance against its domestic net operating losses and certain foreign net operating losses. The Company also placed a valuation allowance against certain other deferred tax assets based on the expected reversal of both deferred tax assets and liabilities. During 2005, the valuation allowance was increased by \$10.9 million for net operating losses and other deferred tax assets realized this year.

In years prior to fiscal 2004 a provision was not made for U.S. income taxes or foreign withholding taxes on undistributed earnings of foreign subsidiaries. In the fourth quarter of fiscal 2004, the Company was no longer able to permanently defer foreign earnings as a result of changes in financing arrangements. As a result, the Company recorded a liability for withholding taxes payable on future repatriation of historical foreign earnings as of April 30, 2005 and 2004, of \$217,000 and a \$1.9 million respectively. In June 2004 and February 2005, the Company repatriated \$3.5 million and \$1.3 million, respectively, from certain foreign subsidiaries and plans to continue to repatriate additional earnings in the future as a result of foreign asset collateral requirements and the amended credit agreements discussed in Note 9.

On October 22, 2004, the President signed the American Jobs Creation Act of 2004 (the Act). The Act creates a temporary incentive for U.S. corporations to repatriate accumulated income earned abroad by providing an 85 percent dividends received deduction for certain dividends from controlled foreign corporations. Although the deduction is subject to a number of limitations and, as of today, significant uncertainty remains as to how to interpret numerous provisions in the Act, the Company believes that it has the information necessary to make an informed decision on the impact of the Act on its repatriation plans. Based on that decision, the Company does not plan to repatriate extraordinary dividends, as defined in the Act, during the qualified period ended June 30, 2006 and accordingly has not recorded an additional tax liability as of April 30, 2005.

Note 12 Stock Options:

The Company has stock options outstanding under various option plans described as follows:

1987 Stock Option Plan for Nonemployee Directors (the 1987 Nonemployee Directors Plan). Approved by the Company's shareholders in September 1987, the 1987 Nonemployee Directors Plan, as subsequently amended, provided for the automatic grant of nonqualified options for 10,000 shares of Company common stock to a nonemployee director when initially elected or appointed, and the issuance of 10,000 options annually thereafter during the term of directorship. There are no further options being granted under this plan.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

1991 Stock Option Plan (the 1991 SO Plan) . The 1991 SO Plan was adopted in October 1991 and amended in August 1993. Incentive and nonqualified stock options up to 700,000 shares may be issued under this plan.

1995 Long-Term Incentive Plan (the 1995 LTI Plan) . The 1995 LTI Plan was adopted in August 1995. In fiscal 2000, the 1995 LTI Plan was amended to increase the number of shares available for grant to 3,350,000 shares.

All options become exercisable upon a change in control of the Company. Options generally have a two-year vesting schedule, and are generally granted with an exercise price equal to the fair market value of the Company's

F-40

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

common stock on the date of grant. The maximum term of options is 10 years from the date of grant. During late fiscal 1999 and early fiscal 2000, the Board of Directors of the Company approved options for 272,171 shares which were priced at fair value on the dates of Board approval, subject however to shareholder approval of a planned increase in the shares available under the 1995 LTI Plan. The grant date for these options occurred at the August 1999 shareholder meeting. Based upon the difference in fair value between the option strike price approved by the Board of Directors approval date and the fair value of the shares at the grant date, compensation expense of \$0, \$0 and \$93,000 and was recorded during fiscal 2005, 2004 and 2003, respectively. As of April 2005 these options were fully vested. All subsequent grants of options were fully authorized at date of grant.

The following chart summarizes the status of the options at April 30, 2005, which expire at various times through 2014:

	1987 Nonemployee Directors Plan	1991 SO Plan and 1995 LTI Plan	Total
Number of options outstanding	454,125	1,580,421	2,034,546
Number of options vested	454,125	1,452,878	1,907,003
Average exercise price per share of options outstanding	\$ 10.26	\$ 8.85	\$ 9.20

The weighted-average fair values at the date of grant for options granted in fiscal 2005, 2004 and 2003 were estimated using the Black-Scholes option-pricing model, based on the following assumptions: (i) no expected dividend yields for fiscal years 2005, 2004 and 2003; (ii) expected volatility rates of 62.7%, 61.8% and 58.9% for fiscal 2005, 2004 and 2003, respectively; and (iii) expected lives of six years for fiscal 2005, 2004 and 2003. The risk-free interest rate applied to fiscal 2005, 2004 and 2003 was 3.8%, 3.9% and 3.7%, respectively.

The following table summarizes information about stock options outstanding at April 30, 2005:

Range of Exercise Prices	Number Outstanding at April 30, 2005	Weighted- Average Remaining Contractual Life	Weighted- Average Exercise Price	Number Exercisable at April 30, 2005	Weighted- Average Exercise Price
\$2.00 \$7.99	306,890	7.56 years	\$ 4.07	183,347	\$ 4.01
\$8.00 \$10.00	704,741	2.96 years	8.99	704,741	8.99
\$10.01 \$12.25	1,022,915	4.74 years	10.82	1,018,915	10.82
Total:	2,034,546	4.62 years	\$ 9.20	1,907,003	\$ 9.49

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

The following table presents the stock option activity for the years ended April 30:

	2005		2004		2003	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Exercise Price
Outstanding beginning of year	2,089,412	\$ 9.05	2,500,682	\$ 9.26	3,262,185	\$ 9.62
Granted during the year:	21,250	5.92	42,500	2.10	263,140	3.68
Exercised during the year:	(44,375)	2.55			(77,000)	5.38
Forfeited during the year:	(31,741)	8.05	(453,770)	9.53	(947,643)	9.27
Outstanding, end of year	2,034,546	\$ 9.20	2,089,412	\$ 9.05	2,500,682	\$ 9.26
Exercisable, end of year	1,907,003	\$ 9.49	1,875,299	\$ 9.65	2,049,636	\$ 9.87
Weighted Average fair value of options granted during each period:		\$ 3.59		\$ 1.26		\$ 2.14

F-41

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

During fiscal 2005, 2004 and 2003 the Company recorded non-cash compensation expense of \$1.6 million, \$763,000 and \$284,000, respectively, related to various compensatory arrangements which provide common stock or restricted stock units, rather than options, to the Board of Directors and executive management.

The table below presents the expense components related to the various common stock arrangements for employees and Directors for the three years ended April 30, 2005.

