

TRANSCAT INC
Form 10-K
June 27, 2007

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

FORM 10-K

(Mark one)

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

For the fiscal year ended: March 31, 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: 000-03905

TRANSCAT, INC.

(Exact name of registrant as specified in its charter)

Ohio

(State or other jurisdiction of
incorporation or organization)

16-0874418

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

35 Vantage Point Drive, Rochester, New York 14624

(Address of principal executive offices) (Zip Code)

(585) 352-7777

(Registrant's telephone number, including area code)

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

Common Stock, \$0.50 par value per share

Securities registered pursuant to section 12(g) of the Act:

None

(Title of class)

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

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

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

Indicate by check mark 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 (as defined in Rule 12b-2 of the Act). (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer

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

The aggregate market value of the voting and non-voting common equity held by non-affiliates of the Registrant on September 23, 2006 (the last business day of the registrant's most recently completed second fiscal quarter) was approximately \$31 million. The market value calculation was determined using the closing sale price of the Registrant's Common Stock on September 23, 2006, as reported on the NASDAQ Capital Market.

The number of shares of Common Stock of the Registrant outstanding as of June 20, 2007 was 7,084,289.

DOCUMENTS INCORPORATED BY REFERENCE

The information required by Part III, Items 10, 11, 12, 13 and 14, of this report, to the extent not set forth herein, is incorporated by reference from the Registrant's definitive proxy statement relating to the Annual Meeting of Shareholders to be held on August 21, 2007, which definitive proxy statement will be filed with the Securities and Exchange Commission (SEC) within 120 days of the end of the fiscal year to which this report relates.

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PART I.

ITEM 1. BUSINESS

FORWARD-LOOKING STATEMENTS

This report and, in particular, the Management's Discussion and Analysis of Financial Condition and Results of Operations section of this report, contains forward-looking statements as defined by the Private Securities Litigation Reform Act of 1995. These include statements concerning expectations, estimates, and projections about the industry, management beliefs and assumptions of Transcat, Inc. (Transcat , we , us , or our). Words such as anticipates , expects , intends , plans , believes , seeks , estimates , and variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and are subject to certain risks, uncertainties and assumptions that are difficult to forecast. Therefore, our actual results and outcomes may materially differ from those expressed or forecast in any such forward-looking statements. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.

INTRODUCTION

Transcat is a leading global distributor of professional grade test, measurement, and calibration instruments and a provider of calibration and repair services primarily throughout the process, life science, and manufacturing industries. We conduct our business through two segments: Distribution Products and Calibration Services. Our reportable business segments offer different products and services to the same customer base.

Through our distribution products segment, we market and distribute national and proprietary brand instruments to approximately 11,000 global customers. Our catalog (Master Catalog) offers access to more than 25,000 process and electrical instruments, including: calibrators, insulation testers, multimeters, pressure and temperature devices, oscilloscopes, recorders and related accessories, from over 200 of the industry's leading manufacturers including Agilent, Fluke, GE, Emerson, and Hart Scientific. In addition, we are the exclusive worldwide distributor for Transmation and Atek products. The majority of the instrumentation we sell requires expert calibration service to ensure that it maintains the most exacting measurements.

Through our calibration services segment, we offer precise, reliable, fast calibration and repair services. As of the end of our fiscal year ended March 31, 2007, (fiscal year 2007), we operated eleven Calibration Centers of Excellence strategically located across the United States, Puerto Rico, and Canada servicing approximately 8,000 customers. Each of our calibration laboratories is ISO-9001:2000 and our scope of accreditation to ISO/IEC 17025 is the widest in the industry for the market segments we serve. See Calibration Services Segment Quality below in Item 1 for more information.

CalTrak[®], our proprietary documentation and asset management system, is used to manage the workflow at our Calibration Centers of Excellence. Additionally, CalTrak[®] provides calibration certificates, calibration data, and access to other key documents required in the calibration process. CalTrak[®] has been validated to U.S federal regulation 21CFR 820.75, which is important to the life science industry, where federal regulations are especially stringent. See Calibration Services Segment CalTrak below in Item 1 for more information.

At Transcat, our attention to quality goes beyond the products and services we deliver. Our sales, customer service and support teams stand ready to provide expert advice, application assistance and technical support wherever and

whenever our customers need it. Since calibration is an intangible service, we believe that our customers trust the integrity of our people and processes and that forms the foundation of our relationships with our customers.

Among our customers, and representing approximately 32% of our consolidated sales, are Fortune 500/Global 500 companies, including Wyeth, Johnson & Johnson, DuPont, Exxon Mobil, Dow Chemical, and Duke Energy. Transcat has focused on the process and life science markets since its founding in 1964. We are the leading supplier of calibrators in the markets we serve. We believe these customers do business with us

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because of our integrity, commitment to quality service, our CalTrak[®] asset management system, and our broad range of product offerings.

Transcat's website address is www.transcat.com. The information contained on our website is not a part of this report. On our investor relations webpage, www.transcat.com/about/investor-relations.aspx, we post the following filings as soon as reasonably practicable after they are electronically filed with or furnished to the SEC: 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. All such filings on our investor relations webpage are available free of charge.

Transcat is an Ohio corporation founded in 1964. We are headquartered in Rochester, New York and employ more than 200 people. Our executive offices are located at 35 Vantage Point Drive, Rochester, New York 14624. Our telephone number is 585-352-7777.

STRATEGY

We are an accredited provider of calibration services and a distributor of test and measurement equipment. Our strategy is to focus on gaining sales and market share in markets where companies value quality systems and/or operate in regulated environments. We strive to differentiate ourselves and build barriers to competitive entry by offering and stocking the best products, through the trusted integrity of our calibration and repair services and integrating those products and services to benefit our customers' operations and lower their costs.

SEGMENTS

We service our customers through two business segments: Distribution Products and Calibration Services. Note 8 of our Consolidated Financial Statements in this report presents financial information for these segments. We serve approximately 15,000 customers, with no customer or controlled group of customers accounting for 5% or more of our consolidated net sales for fiscal years 2005 through 2007. We are not dependent on any single customer, the loss of which would have a material adverse effect on our business, cash flows, balance sheet, or results of operations.

We market and sell to our customers through multiple sales channels consisting of direct catalog marketing, the transcat.com website, a direct field sales organization, proactive outbound sales, and an inbound call center. Our direct field sales team, outbound sales team, and inbound sales team are each staffed with technically trained personnel. Our domestic and international sales organization covers territories in North America, Latin America, Europe, Africa, Asia, and the Middle East. Our calibration and repair services are offered only in North America and Puerto Rico. We concentrate on attracting new customers and increasing product, calibration and repair sales to existing customers. Sales efforts are also focused on cross selling. Approximately 29% of our customers utilize both segments of our business, which provides us with an opportunity to increase our average sales per customer, while adding to our value as a single source supplier. Our sales to customers in the following geographic areas during the periods indicated, expressed as a percentage of total sales, were as follows (calculated on dollars in millions):

	FY 2007	FY 2006	FY 2005
United States	83%	84%	84%
Canada	9%	9%	9%
Other International	8%	7%	7%
Total	100%	100%	100%

We focus primarily on the process, life science, and manufacturing industries. The process industry has been and continues to be the foundation of our business competency. The process industry, as we define it, includes petroleum refining, chemical, water treatment, industrial power, steel, petrochemical, gas and pipeline, textile, pulp and paper, food and dairy, and utility companies. The life science industry, as we define it, includes pharmaceutical and biotechnology companies, medical device manufacturers, and healthcare service providers.

