MATERIAL SCIENCES CORP
Form 10-K
May 11, 2007
Table of Contents

United States

Washington, D.C. 20549

X Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended: February 28, 2007

OR
Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the transition period from ______ to ______

Commission file number: 1-8803

(Exact name of registrant as specified in its charter)

Delaware	95-2673173
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
2200 East Pratt Boulevard, Elk Grove Village, Illinois	60007
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: 847-439-2210

Securities registered pursuant to Section 12(b) of the Act:

Title of each class	Name of each exchange on which registered
Common Stock, $0.02 par value	New York Stock Exchange

Securities registered pursuant to Section 12(g) of the Act: None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ________ No ____X____

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or 15(d) of the Act. Yes ________ No ____X____

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ____X____ No ________

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ________

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

Large accelerated filer ________ Accelerated filer ____X____ Non-accelerated filer ________

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Act) Yes ________ No ____X____

The aggregate market value of the voting and non-voting stock of the registrant held by shareowners of the registrant (not including any voting and non-voting stock owned by directors, executive officers or other affiliates of the registrant) was $120,913,972 as of August 31, 2006, the last business day of the registrant s most recently completed second fiscal quarter (based on the closing sale price on the New York Stock Exchange on such date, as reported by The Wall Street Journal Midwest Edition).

As of May 1, 2007, the registrant had outstanding an aggregate of 14,615,259 shares of its common stock.

Document Incorporated by Reference

Portions of the following document are incorporated herein by reference into the indicated part of this Form 10-K:

Document	Part of Form 10-K into which incorporated
Registrant s Proxy Statement for the Annual Meeting of Shareowners held on June 27, 2007 to be filed with the Securities and Exchange Commission on or about May 30, 2007.	Part III

Table of Contents

TABLE OF CONTENTS

Table of Contents

PART I

This report contains forward-looking statements concerning our future business performance, strategy, outlook, plans, liquidity, pending regulatory matters and outcomes of contingencies including legal proceedings, among others. Forward-looking statements may be typically identified by the use of words such as may , will , should , expect , anticipate , seek , believe , intend , plan estimate , among others. These forward-looking statements are subject to risks and uncertainties that could cause our actual results to differ materially from the expectations expressed in the forward-looking statements. Although we believe that the expectations reflected in our forward-looking statements are reasonable, any or all of our forward-looking statements may prove to be incorrect. Consequently, no forward-looking statements may be guaranteed. Factors that could cause our actual results to differ from expectations include the risks set forth under Item 1A, Risk Factors , Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations , among other items in this report. Forward-looking statements speak only as of the date of this report.

Item 1. Business

Overview

Material Sciences Corporation and its subsidiaries (MSC , we , our or us) designs, manufactures and markets material-based solutions for acoustical and coated applications. We currently report under one segment based on how we view our business for evaluating performance and making operating decisions. Headquartered in Elk Grove Village, Illinois, MSC has been in operation since 1971 and is incorporated under the laws of the State of Delaware.

Our material-based solutions are designed to meet specific customer requirements for the automotive, building and construction, electronics, heating, ventilation and air conditioning (HVAC), lighting and appliance markets worldwide. Our acoustical material-based solutions include multilayer composites consisting of metals, polymeric coatings and other materials used to manage noise and vibration. The coated material-based solutions include coil coated and electrogalvanized (EG) protective and decorative coatings applied to coils of metal in a continuous, high-speed, roll-to-roll process. In previous fiscal years, we reported electronic material-based solutions separately. However, electronic products are extensions of our acoustical and coated applications, so electronic products are reported as acoustical sales when sold for disk drive applications and as coated sales when sold for all other electronic applications.

MSC operates five manufacturing plants in the United States and Europe; two facilities in Elk Grove Village, Illinois (Elk Grove Village); one facility in Morrisville, Pennsylvania (Morrisville); one facility in Walbridge, Ohio (Walbridge); and one facility in Eisenach, Germany.

As a part of our strategic planning process, management has been evaluating the strategic position, growth, and economic value potential of our businesses with the objective of creating additional value for our shareowners. As a result of this planning process and consistent with the demands of the market, management, in fiscal 2005, closed our coil coating facility located in Middletown, Ohio (Middletown) and concluded the sale of our idled coil coating facility in Elk Grove Village. Additional information concerning these transactions is set forth in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

We continue to expand our global reach and presence as a leading supplier of material-based solutions primarily through partnerships, alliances and third party agreements. In South America, we own a 51% interest in a joint-venture partnership with Tekno S.A. (Tekno) which provides for the manufacture and sale of acoustical products. We also provide for the manufacture, sale and marketing of our electronic and brake products in Southeast Asia through a third party in Malaysia. In the second quarter of fiscal 2005, we announced our expansion in the European market through a strategic alliance with Arcelor Mittal. This alliance provides MSC Europe with expanded manufacturing, technical support, marketing, and sales capabilities for our acoustical material-based solutions, primarily Quiet Steel®, a multilayer composite of metals, coatings and other materials, typically consisting of metal outer skins surrounding a thin, highly-engineered, viscoelastic core material. In the third quarter of fiscal 2007, we signed an agreement with a Korean company named Hae Won Steel (Hae Won) to produce Quiet Steel® and other decorative laminate products in Korea. This agreement, along with other initiatives we have begun in Japan and China, will significantly improve our efforts to penetrate the Asian automotive market.