	<u>Year Ended April 30,</u>		
	<u>2005</u> <u>(restated)</u>	<u>2004</u>	<u>2003</u>
Accrual for annual compensatory stock award to Board members	\$ 247	\$ 270	\$
Executive employment and retention contracts	1,338	493	284
	<u>\$ 1,585</u>	<u>\$ 763</u>	<u>\$ 284</u>

The non-employee Board of Directors are eligible to receive and are granted an annual \$30,000 each worth of common stock.

In July 2003, the Company entered into retention agreements with certain key executives which entitles them to cash payments as well as stock grants that vest on December 31, 2006. 350,000 shares have been granted. The related expense is being recognized through 2006.

In fiscal 2004, the Company implemented an incentive compensation program which pays executive management 50% in cash and 50% in common stock upon achievement of certain performance targets. The Company issued 343,000 shares in fiscal 2005 for the payout of the fiscal 2004 plan.

The January 2003 employment agreement with the CEO provides for annual restricted stock grants of 45,000 shares. These restricted stock grants vest on the earlier of the achievement of yearly performance targets or 10 years.

Note 13 Voluntary Pension and Salary Deferral Plan:

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

The Company has a 401(k) savings plan in which employees may contribute a percentage of their compensation. At its discretion, the Company may make contributions based on employee contributions and length of employee service. In October 2002, the Company discontinued its discretionary match to employees. Company contributions and expenses under the plan for the years ended April 30, 2005, 2004, and 2003 were \$0, \$0 and \$452,000 respectively.

Note 14 Preferred Share Rights Purchase Plan:

On June 7, 1990 the Board of Directors of the Company adopted a Preferred Share Rights Purchase Plan, which Plan was amended and restated as of September 1, 1999. Pursuant to the Plan a Preferred Share Purchase Right (a Right) is attached to each share of Company common stock. The Rights will be exercisable only if a person or group acquires 10% or more of the Company s common stock or announces a tender offer, the consummation of which would result in ownership by a person or group of 10% or more of the common stock. Each Right entitles shareholders to buy one one-hundredth of a share of Series B Junior Participating Preferred Stock (the Series B Preferred Shares) of the Company at a price of \$45. If the Company is acquired in a merger or other business combination transaction, each Right will entitle its holder to purchase a number of the acquiring company s common shares having a value equal to twice the exercise price of the Right. If a person or group acquires 10% or more of the Company s outstanding common stock, each Right will entitle its holder (other than

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

such person or members of such group) to receive, upon exercise, a number of the Company's common shares having a value equal to two times the exercise price of the Right. Following the acquisition by a person or group of 10% or more of the Company's common stock and prior to an acquisition of 50% or more of such common stock, the Board of Directors may exchange each Right (other than Rights owned by such person or group) for one share of common stock or for one one-hundredth of a Series B Preferred Share. Prior to the acquisition by a person or group of 10% of the Company's common stock, the Rights are redeemable, at the option of the Board, for \$.0001 per Right. The Rights expire on September 1, 2009. The Rights do not have voting or dividend rights, and until they become exercisable, have no dilutive effect on the earnings of the Company.

Effective October 29, 2003, Flow International Corporation amended its Preferred Share Purchase Rights Plan and the Rights issued pursuant to the Plan. The amendment modifies the definition of "Acquiring Person" to exclude certain persons who inadvertently acquire in excess of 10% of the outstanding common shares if such person enters into a standstill agreement in form and substance satisfactory to the Company and agrees to divest a sufficient number of shares of Common Stock so that such Person would no longer be an Acquiring Person within no more than one year from the date of such agreement.

The amended terms of the Rights are set forth in the Amendment No. 1 dated as of October 29, 2003 between Flow International Corporation and Mellon Investor Services LLC to the Amended and Restated Rights Agreement dated as of September 1, 1999 between Flow International Corporation and Mellon Investor Services LLC. The Amended and Restated Rights Agreement is otherwise unchanged.

Note 15 Commitments and Contingencies:

Lease Commitments

The Company rents certain facilities and equipment under agreements treated for financial reporting purposes as operating leases. The majority of leases currently in effect are renewable for periods of two to five years. Rent expense under these leases was approximately \$4.3 million, \$4.9 million, and \$6.1 million for the years ended April 30, 2005, 2004 and 2003, respectively.

Future minimum rents payable under operating leases for years ending April 30 are as follows:

<u>Year Ending April 30,</u>	
2006	\$ 3,716
2007	3,464
2008	2,814

2009	1,851
2010	1,773
Thereafter	4,096
	<hr/>
	\$ 17,714
	<hr/>

Product Liability

The Company has been subject to product liability claims primarily through a former subsidiary that was sold in September 1997. To minimize the financial impact of product liability risks and adverse judgments, product liability insurance has been purchased in amounts and under terms considered acceptable to management.

At any point in time covered by these financial statements, there are outstanding product liability claims against the Company, and incidents are known to management that may result in future claims. Management, in

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

conjunction with internal legal counsel, as well as external counsel, periodically evaluates the merit of all claims, including product liability claims, as well as considering unasserted claims. The Company aggressively defends itself when warranted and applies the accounting and disclosure criteria of FAS 5, *Accounting for Contingencies* when evaluating its exposure to all claims.

Recoveries, if any, may be realized from indemnitors, codefendants, insurers or insurance guaranty funds. Management, based on estimates provided by the Company's legal counsel on such claims, believes its insurance coverage is adequate.

Legal Proceedings

On November 18, 2004, Omax Corporation (*Omax*) filed suit against the Company alleging that the Company's products infringe on Omax's patents. The suit also seeks to have a specific patent held by the Company declared invalid. The Company filed its response on December 8, 2004. In its answer, the Company asserts that it does not infringe Omax's patents and Omax's patents are invalid and unenforceable. In its counterclaim, the Company seeks damages from Omax for violation of antitrust laws and injunctive relief and damages for infringement of the Company's patent. Although the Omax suit seeks damages of over \$100 million, the Company believes Omax's claims are without merit and intends not only to contest Omax's allegations of infringement but also to vigorously pursue its claims with regard to its own patent. Accordingly, the Company has not provided any loss contingency accrual related to the Omax lawsuit as of April 30, 2005. The Company will incur legal expenses as part of this lawsuit and will expense them as incurred. While an exact amount of legal fees is not known at this time, the total fees are expected to be more than \$1 million over the next year to two years.

Other

During fiscal 2003, the Company was required to repurchase a previously sold industrial press from a bankrupt customer and the Company recorded a charge of \$760,000. During the year ended April 30, 2004, the Company sold this industrial press to an unrelated party.