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The approximate percentage of our business in these industry segments for the periods indicated was as follows:

	FY 2007	FY 2006	FY 2005
Process	35%	38%	39%
Life Science	22%	21%	19%
Manufacturing	13%	12%	12%
Other Non-Manufacturing	30%	29%	30%
Total	100%	100%	100%

DISTRIBUTION PRODUCTS SEGMENT

Summary. Our customers in the process, life science, and manufacturing industries use test, measurement and calibration equipment to ensure that their processes, and ultimately their end product(s), are within specification. Utilization of such diagnostic equipment also allows for continuous improvement processes to be in place, increasing the accuracies of their measurements. The industrial distribution products industry for test and measurement instrumentation, in those geographic markets where we predominately operate, is serviced by broad based national distributors and niche or specialty-focused organizations such as Transcat.

Most industrial customers find that maintaining an in-house inventory of back-up test, measurement, and calibration equipment is cost prohibitive due to the large volume of units. As a result, the distribution of test and measurement instrumentation has traditionally been characterized by frequent, small quantity orders combined with a need for rapid, reliable, and substantially complete order fulfillment. The purchasing decision is generally made by plant engineers, quality managers, or their purchasing personnel. Products are generally purchased from more than one distributor.

The majority of our products are not consumables but are purchased as replacement, upgrades, or for expansion of manufacturing and research and development facilities. Our catalog and sales activities are designed to maintain a constant presence in front of the customer to ensure we receive the order when they are ready to purchase. As a result, we evaluate sales trends over at least a four quarter cycle as any individual months sales can be impacted by numerous factors, many of which are unpredictable and potentially non-recurring.

We believe that a distribution product customer chooses a distributor based on a number of different criteria including the timely delivery and the accuracy of orders, consistent product quality, value added services and price. Value added services include providing technical support to insure our customer receives the right product for their specific need through application knowledge and product compatibility. We also provide calibration of product purchases, on-line procurement, same day shipment of products for in-stock items, a variety of custom product offerings and training programs. Our customers also get the operational efficiency of dealing with one distributor for most or all of their product needs.

Our distribution products segment accounted for approximately 68% (calculated on dollars in thousands) of our sales in fiscal year 2007. Within the distribution products segment, our routine business is comprised of customers who place orders to acquire or to replace specific instruments, which typically range from \$100 to \$5,000 per order, with an average of approximately \$1,500 per order.

Marketing and Sales. Through our comprehensive Master Catalog, supplemental catalogs, opt-in email newsletter, and other direct sales and marketing programs, we offer our customers a broad selection of highly recognized branded

products at competitive prices. The instruments typically range in price from \$100 to over \$20,000 and are sold and marketed to approximately 11,000 customers.

During fiscal year 2007, we distributed approximately 900,000 pieces of direct marketing materials including catalogs, brochures, supplements and other promotional materials to approximately 100,000 customer contacts and 400,000 potential customer contacts. Some of the key factors that determine the number of catalogs and other direct marketing materials received by each customer include new product introductions, their market segments and the recency, frequency and monetary value of past purchases.

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The majority of our product sales are derived from catalog marketing. Our Master Catalog consists of approximately 700 pages of products relevant to the process, life science, and manufacturing industries. We distribute our Master Catalog to approximately 75,000 existing and prospective customers in the United States and Canada approximately every 12 months. The Master Catalog provides standard make/model and related information and is also available in an electronic format upon request and on-line at our website: www.transcat.com. Our new customer acquisition program utilizes smaller catalog supplements which feature new products, promotions, or specific product categories. The catalog supplements are launched at varying periods throughout the year; the publications are mailed to approximately 600,000 customers and targeted prospects.

The approximate percentage of our distribution products business by industry segment for the periods indicated was as follows:

	FY 2007	FY 2006	FY 2005
Process	38%	41%	42%
Life Science	12%	11%	12%
Manufacturing	10%	10%	8%
Other Non-Manufacturing	40%	38%	38%
Total	100%	100%	100%

Competition. The markets we serve are highly competitive. Competition for sales in distribution products is quite fragmented and ranges from large national distributors and manufacturers to small local distribution organizations. Key competitive factors typically include customer service and support, quality, turn around time, inventory availability, product brand name, and price. To address our customers' needs for technical support and product application assistance, and to differentiate ourselves from competitors, we employ a staff of highly trained technical application specialists. To maintain our competitive position with respect to such products and services, we continually demonstrate our commitment to our customers by providing employee training in the areas described above.

Suppliers and Purchasing. We believe that effective purchasing is a key element to maintaining and enhancing our position as a provider of high quality test and measurement equipment. We frequently evaluate our purchase requirements and suppliers' price offerings to obtain products at the best possible cost. We obtain our products from more than 200 suppliers of brand name and private labeled equipment. In fiscal year 2007, our top 10 vendors accounted for approximately 70% of our aggregate business. Approximately 30% of our product purchases on an annual basis are from Fluke Electronics Corporation (Fluke), which is believed to be consistent with Fluke's share of the markets we service.

We plan our product mix, including stocked and non-stocked inventory items, to best serve the anticipated needs of our customers whose individual purchases vary in size. We can usually ship our customers our top selling products the same day they are ordered. During fiscal year 2007, approximately 86% of our product orders were filled with planned inventory items already in stock.

Operations. Our distribution operations take place within an approximate 27,000 square-foot facility located in Rochester, New York. This location is our headquarters and also houses the customer service, sales and administrative functions as well as a calibration laboratory. Approximately 30,000 product orders are shipped from this facility annually with an average order size of approximately \$1,500 per order in fiscal year 2007, \$1,400 per order in fiscal

year 2006 and \$1,200 per order in fiscal year 2005.

Distribution. We distribute our products in the United States, Canada, and internationally from our distribution center in Rochester, New York. We maintain appropriate inventory levels in order to satisfy anticipated customer demand for prompt delivery and complete order fulfillment of their product needs. These inventory levels are managed on a daily basis with the aid of our sophisticated purchasing and stock management information system. Our automated freight manifesting and laser bar code scanning facilitates

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prompt and accurate order fulfillment. We ship our United States orders predominantly by a worldwide express carrier. International orders are shipped by a number of different carriers.

Distribution Agreement. In connection with the sale of Transmation Products Group (TPG) to Fluke in December 2001, we entered into a distribution agreement (the 2001 Distribution Agreement) with Fluke to be the exclusive worldwide distributor of Transmation and Altek products until December 31, 2006. Under the 2001 Distribution Agreement, we also agreed to purchase a pre-determined amount of inventory from Fluke.

On October 31, 2002, with an effective date of September 1, 2002, we entered into a new distribution agreement (the 2002 Distribution Agreement) with Fluke, which replaced the 2001 Distribution Agreement. Under the terms of the 2002 Distribution Agreement, among other items, we agreed to purchase a pre-determined amount of inventory across a broader array of products and brands during each calendar year through 2006. Our purchases for calendar years 2002 through 2006 exceeded the commitment under the 2002 Distribution Agreement.

On March 31, 2007, we entered into a new distribution agreement (the 2007 Distribution Agreement) with Fluke. The 2007 Distribution Agreement does not require us to purchase a minimum amount of inventory. However, the 2007 Distribution Agreement continues our right to be the exclusive worldwide distributor of Altek and Transmation branded products in exchange for our commitment to purchase a minimum amount of those products. The minimum amount for calendar year 2007 is \$3.8 million. We believe this will be achieved based on historical sales trends. Minimum purchase commitments for future years will be determined by June 30 of each year. In the event that Transcat fails to make the required purchases, it may lose its right to be the exclusive worldwide distributor.

Backlog. Customer product orders include orders for products that we routinely stock in our inventory, customized products, and other products ordered less frequently, which we do not stock.

Unshippable product orders are primarily backorders, but also include products that are requested to be calibrated in our calibration laboratories prior to shipment, orders required to be shipped complete, and orders required to be shipped at a future date.