Table of Contents

Products and Services

We are a supplier of engineered material-based solutions; as such, we apply our expertise in metal composite technology to solve design challenges for many of the largest automotive, appliance and electronic equipment manufacturers in the world. We believe that we maintain strong customer relationships by providing engineering innovation, technical application assistance, manufacturing expertise and delivery infrastructure. This combination enhances our ability to deliver engineered material-based solutions to customers manufacturing facilities on time and within design specifications. We maintain our position as a valued partner to our worldwide customer base through innovative thinking, new market penetration and material development strategies.

We manufacture composites typically consisting of steel or other metals in combination with polymers or other materials to achieve specific properties, such as noise and vibration reduction, also known as acoustical materials. MSC also laminates, coats and electrogalvanizes various types of metal. These products consist of functionally engineered materials that are designed to meet specific customer requirements. Products are primarily designed and produced as a result of our research and development efforts and the proprietary equipment and processes designed and implemented by our engineering and manufacturing organizations. We supply our acoustical and coated materials to a variety of markets both in the United States and internationally. The majority of these materials are used in the automotive, building and construction, electronics, HVAC, lighting and appliance markets. Primary products included in the acoustical material-based solutions are Quiet Steel® applications for disc brake noise dampers, automotive body panels, hard disk drive covers and engine parts. In the coated material-based solutions, major products include coil coated and electrogalvanized protective and decorative coated metal for use as automotive fuel tanks, automotive body skins, metal building skins, appliance cabinets (refrigerators, freezers and other appliances), heating and ventilation applications, lighting and furniture and fixtures.

Acoustical Material-Based Solutions. We believe that we are a leader in the development and manufacturing of continuously processed coated and laminated materials that reduce noise and vibration. Our proprietary Quiet Steel® is engineered to meet a variety of needs in the markets that we serve. The automotive industry is currently the largest market for metal composites, which are being used to replace solid sheet metal parts, including body panels, floor pans, wheel wells, oil pans, valve covers and front engine covers. We are evaluating Quiet Steel® for use in other components within appliances, lawn and power equipment and HVAC products. We produce Quiet Steel® products at our Elk Grove Village, Walbridge and Eisenach, Germany locations. Quiet Steel® is also manufactured in Europe, through our strategic alliance with Arcelor Mittal, in Brazil, through our joint venture with Tekno, and in Malaysia through outside processors. We anticipate continued expansion in the European market through this strategic alliance. We received our first purchase order for brake shims in Southeast Asia during the third quarter of fiscal 2007, so we now are producing brake shim materials in all four major markets, North America, Europe, Asia and South America. We believe this new business, coupled with our agreement with Hae Won, will enable us to significantly expand our presence in the Asian market. Management also believes the construction of our Application Research Center in Michigan and the expansion of our Application Development Center in Europe will provide us with state-of-the-art facilities in which to accelerate the development of new products and technologies. Acoustical material-based solutions represented approximately 50% of consolidated net sales in fiscal 2007, 2006 and 2005.

Coated Material-Based Solutions. We continue to be recognized for our research and development and new product and process development activities involving the continuous, high-speed, roll-to-roll coating of metal. Our coated material-based solutions include painted, EG protective and decorative coatings applied to coiled metal of various widths and thicknesses, in a continuous, high-speed, roll-to-roll process. Coated metal material-based solutions represented approximately 50% of consolidated net sales in fiscal 2007, 2006 and 2005.

We believe that coil coating is the most environmentally safe and energy-efficient method available for applying paint and other coatings to metal. In the process, sheet metal is unwound from a coil, cleaned, leveled, chemically treated, coated, oven-cured and rewound into coils for shipment to manufacturers that fabricate the coated metal into finished products that are sold in a variety of industrial and commercial markets. The coatings are designed to produce both protective and decorative finishes. The finished product of pre-painted or coil coated metal is a versatile material capable of being drawn, formed, bent, bolted, riveted, chemically bonded and welded. Our coated products are primarily used by manufacturers of building products, appliances, HVAC, lighting and automotive products. Manufacturers that use pre-painted materials can eliminate or significantly reduce on-site post-fabrication paint lines and the associated costs. Pre-painted materials also facilitate the adoption of just-in-time and continuous process manufacturing techniques providing lower manufacturing costs and improved product quality. Use of pre-painted metal may, however, require product design or fabrication changes and more stringent handling procedures during manufacturing. Our strategy in coil coating has been to produce high-volume, coated products at low cost, as well as to identify, develop and produce specialty niche products meeting specific customer requirements.

Coil coating technology reduces the environmental impact of painting and manufacturers energy needs. In coil coating processes, over 98% of the coating material is applied, in contrast with the significant waste from overspray typical in post-fabrication painting. The energy required to cure coated metal is substantially less than that required by other coating methods. These savings are achieved because of high-speed material processing and because most of the coatings volatile organic compounds are recycled back into the curing ovens and/or used as fuel.