Note 16 Discontinued Operations:

As of April 30, 2003, the Company reported one of its subsidiaries as a discontinued operation. This wholly owned subsidiary of the Company was involved in the decommissioning of oil wells. On May 16, 2003, the Company consummated the sale of the subsidiary's assets, recording proceeds of \$1.8 million and a gain on the sale (net of tax) of approximately \$650,000. The Company retains no future interest in the subsidiary. The Company segregated this subsidiary's assets as assets of discontinued operations on the April 30, 2003 Consolidated Balance Sheet and presented the subsidiary's results of operations as discontinued operations, net of applicable taxes, on the Consolidated Statement of Operations for the three years ended April 30, 2005.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

The operating results of discontinued operations, for the each of three years ended April 30, 2005, are summarized below:

	Year Ended April 30:		
	2005	2004	2003
Net sales	\$	\$	\$ 1,215
(Loss) income before tax		(188)	(792)
Net (loss) income		(124)	(523)

F-44

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)***Note 17 Restructuring and Financial Consulting Charges:*

Since May 2003, the Company has been executing a plan intended to return it to profitability through reductions in headcount, consolidation of facilities and operations, and closure or divestiture of selected operations.

The following table summarizes accrued restructuring activity for fiscal 2004 and 2005 (in thousands):

	North America		Other International			Other		International		Consolidated				
	Waterjet		Waterjet			Waterjet		Food		Press				
	Facility		Facility			Facility		Facility		Facility		Facility		
	Exit	Other	Severance	Exit	Other	Severance	Severance	Exit	Severance	Exit	Severance	Exit	Other	Total
	Costs		Benefits	Costs		Benefits	Benefits	Costs	Benefits	Costs	Benefits	Costs		
Q1 restructuring charge	\$	\$	\$ 248	\$	\$	\$	\$	\$	\$	\$	\$ 248	\$	\$	\$ 248
Q1 cash payments			(128)								(128)			(128)
Balance, July 31, 2003			120								120			120
Q2 restructuring charge		178	(120)	105	302				201	191	81	296	480	857
Q2 cash payments		(178)			(47)								(225)	(225)
Q2 charge-offs					(255)								(255)	(255)
Balance, October 31, 2003				105					201	191	201	296		497
Q3 restructuring charge	407	170		85	484	89					89	492	654	1,235
Q3 cash payments	(270)	(160)		(14)					(121)		(121)	(284)	(160)	(565)
Q3 charge-offs		(10)		(85)	(484)							(85)	(494)	(579)
Balance, January 31, 2004	137			91		89			80	191	169	419		588
Q4 restructuring charge	15	412		255					234		234	270	412	916
Q4 cash payments	(13)	(126)		(13)		(89)			(70)		(159)	(26)	(126)	(311)
Q4 charge-offs		(286)											(286)	(286)
Balance, April 30, 2004	139			333					244	191	244	663		907
Q1 restructuring charge														
Q1 cash payments	(9)			(4)					(68)	(3)	(68)	(16)		(84)
Balance, July 31, 2004	130			329					176	188	176	647		823
Q2 restructuring charge														
Q2 cash payments	(9)			(4)					(64)	(3)	(64)	(16)		(80)
Balance, October 31, 2004	121			325					112	185	112	631		743

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Q3 restructuring charge						120	119			120	119		239
Q3 cash payments	(9)		(10)			(17)	(39)	(39)	(3)	(56)	(61)		(117)
Balance, January 31, 2005	112		315			103	80	73	182	176	689		865
Q4 restructuring charge													
Q4 cash payments	(9)		(31)			(50)	(17)	(39)	(3)	(89)	(60)		(149)
Balance, April 30, 2005	\$ 103	\$	\$ 284	\$	\$	\$ 53	\$ 63	\$ 34	\$ 179	\$ 87	\$ 629	\$	\$ 716

F-45

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

The Company recorded net restructuring charges of \$3.3 million during the year ended April 30, 2004. The Company evaluated the workforce and skill levels necessary to satisfy the expected future requirements of the business. As a result, the Company implemented plans to eliminate redundant positions and realign and modify certain roles based on skill assessments. The Company recorded net restructuring charges of \$652,000 in employee severance related costs for approximately 48 individuals. The fiscal 2004 reductions in the global workforce were made across manufacturing, engineering as well as general and administrative functions within the Company. The Company has also recorded \$1,058,000 of facility exit costs for the year ended April 30, 2004 primarily as a result of consolidating its two Kent facilities into one facility, vacating the manufacturing warehouse portion of its Flow Europe facility and reducing space utilized in its Swedish manufacturing facility. In addition, the Company scrapped obsolete parts, returned surplus parts to vendors or sold parts to third parties, which totaled \$1,546,000 and is included as charge-offs above, in conjunction with the shutdown of its manufacturing operation in Europe and standardization of its product line.

During the year ended April 30, 2005, the Company closed its sales and marketing office for its Food segment and terminated two employees. In connection with this restructuring, the Company accrued lease termination costs, net of expected sublease income, of \$119,000 which will be paid over two years and severance benefits of \$120,000 which will be paid over the next six months. The Company completed its restructuring program by April 30, 2005.

The remaining accrued severance costs in International Press of \$34,000 as of April 30, 2005 will be paid over the next three months and the remaining accrued facility exit costs for all segments other than Food of \$565,000, which consist of long-term lease commitments, net of expected sublease income, will be paid primarily over the next several years.

During the year ended April 30, 2005 and 2004, we incurred \$.6 million and \$1.5 million, respectively, of professional fees associated with the restructuring of our debt in July 2004 and July 2003, respectively. These costs were evaluated under EITF 98-14, Debtor's Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements, and as they were either expenses related to potential senior debt financing with lenders that did not occur, or they related to expenses associated with our subordinated debt and did not result in increase in the facility, they were expensed.

Note 18 Operating Segment and Geographical Information:

The Company has determined that its operating segments are those based upon the manner in which internal financial information is produced and evaluated by the chief operating decision maker (the Company's Chief Executive Officer). Additionally, certain geographical information is required regardless of how internal financial information is generated.