At the end of fiscal year 2007, the value of our unshippable product orders was approximately \$1.8 million, compared to approximately \$1.4 million and \$1.3 million at the end of the fiscal years ending March 25, 2006 (fiscal year 2006) and March 26, 2005 (fiscal year 2005), respectively. At March 31, 2007, unshippable product orders included a \$0.4 million remaining balance on an order related to a single customer. At the request of the customer, this specific order is being shipped across several months. In general, this order accounted for a significant part of the increase in product backorders for fiscal quarters two through four of fiscal year 2007, compared to the same quarters in fiscal year 2006. During fiscal year 2007, the month-end level of unshippable product orders varied between a low of \$1.3 million and a high of \$2.4 million. This variation is due primarily to seasonality, supplier delivery schedules, and variations in customer ordering patterns, as well as the impact of the aforementioned order.

The following graph shows the quarter end trend of unshippable product orders and backorders for fiscal years 2006 through 2007.

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CALIBRATION SERVICES SEGMENT

Summary. Calibration is the act of comparing a unit or instrument of unknown value to a standard of known value and reporting the result in some rigorously defined form. After the calibration has been completed, a decision is made, again based on rigorously defined parameters, on what is to be done to the unit. The decision may be to adjust, optimize, repair, limit its use, range or rating, scrap the unit, or leave the unit as is. The purpose of calibration is to significantly reduce the risk of product or process failures caused by inaccurate measurements.

Transcat's calibration strategy encompasses two methods to manage a customer's calibration and repair needs:

- 1) If a company wishes to outsource its calibration needs, we offer an Integrated Calibration Services Solution that provides a complete wrap-around service:
 - Program management;
 - Calibration;
 - Logistics; and
 - Consultation services.

- 2) If a company has an in-house calibration operation, we can provide:
 - Calibration of primary standards;
 - Overflow capability either on-site or at one of our facilities during periods of high demand; and
 - Consultation and training services.

In either case, we intend to have the broadest accredited calibration offering to our targeted markets which includes certification of our technicians to the American Society for Quality standards, complete calibration management encompassing the entire metrology function, and access to our service offerings.

The billion-dollar commercial calibration services industry in the U.S. is extremely fragmented with an estimated 750 companies participating, ranging from nationally accredited organizations, such as Transcat, to one-person organizations, in addition to companies that do not currently outsource their calibrations. Our typical customer contact is a technically based individual who is employed in a quality, engineering, or manufacturing position.

The calibration services industry has its origins in the military; approximately 65% of our calibration technicians and laboratory managers received metrology training in the military or have calibration experience with the military prior to joining Transcat.

Calibration sourcing decisions are based on quality, customer service, turn-around time, location, documentation, price, and a one-source solution. We believe that our success with customers who value quality is based on the trust they have in the integrity of our people and processes.

Our calibration services segment provides periodic calibration and repair services for our customers' test, measurement, and diagnostic instruments. We perform over 110,000 in-house calibrations annually. These are performed at one of our eleven Calibration Centers of Excellence, or at the customer's physical location. Our calibration services segment accounted for approximately 32% (calculated on dollars in thousands) of our total fiscal year 2007 sales.

The calibration services segment of the market is critically aligned with our strategic focus on quality accreditations. Our calibration services are of the highest technical and quality levels, with broad ranges of accreditation and registration. Our quality systems are further detailed below in Quality .

Acquisition. In February 2006, we acquired N.W. Calibration Inspection, Inc. (NWCI) in Fort Wayne, Indiana. NWCI provides dimensional calibration, first part inspection, and reverse engineering services to the pharmaceutical, medical device, and automotive industries. We paid \$0.8 million in cash and \$0.1 million in stock to purchase NWCI. We allocated the initial purchase price to the estimated fair value of the fixed assets acquired (\$0.5 million) with the excess of \$0.4 million allocated to goodwill. The purchase agreement provides for additional performance-based payments to the sellers up to a maximum of \$0.3 million, of which \$0.1 million was earned in fiscal year 2007. The results of the acquired business have been included in our

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calibration services segment of the Consolidated Financial Statements since the acquisition date. Pro-forma information for this acquisition is not included as it did not have a material impact on the consolidated financial position or results of operations.

Marketing and Sales. Calibration allows for maximum productivity and efficiency by assuring accurate, reliable equipment and processes. Through our calibration services segment, we perform periodic calibrations on new and used equipment as well as repair services for our customers. All of our Calibration Centers of Excellence provide accredited calibration of common measurement parameters.

We utilize our Master Catalog, supplements, mailings, journal advertising, trade shows, and the Internet to market our calibration services to customers with a strategic focus in the highly regulated industries including process, life science, and manufacturing. Our quality process and standards are designed to meet the needs of companies that are highly regulated (e.g., the Food and Drug Administration, or FDA), and/or have a strong commitment to quality and a comprehensive calibration program.

The approximate percentage of our calibration services business by industry segment for the periods indicated was as follows:

	FY 2007	FY 2006	FY 2005
Process	31%	32%	34%
Life Science	39%	38%	34%
Manufacturing	17%	17%	19%
Other Non-Manufacturing	13%	13%	13%
Total	100%	100%	100%

Competition. The calibration outsource industry is highly fragmented and is composed of companies ranging in size from non-accredited, sole proprietorships to internationally recognized and accredited corporations, such as Transcat, resulting in a tremendous range of service levels and capabilities. A large percentage of calibration companies are small businesses that provide only basic measurements and service markets in which quality requirements may not be as demanding as the markets that we strategically target. Very few of these companies are structured to compete on the same scale and level of quality as us. There are also several competitors with whom we compete who have national or regional operations. Certain of these competitors may have greater resources than we have and many of them have accreditations that are similar to ours. We differentiate ourselves from our competitors by demonstrating our commitment to quality and by having a wide range of capabilities that are tailored to the markets we serve. Customers also see the value in using CalTrak[®] to monitor their equipment status. We are also fundamentally different than most of our competitors because we have the ability to bundle product, calibration and repair as a single source for our customers.

Quality. The accreditation process is the only system currently in existence that assures measurement competence. Each of our laboratories is audited and reviewed by external accreditation bodies proficient in the technical aspects of the chemistry and physics that underlie metrology, ensuring that measurements are properly made. Accreditation also requires that all standards used for accredited measurements have a fully documented path, known as the traceability chain, either directly or through other accredited laboratories, back to the national or international standard for that measurement parameter. This ensures that our measurement process is consistent with the global metrology network that is designed to standardize measurements worldwide.

To ensure the quality and consistency of our calibrations to customers, we have sought and achieved several international levels of quality and accreditation. Our calibration laboratories are ISO 9001:2000 registered through Underwriter s Laboratories, which itself has international oversight from the ANSI-ASQ National Accreditation Board (ANAB). Our scope of accreditation to ISO/IEC 17025 is the widest in the industries we serve. The accreditation process also ensures that our calibrations are traceable to the National Institute of Standards and Technology (NIST) or the National Research Council (NRC) (these are the National Measurement Institutes for the U.S. and Canada, respectively), or to other national or international standards bodies, or to measurable conditions created in our laboratory, or accepted fundamental and/or natural physical

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constants, ratio type of calibration, or by comparison to consensus standards. Our laboratories, with the exception of Fort Wayne which has been audited and is in a pending accreditation status, are accredited to ISO/IEC 17025 and ANSI/NCSL Z540-1-1994 using two of the four accrediting bodies (AB s) in the United States that are signatories to the International Laboratory Accreditation Cooperation (ILAC). These two AB s are: American Association for Laboratory Accreditation (A2LA) and National Voluntary Laboratory Accreditation Program (NVLAP). These AB s provide an objective, third party, internationally accepted evaluation of the quality, consistency, and competency of our calibration processes.

The importance of this international oversight, ILAC, to our customers is the assurance that our calibrations will be accepted worldwide, removing one of the barriers to trade that they may experience if using a non-ILAC traceable calibration service provider.