Electrogalvanizing is a corrosion-resistant steel coating process used primarily in the manufacture of automobile and light-truck body skins. We manufacture EG solutions at our MSC Walbridge facility in Walbridge, Ohio. MSC Walbridge has the ability to provide a full complement of pure zinc and zinc-nickel plated products and organic coatings that offer corrosion resistance, as well as forming and cosmetic advantages over competitive products, such as plastic and hot-dip galvanized steel. Most EG customers are suppliers of sheet steel to the United States automobile industry. We believe that MSC Walbridge is the only facility in North America capable of meeting the wide-width sheet steel demand in a single pass through its line.

Competition

The market for our material-based solutions is highly competitive, both domestically and internationally. There are competitors in each product market we serve, some of which may have greater resources than we do. In the acoustical market, we believe that our technology, product development capability, technical support and customer service place us in a strong competitive position. The competition for Quiet Steel® includes mastics, doublers and other add-on damping treatments, which add cost, complexity and weight in their applications, as well as other metal-to-metal laminates.

Our coated material-based solutions compete with other methods of producing coated sheet metal, principally post-fabrication finishing methods such as spraying, dipping and brushing. Competition in the coil coating industry is heavily influenced by geography, due to the high costs involved in transporting sheet metal coils. Within geographic areas, coil coaters compete on the basis of price, quality, manufacturing capability and customer service. The domestic coil coating market is characterized with excess production capacity which also leads to extreme price competition in the market. We believe we are one of the largest coil coaters in the United States. Although there can be no assurance, we expect that the market penetration of coated metal (coil coating) will increase as a result of more stringent environmental regulation and the energy efficiency, quality and cost advantages provided by pre-painted metal as compared to post-fabrication painting, particularly in high-volume manufacturing operations.

Competition for the production and sale of EG steel for the automotive industry consists primarily of both foreign-owned and domestic-owned steel companies that manufacture EG steel in the United States either directly or through joint ventures. Limited quantities of EG steel are imported into the United States from foreign steel suppliers. Although the domestic steel industry has strengthened during the past several years, it continues to go through a period of consolidation through mergers. These factors, along with increased domestic competition from international companies, have affected our EG business and the availability and cost of steel substrate. In addition, the use of automotive quality hot-dip galvanized steel continues to make inroads into the EG market. We are unable to determine the effect, if any, on the market resulting from the substitution of other materials, changes in galvanizing technology, existence of excess capacity and the entrance of additional capacity.

International

We believe that significant international opportunities exist for MSC, particularly for our acoustical products. In an effort to capitalize on these opportunities, we maintain certain distribution, manufacturing, licensing and royalty agreements with agents and companies in Europe, South America and Asia that cover our Quiet Steel® products. These agreements provide us with the opportunity for market expansion in those geographic areas. To further the penetration of our acoustical products in the European market, we entered into a strategic alliance with Arcelor Mittal in the second quarter of fiscal 2005. This alliance allows for the expanded manufacturing, technical support, marketing and sales of our Quiet Steel® products to foreign automotive manufacturers. We have continued to increase our

5

Table of Contents

penetration in the European brake market as our German brake sales increased by approximately 39% in fiscal 2007 compared to fiscal 2006 primarily due to new customer sales. To further the penetration of our acoustical products in the Asian market, we entered into an agreement with Hae Won to produce Quiet Steel® and other decorative laminate products. In addition, we have numerous Asian initiatives designed to help us penetrate this growing market. We continue to pursue a variety of other business relationships, including direct sales, distribution agreements, licensing, acquisitions and other forms of partnering to increase our international sales and expand our international presence.

We implemented certain changes to our international business in fiscal 2005 as a part of our worldwide efforts to reduce costs and improve efficiencies. The manufacture of our electronic products for export sales was transitioned from our Elk Grove Village manufacturing line to our branch in Malaysia in the third quarter of fiscal 2005. As a result of the changes in the supply model for the hard disk drive market, we also shifted our business model in Malaysia from package sales to a toll processing program, moving the cost of the metal from MSC to the customer.

The following table shows our domestic and foreign net sales for fiscal years 2007, 2006 and 2005:

	Fiscal 2007		Fiscal 2006		Fiscal 2005	
Net Sales ($ in millions)	$	%	$	%	$	%
Domestic	$ 253.0	96	$ 274.7	96	$ 253.1	96
Foreign	9.6	4	11.9	4	10.2	4
Total	$ 262.6	100	$ 286.6	100	$ 263.3	100

We own $5.0 million in long-lived assets in foreign countries as of February 28, 2007. The remaining $69.9 million in long-lived assets at February 28, 2007 was in the United States.

Marketing and Sales

We market our products, services and technologies nationally and internationally through our Company sales and marketing organization as well as through independent distributors, agents and licensees. Primary target markets for our products include the automotive, building and construction, electronics, HVAC, lighting and appliance markets. We believe we are a valued leader in the industries we serve because of our engineering innovation, technical application assistance, manufacturing expertise and delivery infrastructure.