The Company has identified seven reportable segments. Four segments, North America Waterjet, Asia Waterjet, Other International Waterjet and Other (together known as Waterjet), utilize the Company's released pressure technology. The remaining three segments, Food, North America Press and International Press (together known as Avure), utilize the Company's contained pressure technology. The Waterjet operation includes cutting and cleaning operations, which are focused on providing total solutions for the aerospace, automotive, job shop, surface preparation and paper industries. The Avure operation includes the Fresher Under Pressure food processing technology, as well as the isostatic and flexform press (General Press) operations. The Fresher Under Pressure technology provides food safety and quality enhancement solutions for food producers, while the General Press business manufactures systems which produce and strengthen advanced materials for the aerospace,

automotive and medical industries. Segment operating results are measured based on operating income (loss).

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The table below presents information about the reported operating (loss) income and assets of the Company for the years ended April 30, 2005, 2004 and 2003.

	Waterjet				Avure			Eliminations	Total
	North America Waterjet	Asia Waterjet	Other International Waterjet	Other(1)	Food	North America Press	International Press		
2005									
External sales	\$ 82,381	\$ 25,505	\$ 34,530	\$ 30,550	\$ 15,072	\$ 16,617	\$ 14,710		\$ 219,365
Operating (loss) income (restated)*	\$ 1,939	\$ 6,247	\$ 552	\$ (307)	\$ (2,138)	\$ 41	\$ (4,372)	\$ (140)	\$ 1,822
Goodwill (restated)*	\$ 2,463	\$ 301							\$ 2,764
Total assets (restated)*	\$ 84,088	\$ 28,967	\$ 19,812	\$ 9,855	\$ 11,296	\$ 8,179	\$ 37,258	\$ (80,988)	\$ 118,467
2004									
External sales	\$ 59,044	\$ 20,502	\$ 28,160	\$ 25,155	\$ 15,296	\$ 7,445	\$ 22,007		\$ 177,609
Operating (loss) income	\$ (4,871)	\$ 5,299	\$ (2,921)	\$ 335	\$ (2,874)	\$ 9	\$ 2,672	\$ 468	\$ (1,883)
Goodwill	\$ 2,463	\$ 301				\$ 765	\$ 7,731		\$ 11,260
Total assets (restated)*	\$ 87,988	\$ 27,587	\$ 17,935	\$ 12,265	\$ 12,855	\$ 4,339	\$ 45,099	\$ (78,796)	\$ 129,272
2003									
External sales	\$ 53,995	\$ 17,667	\$ 23,279	\$ 26,892	\$ 4,851	\$ 7,668	\$ 9,763		\$ 144,115
Operating income (loss)	\$ (7,198)	\$ 3,433	\$ (15,557)	\$ (8,503)	\$ (16,819)	\$ 100	\$ (5,242)	\$ 1,087	\$ (48,699)
Goodwill	\$ 2,463	\$ 301				\$ 765	\$ 7,208		\$ 10,737
Total assets	\$ 107,448	\$ 20,658	\$ 30,190	\$ 13,154	\$ 15,062	\$ 4,523	\$ 45,645	\$ (88,979)	\$ 147,701

* Contains restated balances as of and for the year ended April 30, 2005.

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

The table below presents the Company's operations and other financial information by geographical region:

	United States	Europe	Asia	Other Foreign	Adjustments & Eliminations	Consolidated
Fiscal 2005						
Sales:						
Customers(1)	\$ 131,032	\$ 45,417	\$ 25,505	\$ 17,411	\$	\$ 219,365
Inter-area(2)	20,549	13,171	928	1,725	(36,373)	
Total sales	\$ 151,581	\$ 58,588	\$ 26,433	\$ 19,136	\$ (36,373)	\$ 219,365
Long-Lived Assets (restated)	\$ 12,776	\$ 13,426	\$ 6,941	\$ 599		\$ 33,742
Fiscal 2004						
Sales:						
Customers(1)	\$ 97,546	\$ 46,557	\$ 20,502	\$ 13,004	\$	\$ 177,609
Inter-area(2)	13,917	15,051	1,214	365	(30,547)	
Total sales	\$ 111,463	\$ 61,608	\$ 21,716	\$ 13,369	\$ (30,547)	\$ 177,609
Long-Lived Assets	\$ 12,355	\$ 24,276	\$ 7,068	\$ 761		\$ 44,460
Fiscal 2003						
Sales:						
Customers(1)	\$ 79,450	\$ 31,326	\$ 17,666	\$ 15,673	\$	\$ 144,115
Inter-area(2)	12,499	600	1,166	72	(14,337)	
Total sales	\$ 91,949	\$ 31,926	\$ 18,832	\$ 15,745	\$ (14,337)	\$ 144,115
Long-Lived Assets	\$ 17,455	\$ 25,094	\$ 3,172	\$ 999		\$ 46,720

(1) U.S. sales to unaffiliated customers in foreign countries were \$12.8 million, \$15.1 million, and \$12.5 million in fiscal 2005, 2004, and 2003, respectively.

(2) Inter-area sales to affiliates represent products that were transferred between geographic areas at negotiated prices, which are consistent with the terms sales to third parties, that is, at current market prices. These amounts have been eliminated in the consolidation.

Note 19 New Accounting Pronouncements

During October 2004, the FASB ratified the consensus reached by the EITF with respect to EITF Issue No. 04-10, Determining Whether to Aggregate Operating Segments That Do Not Meet the Quantitative Thresholds (EITF 04-10), which clarifies the guidance in paragraph 19 of FAS No. 131, Disclosures about Segments of an Enterprise and Related Information (FAS No. 131). According to EITF 04-10, operating segments that do not meet the quantitative thresholds can be aggregated under paragraph 19 only if aggregation is consistent with the objective and basic principle of FAS No. 131, the segments have similar economic characteristics, and the segments share a majority of the aggregation criteria listed in items (a)-(e) in paragraph 17 of FAS No. 131. The FASB staff is currently working on a FASB Staff Position (FSP) to provide guidance in determining whether two or more operating segments have similar economic characteristics. The effective date of EITF 04-10 has been delayed in order to coincide with the effective date of the anticipated FSP, with early application is permitted. The adoption of EITF 04-10

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

is not expected to have an impact on the Company's Consolidated Financial Statements.