To provide the widest range of service to our customers in our target markets, our ISO-17025 accreditations extend across a wide range of technical disciplines. The following table represents Transcat s capabilities for each Center of Excellence as of March 31, 2007 (A=Accredited; N=Non-accredited):

WORKING-LEVEL CAPABILITIES:

	<i>Electrical Metrology Disciplines</i>				<i>Dimensional Metrology Disciplines</i>		
	DC/ACLF	HF/UHF	RF/ Microwave	Luminance/ Illuminance	Length	Optics	Parts Inspection (GD&T)
Boston	A	A			A		
Charlotte	A	A			A	A	
Dayton	A	A			A		
Houston	A	A	N		A	A	
Los Angeles	A	A	A		A	A	
Ottawa	A	A	A		A		
Philadelphia	A	A	A	A	A	A	
Rochester	A	A	A		A		
San Juan, PR	A	A			A		
St. Louis	A	A			A		
Ft. Wayne(2)					A	A	A

	<i>Physical Metrology Disciplines</i>						
	Flow	Particle Counters	Force	Gas Analysis	Relative Humidity	Mass Weight	Pressure, Vacuum
Boston						A	A
Charlotte			A	N	A	A	A
Dayton			A		A	A	A
Houston						A	A
Los Angeles			A		A	A	A
Ottawa			A		A	A	A
Philadelphia	A		A	N	A	A	A

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Rochester	N	A	A	A	A
San Juan, PR(1)			N	A	A
St. Louis		A	A	A	A
Ft. Wayne(2)					

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	<i>Physical Metrology Disciplines (continued)</i>				<i>Life Sciences Disciplines</i>
	Torque	Temperature	RPM, Speed	Vibration, Acceleration	Chemical/ Biological
Boston	A	A	A		N
Charlotte	A	A	A		N
Dayton	A	A	A		N
Houston	A	A	A		N
Los Angeles	A	A	A		N
Ottawa	A	A	A		N
Philadelphia	A	A	A	A	N
Rochester	A	A	A		N
San Juan, PR		A	A		
St. Louis		A	A		N
Ft. Wayne(2)					

REFERENCE-LEVEL CAPABILITIES:

	Dimensional Standards	Electrical Standards	Humidity Standards	Mass Standards	Pressure Standards	Temperature Standards
Charlotte	A					
Dayton						A
Houston		A			A	
Philadelphia			A	A		A
Rochester			A			
Ft. Wayne(2)	A					

(1) Our San Juan, Puerto Rico laboratory has recently acquired the Thunder Scientific 2500ST Humidity Standard and is capable of performing non-accredited calibrations. The relative humidity capability will become accredited during their next A2LA audit.

(2) Our Fort Wayne, Indiana laboratory has been audited by A2LA and is in a pending accreditation status, which is expected to be finalized within the next two to three months.

CalTrak®. CalTrak® and CalTrak-Online is our proprietary metrology management system that provides a comprehensive calibration quality program. Many of our customers have unique calibration service requirements to which we have tailored specific services. CalTrak® allows our customers to track calibration cycles via the Internet and provides the customer with a safe and secure off-site archive of calibration records that can be accessed 24 hours a day. Access to records data is managed through our secure password protected website. Calibration assets are tracked with records that are automatically cross-referenced to the equipment that was used to calibrate. CalTrak® has also been validated to meet the most stringent requirements within the industry.

CUSTOMER SERVICE AND SUPPORT

Our breadth of distribution products and calibration services along with our strong commitment to customer sales, service and support enable us to satisfy our customer needs through convenient selection and ordering, rapid, accurate, and complete order fulfillment and on-time delivery.

A key element of our customer service approach is our technically trained direct field sales team, outbound sales team, inbound sales team and customer service organization. Most customer orders are placed through our customer service organization which often provides technical assistance to our customers to facilitate the purchasing decision. To ensure the quality of service provided, we frequently monitor our customer service through customer surveys, interpersonal communication, and daily statistical reports.

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Customers may place orders via:

Mail at Transcat, Inc., 35 Vantage Point Drive, Rochester, NY 14624;

Fax at 1-800-395-0543;

Telephone at 1-800-828-1470;

Email at sales@transcat.com; or

Our website at www.transcat.com.

INFORMATION REGARDING EXPORT SALES

Approximately 17% of our sales in fiscal year 2007 and 16% in fiscal years 2006 and 2005 resulted from sales to customers outside the United States (calculated on dollars in millions). Of those sales in fiscal year 2007, 46.8% were denominated in U.S. dollars and the remaining 53.2% were in Canadian dollars. Our sales are subject to the customary risks of operating in an international environment, including the potential imposition of trade or foreign exchange restrictions, tariff and other tax increases, fluctuations in exchange rates and unstable political situations, any one or more of which could have a material adverse effect on our business, cash flows, balance sheet or results of operations. See Foreign Currency in Item 7A for further details.

INFORMATION SYSTEMS

We utilize a basic software platform, Application Plus, to manage our business and operations segments. We also utilize a turnkey enterprise software solution. This software includes a suite of fully integrated modules to manage our business functions, including customer service, warehouse management, inventory management, financial management, customer management, and business intelligence. This solution is a fully mature business package and has been subject to more than 20 years of refinement.

SEASONALITY

We believe that our line of business has certain historical seasonal factors. Our fiscal second quarter is generally weaker and the fiscal fourth quarter historically stronger due to typical industrial operating cycles.

ENVIRONMENTAL MATTERS

We believe that compliance with federal, state, or local provisions relating to the protection of the environment will not have any material effect on our capital expenditures, earnings, or competitive position.

EMPLOYEES

At the end of fiscal year 2007, we had 228 employees, compared to 238 and 209 employees at the end of fiscal years 2006 and 2005, respectively. The decrease of 10 employees from fiscal year end 2006 to fiscal year end 2007 is primarily attributed to changes in our sales structure.

Table of Contents**EXECUTIVE OFFICERS**

The following table sets forth certain information regarding our executive officers and certain key employees as of March 31, 2007:

Name	Age	Position
Carl E. Sassano	57	Chairman and Chief Executive Officer
Charles P. Hadeed	57	President and Chief Operating Officer
John J. Zimmer	48	Vice President of Finance and Chief Financial Officer
John A. De Voldre	58	Vice President of Human Resources
Jay F. Woychick	50	Vice President of Marketing
Andrew M. Weir	55	Vice President of Field Sales
Derek C. Hurlburt	38	Corporate Controller

In the first quarter of fiscal year 2008, Charles P. Hadeed was named as our Chief Executive Officer. Mr. Hadeed will continue to serve as our President and Chief Operating Officer. Also during the first quarter of fiscal year 2008, Carl E. Sassano was named as Executive Chairman of our Board of Directors.

ITEM 1A. RISK FACTORS

You should consider carefully the following risks and all other information included in this report. The risks and uncertainties described below and elsewhere in this report are not the only ones facing our business. If any of the following risks were to actually occur, our business, financial condition or results of operations would likely suffer. In that case, the trading price of our common stock could fall and you could lose all or part of your investment.

General Economic Conditions May Have A Material Adverse Effect On Our Operating Results, Financial Condition, Or Our Ability To Meet Our Commitments. The electronic instrumentation distribution industry is affected by changes in economic conditions, which are outside our control. Economic slowdowns, adverse economic conditions or cyclical trends in certain customer markets may have a material adverse effect on our operating results, financial condition, or our ability to meet our commitments.