We employ certain individuals with noise, vibration and harshness (NVH) experience using a proven sales methodology for penetrating the automotive markets we serve. We believe that these individuals will also be able to increase penetration of these products in non-automotive markets and it is important we retain these individuals so we can continue to develop solutions which support the growth in sales of all laminate products. All of our selling activities are supported by technical service departments that aid customers in the choice of available materials and their use in customers manufacturing processes.

We estimate that customers in the automotive industry were the end users for approximately 69%, 67% and 55% of our net sales in fiscal 2007, 2006 and 2005, respectively. We also estimate that customers in the building products market were the end users for approximately 12%, 11% and 9% of net sales in fiscal 2007, 2006 and 2005, respectively.

Due to concentration in the automotive industry, we believe that sales to individual automotive companies, including indirect sales, are significant. See Item 1A, Risk Factors , for more discussion on automotive sales. The following table shows direct sales to our significant customers as a percentage of consolidated net sales for fiscal 2007, 2006 and 2005.

	% of Consolidated Net Sales		
Customer	Fiscal 2007	Fiscal 2006	Fiscal 2005
Ford	19%	10%	**
General Motors	13%	12%	4%
DaimlerChrysler	13%	14%	12%
Mitsui Steel	10%	8%	8%

** denotes less than 1%

6

Table of Contents

We believe that additional business opportunities exist for the sale of our acoustical material solutions as a result of the increased presence in the United States by foreign automotive manufacturers, and we are concentrating our marketing and sales efforts accordingly.

Backlog. Our backlog of orders as of February 28, 2007 was approximately $27.7 million, all of which is expected to be filled during the remainder of fiscal year 2008. Our backlog as of February 28, 2006, was approximately $26.3 million.

Raw Materials. We are generally not dependent on any one source for raw materials or purchased components essential to our business for which an alternative source is not readily available. We are, however, affected by the price and availability of certain raw material inputs such as steel, zinc, nickel and natural gas. The shortage of available metal and higher metal prices continue to affect each of the markets we serve. Thin gauged, wide-width material for use in the manufacture of Quiet Steel® for body panels for the automotive industry continues to be difficult to obtain. The price of zinc, nickel and natural gas has been quite volatile in fiscal 2007 and 2006 which has affected our profitability. See Item 1A, Risk Factors , for more discussion on raw material inputs. We participate in purchasing programs supported by our customers, usually large original equipment manufacturers, to maintain an adequate supply of metal at the best available price.

Seasonality. We believe that our business, in the aggregate, is not subject to significant swings in seasonal demand. However, some of our products, such as materials used for building products and swimming pools, experience greater demand in some seasons. In addition, changes in production cycles in the automotive industry, particularly around model changes and summer and holiday shutdown periods, can impact sales in those periods.

Environmental Matters

We believe we operate our facilities and conduct our business, in all material respects, in accordance with applicable environmental laws. We spent approximately $3.9 million ($1.3 million on capital projects and $2.6 million of expense) for maintenance and installation of environmental controls at our facilities in fiscal 2007 and have budgeted approximately $3.6 million for fiscal 2008. For additional information regarding our environmental matters, see Item 3, Legal Proceedings and Note 4 of the Notes to the Consolidated Financial Statements entitled Contingencies.

Research and Development

We spent approximately $5.7 million in fiscal 2007 for product and process development activities compared to $2.7 million and $4.4 million in fiscal 2006 and 2005, respectively. The increase in research and development spending during fiscal 2007 is directly attributable to the opening of the Application Research Center in June 2006 as discussed below. The decrease in research and development spending during fiscal 2006 was primarily due to the divestiture of the EMD business in June 2005.

We are dedicated to our research and development efforts, often initiating technological process developments in the industry. To build upon our position as a leader in the industry, we completed construction of our new Application Research Center in Michigan in March 2006, and this facility was officially opened in June 2006. This new testing and development center provides technical and development facilities for all of our products with a concentration on NVH for the continued engineering, application and validation of our NVH material solutions. We substantially completed the expansion of our Application Development Center in Europe in January 2007. This facility will enhance our ability to develop, test and market our NVH solutions in Europe.

When possible, we seek patent and trademark protection for our products. We own, and are licensed under, a number of U.S. and foreign patents, patent applications, trademarks and trademark applications. Patents for individual products extend for varying periods according to the date of patent filing or grant and the legal terms of patents in the various countries where patent protection is obtained. While we consider our various patents, patent applications, trademarks and trademark applications to be important, we do not believe that the loss of any individual patent, patent application, trademark or trademark application would have a material adverse effect upon our business as a whole.

Employees

As of February 28, 2007, we had 583 full-time employees. Of this number, approximately 160 were engaged in selling, general and administrative activities. Our Walbridge production employees are covered by a union contract expiring in September 2010. The production employees at our Elk Grove Village facility were covered by a union contract that expired in February 2007. A new three-year contract was

7

Table of Contents

ratified in April 2007 that will expire in February 2010. The production employees at our Morrisville facility were covered by a union contract that expired in March 2006. We implemented new terms and conditions of employment which included a voluntary severance package and we commenced hiring employees to replace those who elected the severance package in April 2006. The Morrisville employees are currently working under the terms and conditions we implemented. Employees at our Eisenach, Germany facility are not represented by a union. Our union employees are vital to our operations. We consider our relationships with our employees and unions to be good.