In November 2004, the FASB issued Statement of Financial Accounting Standards No. 151, *Inventory Costs* an Amendment of ARB No. 43, Chapter 4. This statement clarifies the accounting for abnormal amounts of idle facility expense, freight, handling costs and spoilage, requiring these items be recognized as current-period charges. In addition, this statement requires that allocation of fixed production overheads to the

F-48

Table of Contents

FLOW INTERNATIONAL CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)

costs of conversion be based on the normal capacity of the production facilities. The provisions of this statement are effective for inventory costs incurred during fiscal years beginning after June 15, 2005 and will become effective for the Company beginning in May 2006. The full impact that the adoption of this statement will have on the Company's financial position and results of operations has not yet been determined.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123R, Share-Based Payment (Revised 2004). This statement addresses the accounting for share-based payment transactions in which a company receives employee services in exchange for the company's equity instruments or liabilities that are based on the fair value of the company's equity securities or may be settled by the issuance of these securities. SFAS 123R eliminates the ability to account for share-based compensation using APB 25 and generally requires that such transactions be accounted for using a fair value method. The provisions of this statement are effective for financial statements issued for the first interim or annual period beginning after June 15, 2005 and will become effective for the Company beginning with the second quarter of the fiscal 2006 year. The Company has not yet determined which transition method it will use to adopt SFAS 123R. The full impact that the adoption of this statement will have on the Company's financial position and results of operations will be determined by share-based payments granted in future periods.

In March 2005, the FASB issued FASB Staff Position (FSP) FIN 46(R)-5, Implicit Variable Interests Under FIN 46(R). FSP FIN 46(R)-5 states that a reporting entity should consider whether it holds an implicit variable interest in a variable interest entity (VIE) or in a potential VIE. If the aggregate of the explicit and implicit variable interests held by the reporting entity and its related parties would, if held by a single party, identify that party as the primary beneficiary, the party within the group most closely associated with the VIE should be deemed the primary beneficiary. The guidance of FSP FIN 46(R)-5 is effective for the reporting period beginning after March 3, 2005. The Company is currently evaluating the impact of FSP FIN 46(R)-5, but does not believe it will have a material impact on its Consolidated Financial Statements.

In March 2005, the FASB also issued FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47). FIN 47 clarifies that an entity must record a liability for a conditional asset retirement obligation if the fair value of the obligation can be reasonably estimated. FIN 47 is effective for no later than the end of fiscal years ending after December 15, 2005. The Company does not expect the adoption of FIN 47 to have a material effect on its Consolidated Financial Statements.

Note 20 Subsequent Events:

Avure -

With authorization from the Board of Directors in September 2004, we engaged the services of Danske Markets, Inc., which is working in Europe in cooperation with Close Associates to assist us in the sale of our General Press operations. These businesses are comprised of the North America Press and International Press segments. As these segments do not utilize ultrahigh-pressure water pumps, they are not considered core to our business, and it is our intent to divest ourselves of these operations. However, there can be no assurance we will find a suitable buyer at an acceptable price. If we do divest these businesses, it is anticipated that we will enter into a manufacturing agreement to provide the purchaser with the ultrahigh-pressure pump components and related spare parts for the Fresher Under Pressure business. These segments do not meet the

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

accounting criteria to be considered assets held for sale as of April 30, 2005 and accordingly the results of operations are shown as continuing operations and the related assets have not been reported as held for sale in our financial statements.

F-49

Table of Contents**FLOW INTERNATIONAL CORPORATION****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (Continued)****Flow Robotics Systems -**

In an effort to control costs and to focus on the core UHP waterjet systems, on June 2, 2005, the Company announced that it had expanded its strategic relationship with Motoman, Inc. to deliver standard, pre-engineered robotic waterjet cutting solutions to the automotive industry. The relationship means that Motoman, Inc. will be the primary sales contact with the end user for standard systems and the Company will sell UHP pumps and parts to Motoman, Inc. to be integrated into the pre-engineered robotic cutting system. At the same time, the Company announced that, in order to realign its resources with this new strategic direction, its custom robotic waterjet cutting system manufacturing would be relocated from Wixom, Michigan to Burlington, Ontario. This closure is expected to be completed by the second quarter of fiscal year 2006 with restructuring expenses of approximately \$1,000,000. These expenses include severance payments for employees, exit expenses for the facility as well as logistical expenses for moving and disposing of equipment and assets. The Company has also retained a broker to assist in the evaluation of various opportunities for the Applications Group, the Company's Other segment.

Note 21 Subsequent Event Update:

On October 31, 2005, the Company completed the sale of the North America Press and International Press reportable segments, as well as the non ultrahigh-pressure portion of the Food reportable segment with the Gores Technology Group, LLC (Gores) for estimated net proceeds of \$14.0 million, comprised of cash and notes. An \$8.0 million 8% note is due 90 days subsequent to the closing of the transaction while the other \$2.0 million 6% note is due in three years. At closing, the Company also entered into a Supply Agreement with Gores whereby it has agreed to supply certain high pressure pump products on an exclusive basis to Gores. The Company expects to record a gain on the sale transaction.

Note 22 Selected Quarterly Financial Data (unaudited):

				Fourth	Total
Fiscal 2005 Quarters	First	Second	Third	(restated)	(restated)
Sales	\$ 48,982	\$ 55,467	\$ 49,872	\$ 65,044	\$ 219,365
Gross Margin	17,895	18,255	18,614	25,696	80,460
Loss Before Discontinued Operations	(2,340)	(275)	(3,501)	(14,500)	(20,616)
Net (Loss) Income	(2,340)	(275)	(3,501)	(14,500)	(20,616)
Loss Per Share:					
Basic and Diluted					
(Loss) Income Before Discontinued Operations *	(.15)	(.02)	(.22)	(.61)	(1.16)
Net (Loss) Income *	(.15)	(.02)	(.22)	(.61)	(1.16)
Fiscal 2004 Quarters	First	Second	Third	Fourth	Total

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

Sales	\$ 37,182	\$ 43,689	\$ 42,382	\$ 54,356	\$ 177,609
Gross Margin	13,385	15,651	16,298	19,893	65,227
Loss Before Discontinued Operations	(6,193)	(1,929)	(321)	(3,605)	(12,048)
Net Loss	(5,667)	(1,929)	(321)	(3,605)	(11,522)
Loss Per Share:					
Basic and Diluted					
Loss Before Discontinued Operations	(.40)	(.13)	(.02)	(.23)	(.78)
Net Loss	(.37)	(.13)	(.02)	(.23)	(.75)

* Quarters do not equal year due to equity offering in the fourth quarter of fiscal 2005.