We Depend On Manufacturers To Supply Our Inventory And Rely On One Vendor Group To Supply A Significant Amount Of Our Inventory Purchases. If They Fail To Provide Desired Products To Us, Increase Prices, Or Fail To Timely Deliver Products, Our Sales Could Suffer. A significant amount of our inventory purchases are made from one vendor, Fluke. Our reliance on this vendor leaves us vulnerable to having an inadequate supply of required products, price increases, late deliveries, and poor product quality. Like other distributors in our industry, we occasionally experience supplier shortages and are unable to purchase our desired volume of products. If we are unable to enter into and maintain satisfactory distribution arrangements with leading manufacturers, if we are unable to maintain an adequate supply of products, or if manufacturers do not regularly invest in, introduce to us, and/or make available to us for distribution new products, our sales could suffer considerably. Finally, we cannot provide any assurance that particular products, or product lines, will be available to us, or available in quantities sufficient to meet customer demand. This is of particular significance to our business because the products we sell are often only available from one source. Any limits to product access could materially and adversely affect our business.

Our Future Success May Be Affected By Indebtedness. Under our Revolving Credit Facility, as of March 31, 2007, we owed \$2.9 million to our secured creditor. We are required to meet financial tests on a quarterly basis and comply with other covenants customary in secured financings. Although we believe that we will continue to be in compliance

with such covenants, if we do not remain in compliance with such covenants, our lender may demand immediate repayment of amounts outstanding. Changes in interest rates may have a significant effect on our payment obligations and operating results. Furthermore, we are dependent on credit from manufacturers of our products to fund our inventory purchases. If our debt burden increases to high levels, such manufacturers may restrict our credit. Our cash requirements will depend on numerous factors,

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including the rate of growth of our sales, the timing and levels of products purchased, payment terms, and credit limits from manufacturers, the timing and level of our accounts receivable collections and our ability to manage our business profitably. Our ability to satisfy our existing obligations, whether or not under our secured credit facility, will depend upon our future operating performance, which may be impacted by prevailing economic conditions and financial, business, and other factors described in this report, many of which are beyond our control.

If Existing Shareholders Sell Large Numbers Of Shares Of Our Common Stock, Our Stock Price Could

Decline. The market price of our Common Stock could decline as a result of sales by our existing shareholders or holders of stock options of a large number of shares of our Common Stock in the public market or the perception that these sales could occur.

Our Stock Price Has Been, And May Continue To Be, Volatile. The stock market, from time to time, has experienced significant price and volume fluctuations that are both related and unrelated to the operating performance of companies. As our stock may be affected by market volatility, and by our own performance, the following factors, among others, may have a significant effect on the market price of our Common Stock:

- Developments in our relationships with current or future manufacturers of products we distribute;
- Announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures or capital commitments;
- Litigation or governmental proceedings or announcements involving us or our industry;
- Economic and other external factors, such as disasters or other crises;
- Sales of our Common Stock or other securities in the open market;
- Period-to-period fluctuations in our operating results; and
- Our ability to satisfy our debt obligations.

We Expect That Our Quarterly Results Of Operations Will Fluctuate. Such Fluctuation Could Cause Our Stock Price To Decline.

A large portion of our expenses for calibration services, including expenses for facilities, equipment and personnel, are relatively fixed. Accordingly, if sales decline or do not grow as we anticipate, we may not be able to correspondingly reduce our operating expenses in any particular quarter. Our quarterly sales and operating results have fluctuated in the past and are likely to do so in the future. If our operating results in some quarters fail to meet the expectations of stock market analysts and investors, our stock price would likely decline. Some of the factors that could cause our sales and operating results to fluctuate include:

- Fluctuations in industrial demand for products we sell and/or services we provide; and
- Fluctuations in geographic conditions, including currency and other economic conditions.

If We Fail To Attract And Retain Qualified Personnel, We May Not Be Able To Achieve Our Stated Corporate

Objectives. Our ability to manage our anticipated growth, if realized, effectively depends on our ability to attract and retain highly qualified executive officers and technical personnel. If we fail to attract and retain qualified individuals, we will not be able to achieve our stated corporate objectives.

Changes In Accounting Standards, Legal Requirements And The NASDAQ Stock Market Listing Standards, Or Our Ability To Comply With Any Existing Requirements Or Standards, Could Adversely Affect Our Operating

Results. Extensive reforms relating to public company financial reporting, corporate governance and ethics, the NASDAQ Stock Market listing standards and oversight of the accounting profession have been implemented over the past several years. Compliance with the new rules, regulations and standards that have resulted from such reforms has increased our accounting and legal costs and has required significant management time and attention. In the event that additional rules, regulations or standards are implemented or any of the existing rules, regulations or standards to which we are subject undergo additional material modification, we could be forced to spend significant financial and management resources to ensure our continued compliance, which could have an adverse affect on our results of operations. In addition, although we believe we are in full compliance with all such existing rules, regulations and

standards, should we be or become unable to comply with any of such rules, regulations and standards, as they presently exist or as they may exist in the future, our results of operations could be adversely effected and the market price of our Common Stock could decline.

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The Distribution Products Industry Is Highly Competitive, And We May Not Be Able To Compete Successfully. We compete with numerous companies, including several major manufacturers and distributors. Some of our competitors have greater financial and other resources than we do, which could allow them to compete more successfully. Most of our products are available from several sources and our customers tend to have relationships with several distributors. Competitors could obtain exclusive rights to market particular products, which we would then be unable to market. Manufacturers could also increase their efforts to sell directly to end-users and bypass distributors like us. Industry consolidation among product distributors, the unavailability of products, whether due to our inability to gain access to products or interruptions in supply from manufacturers, or the emergence of new competitors could also increase competition. In the future, we may be unable to compete successfully and competitive pressures may reduce our sales.

Our Sales Depend On Our Relationships With Capable Sales Personnel As Well As Key Customers, Vendors And Manufacturers Of The Products That We Distribute. Our future operating results depend on our ability to maintain satisfactory relationships with qualified sales personnel who appreciate the value of our services as well as key customers, vendors and manufacturers. If we fail to maintain our existing relationships with such persons or fail to acquire relationships with such key persons in the future, our business may suffer.

Our Future Success Is Substantially Dependent Upon Our Senior Management. Our future success is substantially dependent upon the efforts and abilities of members of our existing senior management. Competition for senior management is intense, and we may not be successful in attracting and retaining key personnel.

Our Acquisitions May Not Result In The Benefits And Sales Growth We Expect. We may acquire other companies in order to expand our market presence in either or both of the product distribution market or the calibration services market. We cannot be sure that we will achieve the benefits of sales growth that we expect from these acquisitions or that we will not incur unforeseen additional costs or expenses in connection with these acquisitions. To effectively manage our expected future growth, we must continue to successfully manage our integration of these companies and continue to improve our operational systems, internal procedures, accounts receivable and management, financial and operational controls. If we fail in any of these areas, our business could be adversely affected.

Tax Legislation Initiatives Could Adversely Affect The Company's Net Earnings And Tax Liabilities. We are subject to the tax laws and regulations of the United States federal, state and local governments, as well as foreign jurisdictions. From time to time, various legislative initiatives may be proposed that could adversely affect our tax positions. There can be no assurance that our effective tax rate will not be adversely affected by these initiatives. In addition, tax laws and regulations are extremely complex and subject to varying interpretations. Although we believe that our historical tax positions are sound and consistent with applicable laws, regulations and existing precedent, there can be no assurance that our tax positions will not be challenged by relevant tax authorities or that we would be successful in any such challenge.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

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We lease the following properties:

Property	Location	Approximate Square Footage
Corporate Headquarters, Distribution Center and Calibration Laboratory	Rochester, NY	27,250
Calibration Laboratory	Boston, MA	4,000
Calibration Laboratory	Charlotte, NC	4,860
Calibration Laboratory	Dayton, OH	9,000
Calibration Laboratory	Houston, TX	8,780
Calibration Laboratory	Anaheim, CA	4,000
Calibration Laboratory	Ottawa, ON	3,990
Calibration Laboratory	Philadelphia, NJ	8,550
Calibration Laboratory	St. Louis, MO	4,000
Calibration Laboratory	Fort Wayne, IN	5,000
Calibration Laboratory	San Juan, PR	700

We also lease office space in Shanghai, China. We believe that our properties are generally in good condition, are well maintained, and are generally suitable and adequate to carry on our business in its current form.