Available Information

MSC s annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and any amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934 are available free of charge on our website at www.matsci.com as soon as reasonably practicable after electronically filing such reports with the Securities and Exchange Commission (SEC). We will also furnish paper copies of such filings free of charge upon request. Our corporate headquarters are located at 2200 East Pratt Boulevard, Elk Grove Village, Illinois 60007, and our telephone number is (847) 439-2210. Copies of any materials we file with the SEC are also available at the SEC s Public Reference Room at 100 F Street, N.E. Washington, D.C. 20549. Information on the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330. In addition, the SEC maintains an Internet site that contains reports, proxy and information statements, and other information regarding issuers that file electronically with the SEC at http://www.sec.gov.

Executive Officers of the Registrant

As of May 1, 2007, our executive officers, who are elected by and serve at the discretion of our Board of Directors, are as follows:

Executive Officer	Age	Position(s)	Officer Since
Clifford D. Nastas	44	Chief Executive Officer	2001
James M. Froisland	56	Senior Vice President, Chief Financial Officer, Chief Information Officer and Corporate Secretary	2006
John M. Klepper	60	Vice President, Human Resources	2003
Kevin R. Williams	36	Vice President, Operations	2006
Mark J. Gresser	43	Vice President, Sales and Marketing	2006
Robert R. Rogowski	48	Vice President and Corporate Controller	2007

Clifford D. Nastas. On December 1, 2005, Mr. Nastas was named our Chief Executive Officer. Previously, Mr. Nastas served as President and Chief Operating Officer since June 2005. Prior to that time he held numerous executive positions with us including Executive Vice President and Chief Operating Officer from October 2004 to June 2005, Vice President and General Manager of the Engineered Materials and Solutions Group (EMS) from May 2004 to October 2004; Vice President of Sales and Marketing of EMS from July 2003 to May 2004; and Vice President of Marketing of MSCLC from January 2001 to July 2003. Prior to joining MSC, Mr. Nastas served as the Global Automotive Business Director for Honeywell International Inc., a technology and manufacturing provider of aerospace products, control technologies, automotive products, specialty chemicals and advanced materials, since 1995.

James M. Froisland. On June 21, 2006, Mr. Froisland was named our Senior Vice President, Chief Financial Officer, Chief Information Officer and Corporate Secretary. Previously, Mr. Froisland worked as a private consultant from September 2005 to June 2006. Prior to that time, Mr. Froisland served as Senior Vice President, Chief Financial Officer and Chief Information Officer at InteliStaf Healthcare, Inc., a private provider of healthcare staffing services, from May 2002 to September 2005. He also held executive and senior finance, accounting and information technology positions with a number of other companies including Burns International, Anixter International Inc., Budget Rent A Car, Allsteel Inc. and The Pillsbury Company. Mr. Froisland started his career with KPMG and is a Certified Public Accountant.

John M. Klepper. Mr. Klepper has served as our Vice President of Human Resources since June 2003 and Vice President of Human Resources for MSC EMS since March 2002. Previous to this, he held the position of Director of Corporate Human Resources of MSC from March 2000 to March 2002. Prior to joining MSC, Mr. Klepper was the Vice President of Human Resources for Fluid Management, Inc., a worldwide manufacturer of mixing and tinting equipment for the paint, coatings, and ink industries, since 1997.

Kevin R. Williams. On April 20, 2006, Mr. Williams was named an officer of MSC. Mr. Williams has served as Vice President, Operations since June 2005. Prior to this, Mr. Williams was the Plant Manager of the Walbridge manufacturing facility from December 2004. Prior to joining MSC, Mr. Williams held positions in manufacturing, quality, engineering, business development, Six Sigma, lean manufacturing and general management. The majority of his experience has been with major Tier I automotive suppliers such as ArvinMeritor and Siegel Robert, including international assignments in Southeast Asia. On May 9, 2007, we announced that Mr. Williams would step down as Vice President, Operations. Mr. Williams will continue in his role until a successor has been identified.

Mark J. Gresser. On April 20, 2006, Mr. Gresser was named an officer of MSC. Mr. Gresser has served as Vice President, Sales and Marketing since March 2005. Prior to this position, Mr. Gresser was the Director of Automotive Sales and Marketing since April 2001. Prior to joining MSC, Mr. Gresser held positions in manufacturing, sales, marketing and general management with Ford Motor Company, ExxonMobil, AlliedSignal, and, most recently, Honeywell International.

Robert R. Rogowski. On February 19, 2007, Mr. Rogowski joined us as our Vice President and Corporate Controller, and was named an executive officer of the Company on April 18, 2007. Previously, Mr. Rogowski held several positions at WMS Industries Inc. since June 1992, including the executive officer position of Vice President-Finance and Controller. He also served in several positions for Sara Lee Corporation. Mr. Rogowski is a Certified Public Accountant.