F-50

Table of Contents**FLOW INTERNATIONAL CORPORATION****SCHEDULE II****VALUATION AND QUALIFYING ACCOUNTS****(In Thousands)**

<u>Classification</u>	<u>Balance at Beginning of Period</u>	<u>Additions</u>		<u>Deductions *</u>	<u>Balance at End of Period</u>
		<u>Charged to Costs and Expenses</u>	<u>Charged to Other Accounts</u>		
<i>Year Ended April 30:</i>					
<i>Allowance for Doubtful Accounts</i>					
2005	\$ 4,777	\$ 584	\$ 54	\$ (1,556)	\$ 3,859
2004	5,019	1,366	(19)	(1,589)	4,777
2003	962	4,978	131	(1,052)	5,019
<i>Provision for Slow-Moving and Obsolete Inventories</i>					
2005	\$ 2,499	\$ 1,053	\$ 46	\$ (665)	\$ 2,933
2004	4,336	975		(2,812)	2,499
2003	1,792	4,271	69	(1,796)	4,336

* Write-offs of uncollectible accounts and disposal of obsolete inventory.

<u>Classification</u>	<u>Balance at Beginning of Period</u>	<u>Net Change</u>	<u>Balance at End of Period</u>
<i>Year Ended April 30</i>			
<i>Valuation Allowance on Deferred Tax Assets</i>			
2005	\$ 23,927	\$ 10,919	\$ 34,846
2004	25,768	(1,841)	23,927
2003	615	25,153	25,768

Table of Contents

20,692,359 Shares

Common Stock

PROSPECTUS

, 2005

Table of Contents**PART II****INFORMATION NOT REQUIRED IN THE PROSPECTUS****Item 13. *Other Expenses of Issuance and Distribution***

The following table sets forth the costs and expenses, other than underwriting discounts and commissions, payable by us in connection with the sale of common stock being registered. All amounts are estimates except the SEC registration fee and the NASD filing fee. We will pay all these expenses.

	Amount to be
	Paid

SEC Registration Fee	\$ 16,464
Legal Fees and Expenses	325,000
Accounting Fees and Expenses	250,000
Transfer Agent and Registrar Fees	25,000
Miscellaneous	9,536

Total	\$ 626,000

Item 14. *Indemnification of Directors and Officers*

Article XII of the Restated Articles of Incorporation of Flow International Corporation authorizes Flow International Corporation to indemnify any present or former director or officer to the fullest extent not prohibited under the WBCA, public policy or other applicable law. Chapter 23B.08.560 and .570 of the WBCA authorize a corporation to indemnify its directors or officers in terms sufficiently broad to permit such indemnification under certain circumstances for liabilities (including provisions permitting advances for expenses incurred) arising under the 1933 Act.

The directors and officers of Flow International Corporation are entitled to indemnification by the Selling Shareholder against any loss, claim, damage, or liability to the extent it arises out of or is based upon the failure of the Selling Shareholder (or its donees, legatees, or pledges) and each underwriter to comply with the Prospectus delivery requirements under the federal securities laws or any applicable state securities laws or upon any untrue statement or omission made in this Registration Statement and the Prospectus contained therein, as the same shall be amended or supplemented, made in reliance upon or in conformity with written information furnished to Flow International Corporation by such Selling Shareholder or such underwriter.

In addition, Flow International Corporation maintains directors and officers liability insurance under which Flow International Corporation's directors and officers are insured against loss (as defined in the policy) as a result of claims brought against them for their wrongful acts in such capacities.

Edgar Filing: FLOW INTERNATIONAL CORP - Form S-1/A

The Company's Restated Articles of Incorporation contain a provision eliminating the personal liability of directors to the Company or its shareholders for monetary damages arising out of a breach of fiduciary duty. Under Washington law, this provision eliminates the liability of a director for breach of fiduciary duty but does not eliminate the personal liability of any director for (i) acts or omissions of a director that involve intentional misconduct or a knowing violation of law, (ii) conduct in violation of Section 23B.08.310 of the WBCA or (iii) any transaction from which a director personally received a benefit in money, property or services to which the director was not legally entitled.

Item 15. *Recent Sales of Unregistered Securities*

On March 21, 2005, in a Private Placement in Equity Securities Transaction (*PIPE Transaction*), we sold 17,473,116 equity units at \$3.72 per unit for gross proceeds of \$65 million, and net proceeds of \$59.3 million. A unit consists of one share of our common stock and one warrant to buy 1/10th of a share of our common stock.

II-1

Table of Contents

Ten warrants give the holder the right to purchase one share of common stock for \$4.07. Under terms of PIPE Transaction, we are required to cause the Form S-1 to go effective on or before September 17, 2005. We are subject to liquidated damages of \$650,000 per month if we fail to meet the date requirement. The issuance of shares and warrants was exempt from registration under Section 4(2) of the Securities Act of 1933 because these were not transactions involving a public offering.

In addition, on July 28, 2004, in connection with the execution of amendments to its senior credit agreement, we issued the senior lenders, Banc of America Strategic Solutions, Inc., U.S. Bank National Association and Keybank National Association, 150,000 detachable \$.01 warrants as a fee. Also, in connection with the July 28, 2004 amendment of our subordinated note agreement, we issued the subordinated lenders, The John Hancock Life Insurance Company, John Hancock Variable Life Insurance Company, Signature 4 Limited and Signature 5 L.P., 150,000 detachable \$.008 warrants as a fee. The 304,000 warrants were valued at \$960,000 and are being amortized to interest expense beginning August 1, 2004 through August 1, 2005. The issuance of warrants in both cases were exempt from registration under Section 4(2) of the Securities Act of 1933 because these were not transactions involving a public offering.

Consulting Agreement

We have entered into a Consulting Agreement effective March 1, 2003 pursuant to which we have engaged Mr. Chrismon Nofsinger to provide executive coaching and organizational services. In partial consideration for such services, we issued 19,097 unregistered shares of our common stock to Mr. Nofsinger in June 2004; 1,511 shares were issued in September 2004; 4,695 shares were issued in August 2004; and 7,006 unregistered shares of our common stock were issued to Mr. Nofsinger in April 2005. The issuance of shares to Mr. Nofsinger was exempt from registration under Section 4(2) of the Securities Act of 1933 because it was a transaction not involving a public offering.

Non-Cash Compensation

During the year ended April 30, 2005, we recorded non-cash compensation expense of \$1.4 million related to various compensatory arrangements which provide common stock or restricted stock units, rather than options, to the Board of Directors and executive management. This compensation expense consists of \$240,000 related to the accrual for annual compensatory stock awards to Board of Directors members and \$1.1 million related to the executive employment and retention contracts of Stephen R. Light, D. Patterson Adams, Jr., Thomas C. Johnson, Richard A. LeBlanc, John S. Leness, Felix M. Sciulli and Stephen D. Reichenbach. The issuance of shares was exempt from registration under Section 4(2) of the Securities Act of 1933 because these were not transactions involving a public offering.