ITEM 3. LEGAL PROCEEDINGS

None.

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

No matters were submitted to a vote of our shareholders during the quarter ended March 31, 2007.

PART II.**ITEM 5. MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our Common Stock is traded on the NASDAQ Capital Market under the symbol TRNS. As of June 20, 2007, we had approximately 700 shareholders of record.

PRICE RANGE OF COMMON STOCK

The following table sets forth, on a per share basis, for the periods indicated, the high and low reported sales prices of our Common Stock as reported on the NASDAQ Capital Market for each quarterly period in fiscal years 2007 and 2006.

First	Second	Third	Fourth
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	Quarter	Quarter	Quarter	Quarter
Fiscal Year 2007:				
High	\$ 5.52	\$ 6.08	\$ 5.71	\$ 5.87
Low	\$ 4.75	\$ 4.95	\$ 4.64	\$ 4.90
Fiscal Year 2006:				
High	\$ 5.00	\$ 4.73	\$ 5.38	\$ 5.40
Low	\$ 3.80	\$ 4.15	\$ 4.19	\$ 4.90

DIVIDENDS

We have not declared any cash dividends since our inception and do not intend to pay any dividends for the foreseeable future.

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The following table provides selected financial data for fiscal year 2007 and the previous four fiscal years (in thousands, except per share data). Certain reclassifications of prior fiscal year's financial information have been made to conform to the current fiscal year presentation.

	FY 2007	FY 2006	FY 2005	FY 2004	FY 2003(1)
Statements of Operations Data:					
Net Sales	\$ 66,473	\$ 60,471	\$ 55,307	\$ 53,317	\$ 57,172
Cost of Sales	49,783	45,372	41,415	39,919	43,853
Gross Profit	16,690	15,099	13,892	13,398	13,319
Operating Expenses	14,341	13,581	12,993	13,091	12,850
Gain on TPG Divestiture(2)	(1,544)				
Operating Income	3,893	1,518	899	307	469
Interest Expense	334	427	350	434	657
Gain on Extinguishment of Debt					(1,593)
Other Expense (Income), net	283	162	293	(288)	56
Income Before Income Taxes	3,276	929	256	161	1,349
Provision for (Benefit from) Income Taxes	1,217	(2,648)		(192)	(408)
Income Before Cumulative Effect of a Change in Accounting Principle	2,059	3,577	256	353	1,757
Cumulative Effect of a Change in Accounting Principle					(6,472)
Net Income (Loss)	\$ 2,059	\$ 3,577	\$ 256	\$ 353	\$ (4,715)
Share Data:					
Basic Earnings Per Share Before Cumulative Effect of a Change in Accounting Principle	\$ 0.30	\$ 0.54	\$ 0.04	\$ 0.06	\$ 0.29
Basic Average Shares Outstanding	6,914	6,647	6,396	6,252	6,147
Diluted Earnings Per Share Before Cumulative Effect of a Change in Accounting Principle	\$ 0.28	\$ 0.50	\$ 0.04	\$ 0.05	\$ 0.29
Diluted Average Shares Outstanding	7,335	7,176	6,966	6,808	6,147
Closing Price Per Share	\$ 5.25	\$ 5.00	\$ 3.80	\$ 2.40	\$ 1.40

As of or for the Fiscal Years Ended March
31, 2007 25, 2006 26, 2005 27, 2004 31, 2003

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Balance Sheets and Working Capital Data:

Inventory, net	\$ 4,336	\$ 3,952	\$ 5,952	\$ 3,736	\$ 2,842
Property and Equipment, net	2,814	2,637	1,984	2,025	2,556
Goodwill	2,967	2,967	2,524	2,524	2,524
Total Assets	22,422	21,488	20,207	18,385	16,758
Depreciation and Amortization	1,622	1,401	1,486	1,299	2,047
Capital Expenditures	1,194	914	866	459	291
Revolving Line of Credit	2,900	3,252	5,498	6,441	5,248
Term Loan		1,020	1,778	668	1,334
Shareholders' Equity	11,229	8,647	4,314	3,428	2,698

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- (1) In fiscal year 2003, we recorded a \$6.5 million impairment charge from the implementation of Statement of Financial Accounting Standard (SFAS) No. 142, Goodwill and Other Intangible Assets, as a change in accounting principle.
- (2) In fiscal year 2007, we recognized a previously deferred pre-tax gain of \$1.5 million from the sale of TPG to Fluke. See Note 9 of the Consolidated Financial Statements for further disclosure.

ITEM 7. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

RECLASSIFICATION OF AMOUNTS

Certain reclassifications of prior fiscal year's financial information have been made to conform with current fiscal year's presentation. In addition, certain reclassifications of prior fiscal quarters' financial information have been made to conform with current fiscal quarter presentation.

ROUNDING

Certain percentages may vary depending on the basis used for the calculation, such as dollars in thousands and dollars in millions.

OVERVIEW

Operational Overview. We are a leading distributor of professional grade test, measurement, and calibration equipment and provider of nationally recognized and accredited calibration and repair services across a wide array of measurement disciplines.

We operate our business through two reportable business segments that offer different products and services to the same customer base. Those two segments are Distribution Products and Calibration Services.

In our distribution products segment, our Master Catalog is widely recognized by both original equipment manufacturers and customers as the ultimate source for test, measurement and calibration equipment. Additionally, because we specialize in test, measurement and calibration equipment, as opposed to a wide array of industrial products, our sales and customer service personnel can provide value added technical assistance to our customers to assist them in determining what product best meets their particular application requirements.

Our sales in our distribution products segment can be heavily impacted by changes in the economic environment. As industrial customers increase or curtail capital and discretionary spending, our product sales will typically be directly impacted. The majority of our products are not consumables but are purchased as replacements, upgrades, or for expansion of manufacturing and research and development facilities. Year over year sales growth in any one quarter can be impacted by a number of factors including the addition of new product lines or channels of distribution.

Our strength in our calibration services segment is based upon our wide range of disciplines and our investment in the quality systems that are required in our targeted market segments. Our services range from the calibration and repair of a single unit to managing a customer's entire calibration program. We believe our calibration services segment offers long term growth opportunity and the potential for continuing sales from established customers from what is typically an annual calibration cycle.

We evaluate sales growth in both of our business segments against a four quarter trend analysis, and not by analyzing any single quarter.

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Financial Overview. In evaluating the Company's results for fiscal year 2007 and the fiscal year 2007 fourth quarter, the following factors should be taken into account:

Fiscal year 2007 and the fiscal year 2007 fourth quarter operating results include 53 weeks and 14 weeks, respectively, compared to 52 weeks and 13 weeks for the corresponding periods for fiscal year 2006.

The fiscal year 2007 operating results include the recognition of a previously deferred pre-tax gain of \$1.5 million from the sale of TPG to Fluke. Although the sale of TPG occurred in fiscal year 2002, Transcat had entered into a distribution agreement in connection with the transaction and was precluded from recognizing the gain at that time because the distribution agreement required us to purchase a pre-determined amount of inventory during each calendar year from 2002 to 2006. In December 2006, Transcat's purchases exceeded the required amount for calendar year 2006, as they had in each of the prior four years, which fulfilled the obligation and triggered the recognition of the gain in the fiscal year 2007 third quarter.

We adopted Statement of Financial Accounting Standards No. 123R, Share-Based Payment (SFAS 123R), which requires the expensing of stock awards, at the beginning of fiscal year 2007. Approximately \$0.3 million of stock expense was recorded in fiscal year 2007. There was no stock expense recorded in fiscal year 2006.