9

Table of Contents

ITEM 1A. Risk Factors

The Securities and Exchange Commission encourages companies to disclose forward-looking information so that investors can better understand a company s future prospects and make informed investment decisions. This Form 10-K contains forward-looking statements, which include, without limitation, those statements regarding anticipated results based on management s plans and assumptions. We have tried, wherever possible, to identify such statements by using words such as anticipates , estimates , expects , projects , intends , plans , believes and words and terms of similar substance in connection with any discussion of future operating or financial performance.

Achievement of future results is subject to risks, uncertainties and inaccurate assumptions. Should known or unknown risks or uncertainties materialize, or should underlying assumptions prove inaccurate, actual results could vary materially from those anticipated, estimated or projected. Many factors also could cause actual results to be materially different from any future results that may be expressed or implied by the forward-looking statements contained in this Form 10-K. We undertake no obligation to update forward-looking statements as a result of future events or developments.

Outlined below are some of the risks that we face that could affect the business and financial position for fiscal 2008 and beyond. However, they are not the only risks that we face. There may be additional risks that are not presently known or that management currently believes are immaterial which could also impair business or financial position.

We face intense competition in the acoustical and coated application industries and failure to successfully compete may negatively affect our business and financial performance.

We operate in a highly competitive business environment and face intense competition from a growing number of competitors, including an increasing number of foreign-based competitors, with greater resources than us. The elements of competition include price, quality and customer service. In the past, our competitors, especially global competitors with low-cost sources of supply outside the United States, have aggressively priced their products and/or introduced new products in order to increase market share. If we are unable to compete in this highly competitive environment, our business and financial performance could be negatively affected.

We rely on sales to a small number of customers; the loss of any one of these customers could have an adverse impact on revenues.

We derive a substantial portion of our revenue from a limited number of customers (most of which are North American automobile manufacturers) and the loss of any one of these customers could adversely impact our operations. In fiscal 2007, our three largest customers, Ford, General Motors and DaimlerChrysler, represented 19%, 13% and 13% of consolidated net sales, respectively. During the past several years, these customers have lost market share in the United States, primarily to Asian competitors. Although we are actively targeting these Asian competitors as potential customers, any further market share loss by these North American-based automakers could have a material adverse effect on our business. In fiscal 2007, these automakers announced significant production cuts which reduced the demand for our acoustical and coated products and hurt our profitability.

Our three largest customers all have major union contracts with the same automobile workers unions. Any extended work stoppage could have a material adverse impact on our operating results and financial position.

Our three largest customers all have major union contracts with the same automobile workers unions and some of these union contracts expire during fiscal 2008. History has shown these contract negotiations can be lengthy and issues may be very difficult to resolve. Any extended work stoppage which may occur during these negotiations could have a material adverse effect on our operating results and financial position.

The volatility in the price and availability of raw material inputs used by us, particularly steel, zinc, nickel and natural gas, could adversely affect our ability to conduct business both timely and profitably.

In recent years, there has been a shortage of readily available metals that meet the requirements of our customers. Such shortage adversely affects our ability to deliver products to our customers on a timely basis. In conjunction with that shortage and rising material costs, the cost of metals used in our products has risen dramatically over the past few years, which has caused us to increase prices in a competitive

10

market and/or absorb higher costs. Our future profitability may be adversely affected to the extent we are unable to pass higher raw material costs to our customers.

In fiscal 2007, we experienced a dramatic increase in the cost of zinc which is a critical element in the production of certain Quiet Steel® parts. We entered into a long-term purchase contract to curtail the increase in cost and we have passed some of this cost increase onto our customers, but we have experienced a significant decrease in our profitability. In fiscal 2006, there was a dramatic volatility in the price of natural gas, particularly subsequent to Hurricanes Katrina and Rita in the Gulf region. Increases in raw material prices (such as for zinc, nickel and natural gas) and prices of other energy sources adversely affect our profitability.

The acceptance of our brake damping materials, engine components and body panel laminate parts by customers in North America, Europe and Asia is critical to our financial performance.

We have made a significant investment in the design and development of our material-based solutions to NVH problems in the automotive industry. If these solutions are not introduced and marketed successfully into North America, Europe and Asia, our results of operations and financial position may be adversely affected.

If we are unable to successfully introduce and market new products, we may not achieve our targeted financial results.

Management believes that our past success has been partially due to our ability to design and market new solutions to customer needs. Management also believes that the construction of our Application Research Center in Michigan and the expansion of our Application Development Center in Europe will provide us with state-of-the-art facilities in which to accelerate the development of new products and technologies. However, if these new products and technologies are not accepted by customers, we may not be able to attract new business or maintain existing customers, thus adversely affecting our business.

Our financial performance could be adversely affected by an inability to effectively execute and manage our business objectives.