Table of Contents

Item 16. Exhibits and Financial Statement Schedules

**Exhibit
Number**

3.1*	Restated Articles of Incorporation, filed with the state of Washington April 27, 2005.
3.2*	By-Laws of Flow International Corporation.
4.1*	Certificate of Designation of Series B Junior Participating Preferred Stock.
4.2*	Amended and Restated Rights Agreement dated as of September 1, 1999, between Flow International Corporation and ChaseMellon Shareholder Services, L.L.C.
4.3*	Warrant to Purchase Shares of Common Stock of Flow International Corporation.
4.4*	Warrants to Purchase Shares of Common Stock of Flow International Corporation in connection with Subordinated Notes due April 30, 2008 between Flow International Corporation and The John Hancock Life Insurance Company, John Hancock Variable Life Insurance Company, Signature 4 Limited, and Signature 5 L.P.
5.1	Second Revised Opinion of Preston Gates & Ellis LLP.
10.1*	Flow International Corporation 1987 Stock Option Plan for Nonemployee Directors, as amended.
10.2*	Flow International Corporation 1995 Long-Term Incentive Plan.
10.3*	Flow International Corporation Voluntary Pension and Salary Deferral Plan and Trust Agreement, as amended and restated effective January 1, 2002.
10.4*	Note Purchase Agreement dated as of April 30, 2001.
10.5*	First Amendment to Note Purchase Agreement dated October 31, 2001 among John Hancock Life Insurance Company, John Hancock Variable Life Insurance Company, Signature 4 Limited and Signature 5 L.P. and Flow International Corporation dated as of April 30, 2001.
10.6*	Second Amendment to Note Purchase Agreement dated September 13, 2002 among John Hancock Life Insurance Company, John Hancock Variable Life Insurance Company, Signature 4 Limited and Signature 5 L.P. and Flow International Corporation dated as of April 30, 2001.
10.7*	Employment Agreement dated November 25, 2002 between Stephen R. Light and Flow International Corporation.
10.8*	Second Amended and Restated Credit Agreement dated July 28, 2003.
10.9*	Third Amendment to Note Purchase Agreement dated July 28, 2003 among John Hancock Life Insurance Company, John Hancock Variable Life Insurance Company, Signature 4 Limited and Signature 5 L.P. and Flow International Corporation.
10.10*	Lease dated January 30, 2003 between Flow International and Property Reserve, Inc.
10.11*	Amendments Number One, Two, and Three to the Second Amended and Restated Credit Agreement dated July 28, 2004 among Banc of America Strategic Solutions, Inc., U.S. Bank National Association, Keybank National Association, Bank of America, N.A., as agent for the lenders, and Flow International Corporation.
10.12*	Credit Agreement dated April 28, 2005 among Flow International Corporation, Bank of America, N.A. and U.S. Bank National Association
10.13*	Fourth Amendment to Note Purchase Agreement dated July 28, 2004 among John Hancock Life Insurance Company, John Hancock Variable Life Insurance Company, Signature 4 Limited and Signature 5 L.P. and Flow International Corporation .

Table of Contents

**Exhibit
Number**

10.14*	Securities Purchase Agreement dated February 18, 2005.
10.15*	Registration Rights Agreement, as amended September 13, 2005, and as subsequently amended on October 17, 2005 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on September 15, 2005 and to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on October 18, 2005).
10.16	Credit Agreement dated July 8, 2005 among Flow International Corporation, Bank of America, N.A. and U.S. Bank National Association (incorporated by reference to Exhibit 10.1 to the registrant's Form 8-K/A dated July 29, 2005).
10.17*	2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on September 27, 2005).
10.18*	Annual Incentive Plan for Executives, Senior Managers and Select Administrative Staff (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on September 27, 2005).
10.19*	Long Term Incentive Plan for Executives For the Fiscal Year Period Beginning May 1, 2005 and Ending April 30, 2008 (incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on September 27, 2005).
10.20*	Purchase Agreement with Quintus Holdings, LLC dated September 30, 2005, as amended on October 31, 2005 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on October 4, 2005 and to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on November 4, 2005).
21.1	Subsidiaries of the Registrant (incorporated by reference to Exhibit 21.1 to the registrant's Form 10-K dated July 29, 2005).
24.1*	Power of Attorney, included in signature page.
23.2	Consent of Preston Gates & Ellis LLP (included in Exhibit 5.1).

* previously filed

Table of Contents

Item 17. *Undertakings*

The undersigned hereby undertakes:

1. To file, during any period in which offers or sales are being made, a post-effective amendment to this registration statement: (i) to include any prospectus required by section 10(a)(3) of the Securities Act of 1933; (ii) to reflect in the prospectus any facts or events arising after the effective date of the registration statement (or the most recent post-effective amendment thereof) which, individually or in the aggregate, represents a fundamental change in the information set forth in the registration statement. Notwithstanding the foregoing, any increase or decrease in volume of securities offered (if the total dollar value of securities offered would not exceed that which was registered) and any deviation from the low or high end of the estimated maximum offering range may be reflected in the form of prospectus filed with the Commission pursuant to Rule 424(b) if, in the aggregate, the changes in volume and price represent no more than 20 percent change in the maximum aggregate offering price set forth in the *Calculation of Registration Fee* table in the effective registration statement; and (iii) to include any material information with respect to the plan of distribution not previously disclosed in the registration statement or any material change to such information in the registration statement; provided, however, that paragraphs (a)(1)(i) and (a)(1)(ii) do not apply if the information required to be included in a post-effective amendment by those paragraphs is contained in periodic reports filed with or furnished to the Commission by the registrant pursuant to section 13 or section 15(d) of the Securities Exchange Act of 1934 that are incorporated by reference in the registration statement.

2. That, for the purpose of determining any liability under the Securities Act of 1933, each such post-effective amendment shall be deemed to be a new registration statement relating to the securities offered therein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

3. To remove from registration by means of a post-effective amendment any of the securities being registered that remain unsold at the termination of the offering.

4. The undersigned registrant hereby undertakes that, for purposes of determining any liability under the Securities Act of 1933, each filing of the registrant's annual report pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 that is incorporated by reference in this registration statement shall be deemed to be a new registration statement related to securities offered herein, and the offering of such securities at that time shall be deemed to be the initial bona fide offering thereof.