Net income for fiscal year 2007 and the fiscal year 2007 fourth quarter includes income tax provisions of \$1.2 million and \$0.2 million, respectively. Approximately \$0.6 million of the full year amount relates to the gain on the sale of TPG. The results for fiscal year 2006 and the fiscal year 2006 fourth quarter included a benefit from income taxes of \$2.6 million that resulted from the reversal of a large portion of the Company's deferred tax asset valuation allowance.

The end of fiscal year 2007's fourth quarter marked eight consecutive quarters of year-over-year quarterly net sales growth in both our product distribution and calibration services segments. Taking the additional week in fiscal year 2007 into account, our overall product growth rate of 11.3% (calculated on dollars in thousands) was in line with our expectations for the year. During fiscal year 2007, we experienced 33.5% growth within our indirect channel. Our direct channel continued to grow, with year-over-year sales growth of 9.0%. Calibration services sales grew by 7.1% in fiscal year 2007 compared to fiscal year 2006 (calculated on dollars in thousands).

Our overall gross margin, as a percent of sales, was relatively consistent with the prior fiscal year. On a segment basis, our distribution products gross margin ratio improved by 2.4 points, driven primarily by increased vendor rebates and continued focus on controlling promotional pricing, offset to a degree by increased sales to indirect markets which generated lower margins. In our calibration services segment, gross margin declined 4.6 points due to the rate of investment in lab operating expenses exceeding the rate of growth in sales.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Financial Reporting Release No. 60 requires all companies to include a discussion of critical accounting principles or methods used in the preparation of financial statements. Note 1 of our Consolidated Financial Statements includes a complete discussion of the significant accounting policies and methods used in the preparation of our Consolidated Financial Statements. A summary of our most critical accounting policies follows:

Use of Estimates. The preparation of our Consolidated Financial Statements in accordance with accounting principles generally accepted in the United States requires that we make estimates and assumptions that affect the reported amounts of assets and liabilities, and the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of sales and expenses during the reporting period. Significant estimates and assumptions are used for, but not limited to, allowance for doubtful accounts and returns, depreciable lives of fixed

assets, estimated lives of our Master Catalog, and deferred tax asset valuation allowances. Future events and their effects cannot be predicted with certainty; accordingly, our

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accounting estimates require the exercise of judgment. The accounting estimates used in the preparation of our Consolidated Financial Statements will change as new events occur, as more experience is acquired, as additional information is obtained, and as our operating environment changes. Actual results could differ from those estimates. Such changes and refinements in estimation methodologies are reflected in reported results of operations in the period in which the changes are made and, if material, their effects are disclosed in the Notes to our Consolidated Financial Statements.

Accounts Receivable. Accounts receivable represent receivables from customers in the ordinary course of business. These amounts are recorded net of the allowance for doubtful accounts and returns in the Consolidated Balance Sheets. The allowance for doubtful accounts is based upon the expected collectibility of accounts receivable. We apply a specific formula to our accounts receivable aging, which may be adjusted on a specific account basis where the formula may not appropriately reserve for loss exposure. After all attempts to collect a receivable have failed, the receivable is written-off against the allowance for doubtful accounts. The returns reserve is calculated based upon the historical rate of returns applied to sales over a specific timeframe. The returns reserve will increase or decrease as a result of changes in the level of sales and/or the historical rate of returns.

Inventory. Inventory consists of products purchased for resale and is valued at the lower of cost or market. Costs are determined using the average cost method of inventory valuation. Inventory is reduced by a reserve for items not saleable at or above cost by applying a specific loss factor, based on historical experience, to specific categories of our inventory. We evaluate the adequacy of the reserve on a quarterly basis.

Property and Equipment, Depreciation, and Amortization. Property and equipment are stated at cost. Depreciation and amortization is computed primarily under the straight-line method over the following estimated useful lives:

	Years
Machinery, Equipment, and Software	2 - 6
Furniture and Fixtures	3 - 10
Leasehold Improvements	4 - 10

Property and equipment determined to have no value are written off at their then remaining net book value. We account for software costs in accordance with Statement of Position No. 98-1, Accounting for the Costs of Computer Software Developed or Obtained for Internal Use. Leasehold improvements are amortized under the straight-line method over the estimated useful life or the lease term, whichever is shorter. Maintenance and repairs are expensed as incurred. See Note 2 of our Consolidated Financial Statements for further details.

Goodwill. We estimate the fair value of our reporting units in accordance with SFAS No. 142, Goodwill and Other Intangible Assets, using the fair market value measurement requirement, rather than the undiscounted cash flows approach. We test our goodwill for impairment on an annual basis, or immediately if conditions indicate that such impairment could exist. The evaluation of our reporting units on a fair value basis indicated that no impairment existed as of March 31, 2007, March 25, 2006 and March 26, 2005.

Catalog Costs. We capitalize the cost of each Master Catalog mailed and amortize the cost over the respective catalog's estimated productive life. We review response results from catalog mailings on a continuous basis; and if warranted, modify the period over which costs are recognized. We amortize the cost of each Master Catalog over an eighteen month period and amortize the cost of each catalog supplement over a three month period. Total unamortized catalog costs in prepaid expenses and deferred charges on the Consolidated Balance Sheets were \$0.5 million as of March 31, 2007 and March 25, 2006.

Deferred Taxes. We account for certain income and expense items differently for financial reporting purposes than for income tax reporting purposes. Deferred taxes are provided in recognition of these temporary differences. A valuation allowance on deferred tax assets is provided for items for which it is more likely than not that the benefit of such items will not be realized, in accordance with the provisions of SFAS No. 109, Accounting for Income Taxes. SFAS No. 109 requires an assessment of both positive and negative evidence when measuring the need for a deferred tax valuation allowance. See **Taxes** below in this section and Note 4 of our Consolidated Financial Statements for further details.

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Stock-Based Compensation. Effective March 26, 2006, we adopted SFAS 123R, which requires us to measure the cost of services received in exchange for all equity awards granted, including stock options and warrants, based on the fair market value of the award as of the grant date. SFAS 123R supersedes SFAS No. 123, Accounting for Stock-Based Compensation, and Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). We have adopted SFAS 123R using the modified prospective application method which requires us to record compensation cost related to unvested stock awards as of March 25, 2006 by recognizing the unamortized grant date fair value of these awards over the remaining service periods of those awards with no change in historical reported earnings. Awards granted after March 25, 2006 will be valued at fair value in accordance with the provisions of SFAS 123R and recognized on a straight line basis over the service periods of each award. SFAS 123R also requires excess tax benefits from the exercise of stock awards to be presented in the consolidated statements of cash flows as a financing activity rather than an operating activity, as presented prior to the adoption of SFAS 123R. Excess tax benefits are realized benefits from tax deductions for exercised awards in excess of the deferred tax asset attributable to stock-based compensation costs for such awards. We did not have any stock-based compensation costs capitalized as part of an asset. We estimated forfeiture rates for fiscal year 2007 based on our historical experience.

Prior to fiscal year 2007, we accounted for stock-based compensation in accordance with APB 25, using the intrinsic value method, which did not require that compensation cost be recognized for our stock awards provided the exercise price was equal to or greater than the common stock fair market value on the date of grant. Prior to fiscal year 2007, we provided pro forma disclosure amounts in accordance with SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure (SFAS 148), as if the fair value method defined in SFAS 123 had been applied to its stock-based compensation. Our net income and net income per share for the fiscal years 2006 and 2005 would have been reduced if compensation cost related to stock awards had been recorded in the financial statements based on fair value at the grant dates.

See Note 1 of our Consolidated Financial Statements for our disclosure regarding the effects of SFAS 123R. See Note 7 of our Consolidated Financial Statements for further disclosure regarding our stock-based compensation.