The highly competitive nature of our industry requires that we effectively execute and manage our business including our operating initiatives, which aim to reduce costs and drive productivity and quality improvements. Our inability to effectively control costs and drive productivity improvements could affect our profits. In addition, our failure to provide high-quality, innovative products could adversely affect our ability to maintain or increase our sales, which could negatively affect our revenues and overall financial performance. Additionally, our success is dependent on successful new product and process development. Our future results and our ability to maintain or improve our competitive position will depend on our capacity to gauge the direction of our key markets and our ability to successfully and timely identify, develop, manufacture, market and sell new or improved products in these changing markets.

An increase in the environmental risks, costs, recoveries and penalties associated with our past and present manufacturing operations could adversely affect our financial performance.

We are a party to various legal proceedings in connection with the remediation of certain environmental matters. We record reserves for these environmental matters using our historical experience and relevant information available from various third parties. There are a number of assumptions made in establishing these reserves, including, without limitation, the estimated extent of environmental damage to any particular site, the available methods of remedy, estimated contribution of various other potentially responsible parties and the discretionary authority of federal and state regulatory authorities in bringing enforcement actions. New environmental issues or changes in the assumptions surrounding existing environmental issues could have an adverse affect on our results of operations and financial condition.

Our business and future development may be adversely affected if we are unable to retain key personnel.

Our success is highly dependent upon the services of key personnel in all areas of our business including, but not limited to, senior management, sales (including persons trained in our NVH sales methodology) and operations, administration and finance. The loss of the services of one or more of these people could have an adverse effect upon the business and plans for future development. In addition, we have downsized administrative and management positions in past years as a result of cost-cutting initiatives. Lack of management resources could impact our ability to operate and compete in our industry.

11

Table of Contents

Our business could be negatively impacted by deterioration in labor relations.

As of February 28, 2007, we had 583 full-time employees, of which approximately 47% were represented by labor unions with separate collective bargaining agreements. As these agreements expire, we cannot be assured that we will be able to renew the collective bargaining agreements on the same or similar terms, or at all, which could affect our business, results of operations or financial condition. Moreover, if new labor agreements are negotiated, there can be no guarantee that the agreements will be at satisfactory terms with regard to the efficiency and productivity of the work force. We had one union contract that expired in March 2006 and we implemented new terms and conditions of employment which included a voluntary severance package. We cannot be assured that the employees who remained will continue to work under the terms and conditions we implemented. Further, we cannot be assured that we will not be subject to work stoppages that could have a material adverse effect on our business, results of operations or financial condition.

We may experience adverse effects on the results of operations if proposed gross revenue tax legislation in the State of Illinois is passed into law.

The government of the State of Illinois is considering proposed tax legislation that would create a gross revenue tax on all products and services sold in Illinois. The proposed legislation, in its current form, would not allow companies to pass the additional cost of the tax onto their customers or to deduct the tax from corporate income tax calculations. This tax would adversely affect our future operations results if passed into law.

Item 1B. Unresolved Staff Comments

None.

Item 2. Properties

We own or lease facilities with an aggregate of approximately 1,229,000 square feet of space. In addition to the principal physical properties we use in our manufacturing operations as summarized in the table below, we lease sales and administrative offices pursuant to operating leases.

Table of Contents

In fiscal 2005, we completed the sale of our property associated with our idled coil coating facility in Elk Grove Village and closed our Middletown coil coating production facility. Additional information concerning these transactions and events is set forth in Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations.

We consider all of our principal facilities to be in good operating condition and sufficient to meet our near-term operating requirements.

Location	Approximate Area in Square Feet	Ownership or Lease Expiration	Description
Elk Grove Village, Illinois Plant No. 2	205,000	Owner	Laminating and Coil Coating Facility, General Offices
Elk Grove Village, Illinois Plant No. 7	281,000	Owner	Coil Coating Facility, Corporate and General Offices
Morrisville, Pennsylvania	136,000	Owner	Coil Coating Facility, General Offices
Middletown, Ohio (Closed July 2004)	171,000	Owner	Coil Coating Facility
Walbridge, Ohio	351,000	April 2012[1]	Electrogalvanizing, Laminating and Coil Coating Facility
Canton, Michigan	57,000	Sept. 2018[2]	NVH Testing and Development Center, General Offices
Eisenach, Germany	16,000	Owner	Stamping and Testing Facility, General Offices

(1) At the option of the Company, this lease may be further extended in three year increments through April 30, 2027.
(2) At the option of the Company, this lease may also be extended in five year increments through September 2043 and includes an option to purchase beginning in March 2015.

Item 3. Legal Proceedings

Environmental Matters

MSC is a party to various legal proceedings in connection with the remediation of certain environmental matters as detailed below. We record these environmental reserves based upon historical experience and the extent of relevant information available from various third parties. There are a number of assumptions that are made, including, without limitation, the estimated extent of the environmental damage to any particular site, the available methods of remedy, the contribution expected from various other potentially responsible parties (PRP) and the discretionary authority of federal and state regulatory authorities in bringing enforcement actions. We believe our range of exposure for these proceedings and known sites is $0.9 million to $1.3 million and, as of February 28, 2007, have approximately $0.9 million in our environmental reserves.