Table of Contents**SIGNATURES**

Pursuant to the requirements of the Securities Act of 1933, as amended, the registrant certifies that it has duly caused this Amendment to Registration Statement on Form S-1 to be signed on its behalf by the undersigned, thereunto duly authorized, in the City of Kent, State of Washington, on the 9th day of December, 2005.

FLOW INTERNATIONAL CORPORATION

By: */s/* STEPHEN R. LIGHT
Stephen R. Light
President and Chief Executive Officer

Pursuant to the requirements of the Securities Act of 1933, as amended, this Registration Statement on Form S-1 has been signed by the following persons in the capacities indicated on December 9, 2005.

<u>Signature</u>	<u>Title</u>
<i>/s/</i> STEPHEN R. LIGHT	President and Chief Executive Officer, Director
Stephen R. Light	(Principal Executive Officer)
<i>/s/</i> DOUGLAS P. FLETCHER	Chief Financial Officer (Principal Financial and Principal Accounting Officer)
Douglas P. Fletcher	
<i>/s/</i> RICHARD P. FOX*	Director
Richard P. Fox	
<i>/s/</i> KATHRYN L. MUNRO*	Chairman, Director
Kathryn L. Munro	
<i>/s/</i> ARLEN I. PRENTICE*	Director
Arlen I. Prentice	
<i>/s/</i> J. MICHAEL RIBAUDO*	Director
J. Michael Ribaud	
<i>/s/</i> KENNETH M. ROBERTS*	Director
Kenneth M. Roberts	
<i>/s/</i> SANDRA F. ROREM*	Director
Sandra F. Rorem	
<i>/s/</i> JAN K. VER HAGEN*	Director

Jan K. Ver Hagen

/s/ RONALD D. BARBARO*

Director

Ronald D. Barbaro

*By:

/s/ STEPHEN R. LIGHT
Stephen R. Light
Attorney-in-Fact

II-6

Table of Contents**INDEX TO EXHIBITS****Exhibit
Number**

3.1*	Restated Articles of Incorporation, filed with the state of Washington April 27, 2005.
3.2*	By-Laws of Flow International Corporation.
4.1*	Certificate of Designation of Series B Junior Participating Preferred Stock.
4.2*	Amended and Restated Rights Agreement dated as of September 1, 1999, between Flow International Corporation and ChaseMellon Shareholder Services, L.L.C.
4.3*	Warrant to Purchase Shares of Common Stock of Flow International Corporation.
4.4*	Warrants to Purchase Shares of Common Stock of Flow International Corporation in connection with Subordinated Notes due April 30, 2008 between Flow International Corporation and The John Hancock Life Insurance Company, John Hancock Variable Life Insurance Company, Signature 4 Limited, and Signature 5 L.P.
5.1	Second Revised Opinion of Preston Gates & Ellis LLP.
10.1*	Flow International Corporation 1987 Stock Option Plan for Nonemployee Directors, as amended.
10.2*	Flow International Corporation 1995 Long-Term Incentive Plan.
10.3*	Flow International Corporation Voluntary Pension and Salary Deferral Plan and Trust Agreement, as amended and restated effective January 1, 2002.
10.4*	Note Purchase Agreement dated as of April 30, 2001.
10.5*	First Amendment to Note Purchase Agreement dated October 31, 2001 among John Hancock Life Insurance Company, John Hancock Variable Life Insurance Company, Signature 4 Limited and Signature 5 L.P. and Flow International Corporation dated as of April 30, 2001.
10.6*	Second Amendment to Note Purchase Agreement dated September 13, 2002 among John Hancock Life Insurance Company, John Hancock Variable Life Insurance Company, Signature 4 Limited and Signature 5 L.P. and Flow International Corporation dated as of April 30, 2001.
10.7*	Employment Agreement dated November 25, 2002 between Stephen R. Light and Flow International Corporation.
10.8*	Second Amended and Restated Credit Agreement dated July 28, 2003.
10.9*	Third Amendment to Note Purchase Agreement dated July 28, 2003 among John Hancock Life Insurance Company, John Hancock Variable Life Insurance Company, Signature 4 Limited and Signature 5 L.P. and Flow International Corporation.
10.10*	Lease dated January 30, 2003 between Flow International and Property Reserve, Inc.
10.11*	Amendments Number One, Two, and Three to the Second Amended and Restated Credit Agreement dated July 28, 2004 among Banc of America Strategic Solutions, Inc., U.S. Bank National Association, Keybank National Association, Bank of America, N.A., as agent for the lenders, and Flow International Corporation.
10.12*	Credit Agreement dated April 28, 2005 among Flow International Corporation, Bank of America, N.A. and U.S. Bank National Association
10.13*	Fourth Amendment to Note Purchase Agreement dated July 28, 2004 among John Hancock Life Insurance Company, John Hancock Variable Life Insurance Company, Signature 4 Limited and Signature 5 L.P. and Flow International Corporation.
10.14*	Securities Purchase Agreement dated February 18, 2005.

Table of Contents

**Exhibit
Number**

10.15*	Registration Rights Agreement, as amended September 13, 2005, and as subsequently amended on October 17, 2005 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on September 15, 2005 and to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on October 18, 2005).
10.16	Credit Agreement dated July 8, 2005 among Flow International Corporation, Bank of America, N.A. and U.S. Bank National Association (incorporated by reference to Exhibit 10.1 to the registrant's Form 8-K/A dated July 29, 2005).
10.17*	2005 Equity Incentive Plan (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on September 27, 2005).
10.18*	Annual Incentive Plan for Executives, Senior Managers and Select Administrative Staff (incorporated by reference to Exhibit 10.2 to the Registrant's Current Report on Form 8-K filed on September 27, 2005).
10.19*	Long Term Incentive Plan for Executives For the Fiscal Year Period Beginning May 1, 2005 and Ending April 30, 2008 (incorporated by reference to Exhibit 10.3 to the Registrant's Current Report on Form 8-K filed on September 27, 2005).
10.20*	Purchase Agreement with Quintus Holdings, LLC dated September 30, 2005, as amended on October 31, 2005 (incorporated by reference to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on October 4, 2005 and to Exhibit 10.1 to the Registrant's Current Report on Form 8-K filed on November 4, 2005).
21.1	Subsidiaries of the Registrant (incorporated by reference to Exhibit 21.1 to the registrant's Form 10-K dated July 29, 2005).
24.1*	Power of Attorney, included in signature page.
23.2	Consent of Preston Gates & Ellis LLP (included in Exhibit 5.1).

* previously filed