Revenue Recognition. Sales are recorded when products are shipped or services are rendered to customers, as we generally have no significant post delivery obligations. Our prices are fixed and determinable, collection of the resulting receivable is probable, and returns are reasonably estimated. Provisions for customer returns are provided for in the period the related sales are recorded based upon historical data. We recognize the majority of our service revenues based upon when the calibration or repair activity is performed and then shipped and/or delivered to the customer. Some of our service revenue is generated from managing customers calibration programs in which we recognize revenue in equal amounts at fixed intervals. Our shipments are generally free on board shipping point and our customers are generally invoiced for freight, shipping, and handling charges.

Gain on TPG Divestiture. During the fiscal year ended March 31, 2002, we sold TPG. As a result of certain post closing commitments, we deferred recognition of a \$1.5 million gain on the sale. During fiscal year 2007, we satisfied those commitments and consequently realized the gain as a component of operating income in our Consolidated Financial Statements.

Off-Balance Sheet Arrangements. We do not maintain any off-balance sheet arrangements.

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The following table sets forth, for the prior three fiscal years, the components of our Consolidated Statements of Operations (calculated on dollars in thousands).

	FY 2007	FY 2006	FY 2005
<i>Gross Profit Percentage:</i>			
Product Gross Profit	26.4%	24.0%	23.7%
Service Gross Profit	22.3%	26.9%	28.1%
Total Gross Profit	25.1%	25.0%	25.1%
<i>As a Percentage of Net Sales:</i>			
Product Sales	68.3%	67.5%	67.1%
Service Sales	31.7%	32.5%	32.9%
Net Sales	100.0%	100.0%	100.0%
Selling, Marketing, and Warehouse Expenses	12.7%	14.1%	14.4%
Administrative Expenses	8.8%	8.3%	9.1%
Total Operating Expenses	21.5%	22.4%	23.5%
Gain on TPG Divestiture	2.3%	%	%
Operating Income	5.8%	2.5%	1.6%
Interest Expense	0.5%	0.7%	0.6%
Other Expense, net	0.4%	0.3%	0.5%
Total Other Expense	0.9%	1.0%	1.1%
Income Before Income Taxes	4.9%	1.5%	0.5%
Provision for (Benefit from) Income Taxes	1.8%	(4.4)%	%
Net Income	3.1%	5.9%	0.5%

FISCAL YEAR ENDED MARCH 31, 2007 COMPARED TO FISCAL YEAR ENDED MARCH 25, 2006 (dollars in millions):

Sales:

	For The Years Ended	
	March 31, 2007	March 25, 2006
Net Sales:		
Product	\$ 45.4	\$ 40.8
Service	21.1	19.7

Total \$ 66.5 \$ 60.5

Net sales increased \$6.0 million, or 9.9% (calculated on dollars in millions), from fiscal year 2006 to 2007.

Our distribution products net sales growth, which accounted for 68.3% of our sales in fiscal year 2007 and 67.5% of our sales in fiscal year 2006 (calculated on dollars in thousands), reflects customer response to our sales and marketing activities and an additional week's worth of shipments. Our fiscal years 2007 and 2006 product sales in relation to prior fiscal year quarter comparisons, is as follows (calculated on dollars in millions):

	FY 2007				FY 2006			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Product Sales Growth	21.0%	7.0%	5.3%	11.7%	4.0%	16.2%	13.3%	5.6%

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We experienced distribution products net sales growth in our direct and indirect distribution channels in fiscal year 2007 compared to fiscal year 2006. The growth in our indirect distribution channels, primarily from high-volume electrical and instrumentation wholesalers, caused a shift in our mix by distribution channel. The following table provides the percent of net sales and approximate gross profit percentage for significant product distribution channels (calculated on dollars in thousands):

	FY 2007		FY 2006	
	Percent of Net Sales	Gross Profit % (1)	Percent of Net Sales	Gross Profit % (1)
Direct	82.6%	25.9%	84.3%	25.2%
Government	0.8%	5.0%	1.9%	1.3%
Indirect	16.6%	13.5%	13.8%	13.5%
Total	100.0%	23.7%	100.0%	23.2%

(1) Calculated at net sales less purchase costs divided by net sales.

Customer product orders include orders for products that we routinely stock in our inventory, customized products, and other products ordered less frequently, which we do not stock. Unshippable product orders are primarily backorders, but also include products that are requested to be calibrated in our calibration laboratories prior to shipment, orders required to be shipped complete, and orders required to be shipped at a future date. Our total unshippable product orders for fiscal year 2007 increased by approximately \$0.4 million, or 28.6% (calculated on dollars in millions) from fiscal year 2006. This was mainly the result of a single, large product order being placed by a customer during our fiscal 2007 second quarter, but is being shipped across multiple months based on an agreed upon delivery schedule with that customer. As of March 31, 2007, the remaining balance to be shipped on this order was \$0.4 million. The following table reflects the percentage of total unshippable product orders that are backorders at the end of each fiscal quarter and our historical trend of total unshippable product orders (calculated on dollars in millions):

	FY 2007				FY 2006			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Total Unshippable Product Orders	\$ 1.8	\$ 2.1	\$ 2.1	\$ 1.4	\$ 1.4	\$ 1.3	\$ 1.5	\$ 1.3
% of Unshippable Product Orders that are Backorders	88.9%	90.5%	90.5%	78.6%	92.9%	84.6%	72.1%	78.7%

Calibration services net sales increased \$1.4 million, or 7.1% (calculated on dollars in millions), from fiscal year 2006 to fiscal year 2007. This increase is primarily attributable to incremental sales as a result of our acquisition of NWCi during the fourth quarter of fiscal year 2006, increased order volume and an additional week in the fourth quarter of fiscal year 2007. In addition, within any year, while we may add new customers, we may also have customers from

the prior year whose calibrations may not repeat for any number of factors. Among those factors are the variations in the timing of customer periodic calibrations on equipment and repair services, customer capital expenditures and customer outsourcing decisions. Our fiscal years 2007 and 2006 calibration service sales in relation to prior fiscal year quarter comparisons, is as follows (calculated on dollars in millions):

	FY 2007				FY 2006			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Service Sales Growth	12.7%	4.3%	6.4%	6.4%	0.0%	11.9%	11.9%	6.8%

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	For the Years Ended	
	March 31, 2007	March 25, 2006
Gross Profit:		
Product	\$ 12.0	\$ 9.8
Service	4.7	5.3
Total	\$ 16.7	\$ 15.1

Gross profit, as a percent of net sales, slightly increased from 25.0% in fiscal year 2006 to 25.1% in fiscal year 2007 (calculated on dollars in thousands).

Product gross profit increased \$2.2 million from fiscal year 2006 to fiscal year 2007, primarily attributable to the 11.3% (calculated on dollars in millions) increase in product net sales. As a percent of net sales, product gross profit increased 2.4 points (calculated on dollars in thousands) from fiscal year 2006 to fiscal year 2007. This percentage increase is primarily the result of \$0.7 million in additional vendor rebates and \$0.2 million in additional cooperative advertising received from suppliers during fiscal year 2007 compared to fiscal year 2006.

Our product gross profit can be influenced by a number of factors that can impact quarterly comparisons. Among those factors are sales to certain channels that do not support the margins of our direct customer base, periodic rebates on purchases discussed above, and the aforementioned cooperative advertising received from suppliers. The following table reflects the quarterly historical trend of our product gross profit as a percent of net sales (calculated on dollars in millions):

	FY 2007				FY 2006			
	Q4	Q3	Q2	Q1	Q4	Q3	Q2	Q1
Product Gross Profit%(1)	24.0%	24.0%	23.7%	22.1%	23.1%	23.9%	22.6%	22.8%
Other Income (Expense)%(2)	3.6%	3.6%	1.6%	3.6%	(0.2)%	0.4%	1.9%	1.7%
Product Gross Profit%	27.6%	27.6%	25.3%	25.7%	22.9%	24.3%	24.5%	24.5%