In 1984 MSC was named as a PRP under the Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA) for the surface, soil and ground water contamination at a Superfund site in Gary, Indiana. The U.S. District Court for the Northern District of Indiana entered a Consent Decree between the government and certain PRPs (including MSC) on the scope of the remediation work at the site. We receive periodic updates on the projected costs of the remediation work from the environmental consultant employed by certain PRPs (including MSC) to manage the remediation project. In late December 2005, we received an update indicating that the projected remediation costs would increase significantly due primarily to additional efforts required to

13

Table of Contents

complete the remediation project, higher energy costs associated with certain remediation techniques employed and increased oversight costs of the United States Environmental Protection Agency (USEPA). Accordingly, we treated the cost update as a change in estimate and increased our reserves related to the matter by $0.5 million in the second quarter of fiscal 2006 to reflect our share of the increased remediation costs. This charge was recorded in Selling, General and Administrative expenses in the accompanying Consolidated Statement of Operations. The estimated range of our remaining liability for this site is $0.6 million to $0.7 million. Remediation work is ongoing and we maintain a letter of credit for approximately $1.2 million to secure our obligation to pay our estimated share of the remediation expenses at the site.

In 2003, MSC, along with many other companies, was named as a PRP by the USEPA under CERCLA at the Lake Calumet Cluster Site in Chicago, Illinois for allegedly sending certain waste from its Elk Grove Village facility to the site. The Illinois EPA has assumed the role of lead agency for the site and is conducting soil grading work, capping and a cost analysis at the site with funds made available by the state. No lawsuits have been filed against any of the PRPs, but it is likely that the USEPA will seek reimbursement of its past costs. Consequently, we have maintained the range of potential liability previously established as $25,000 to $35,000.

In December 2004, the purchaser of our former Pinole Point Steel facility received a letter from the California Regional Water Quality Control Board requesting an investigation of contamination of the soil and groundwater at the facility. Depending on the results of the investigation, remediation efforts may be required. We believe that any such contamination occurred prior to our acquisition of the facility in 1997 and therefore, the sellers of the facility in the 1997 transaction are responsible for the funding of any necessary remediation. In the event that the sellers fail to fund the remediation, we may be required to do so. We are unable to estimate the potential liability, if any, in this matter due to the limited information provided to date.

For additional information regarding our environmental matters, see Note 4 of the Notes to the Consolidated Financial Statements entitled Contingencies.

Other Matters

We are also a party to various legal actions and customer disputes arising in the ordinary course of our business. We believe that the resolution of these legal actions and customer disputes will not, individually or in the aggregate, have a material adverse effect on our financial statements.

Item 4. Submission of Matters to a Vote of Security Owners

There were no matters submitted to our shareowners during the fourth quarter of fiscal 2007.

Table of Contents

PART II

Item 5. Market for the Registrant s Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

Our common stock, $0.02 par value, is listed on the New York Stock Exchange under the symbol MSC. The table below sets forth, by fiscal quarter, the high and low closing sales prices of our common stock during the past two fiscal years.

Fiscal Year	Fiscal Quarter	High	Low
2007	1st	$ 13.00	$ 10.31
	2nd	10.99	8.72
	3rd	12.06	8.87
	4th	13.33	10.77

Fiscal Year	Fiscal Quarter	High	Low
2006	1st	$ 15.49	$ 11.21
	2nd	16.30	11.80
	3rd	15.54	14.13
	4th	14.29	11.97

There were 518 stockholders of record of our common stock at the close of business on May 1, 2007.

Dividends

MSC has not paid cash dividends other than a nominal amount in lieu of fractional shares in connection with stock dividends. Management currently anticipates that all earnings either will be retained for development of our business or will be used to repurchase our common stock. If business circumstances should change, the Board of Directors may declare and instruct us to pay dividends. However, our ability to pay dividends on our common stock is limited by certain covenants contained in our credit agreement (see Note 5 of the Notes to the Consolidated Financial Statements entitled Indebtedness).

Purchases of Securities

On February 8, 2006, we announced that our Board of Directors had authorized the repurchase of up to one million shares of common stock, or approximately 7% of the shares outstanding at that time. In fiscal 2007, we repurchased 227,000 shares of our common stock for a total cost of approximately $2.2 million. There were no shares repurchased during the fourth quarter of fiscal 2007 or during fiscal 2006. There are 773,000 shares remaining under this authorization.

Table of Contents

Item 6. Selected Financial Data

The following selected financial data should be read in conjunction with our Consolidated Financial Statements. The information set forth below is not necessarily indicative of results of future operations, and should be read in conjunction with Item 7, Management s Discussion and Analysis of Financial Condition and Results of Operations and the Consolidated Financial Statements and notes thereto included in Item 8, Financial Statements and Supplementary Data in order to fully understand factors that may affect the comparability of the financial data below.

Selected Financial Data

Material Sciences Corporation and Subsidiaries

(Dollars and number of shares in thousands,	Fiscal Year				
except per share data)	2007	2006	2005	2004	2003
Statement of Operations Data					
Net Sales	$ 262,627	$ 286,614	$ 263,323	$ 242,748	$ 266,546