

LAKELAND INDUSTRIES INC  
Form 10-Q  
December 07, 2006

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

**FORM 10-Q**

(Mark one)

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

For the quarterly period ended October 31, 2006

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: 0-15535**

**LAKELAND INDUSTRIES, INC.**

(Exact name of Registrant as specified in its charter)

Delaware  
(State of incorporation)

13-3115216 .  
(IRS Employer Identification  
Number)

**701 Koehler Avenue, Suite 7, Ronkonkoma, New York**  
(Address of principal executive offices)

**11779**  
(Zip Code)

**(631) 981-9700**

(Registrant's telephone number, including area code)

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

YES  NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

YES  NO

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

Class  
Common Stock, \$0.01 par value per share

Outstanding at December 7, 2006  
5,521,824 shares.

**LAKELAND INDUSTRIES, INC.  
AND SUBSIDIARIES**

**FORM 10-Q**

The following information of the Registrant and its subsidiaries is submitted herewith:

**PART I - FINANCIAL INFORMATION:**

| <u>Item 1.</u>                             | Financial Statements (unaudited):   | <u>Page</u> |
|--|---|-------------|
|  | Introduction  | 1           |
|  | Condensed Consolidated Balance Sheets October 31, 2006 and January 31, 2006                               | 2           |
|  | Condensed Consolidated Statements of Income for the Three and Nine Months Ended October 31, 2006 and 2005 | 3           |
|  | Condensed Consolidated Statement of Stockholders' Equity -Nine Months Ended October 31, 2006              | 4           |
|  | Condensed Consolidated Statements of Cash Flows -Nine Months Ended October 31, 2006 and 2005              | 5           |
|  | Notes to Condensed Consolidated Financial Statements  | 6           |
| <u>Item 2.</u>                             | Management's Discussion and Analysis of Financial Condition and Results of Operations                     | 15          |
| <u>Item 3.</u>                             | Quantitative and Qualitative Disclosures About Market Risk  | 20          |
| <u>Item 4.</u>                             | Controls and Procedures   | 20          |
| <b><u>PART II - OTHER INFORMATION:</u></b> |   |             |
| <u>Item 6.</u>                             | Exhibits and Reports on Form 8-K  | 20          |
| <u>Signature Page</u>                      |   | 21          |

Index

**LAKELAND INDUSTRIES, INC.  
AND SUBSIDIARIES**

**PART I - FINANCIAL INFORMATION**

Item 1. Financial Statements:

Introduction

**SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS**

This 10-Q may contain certain forward-looking statements. When used in this 10-Q or in any other presentation, statements which are not historical in nature, including the words “anticipate,” “estimate,” “should,” “expect,” “believe,” “inter” “project” and similar expressions are intended to identify forward-looking statements. They also include statements containing a projection of sales, earnings or losses, capital expenditures, dividends, capital structure or other financial terms.

The forward-looking statements in this 10-Q are based upon our management’s beliefs, assumptions and expectations of our future operations and economic performance, taking into account the information currently available to us. These statements are not statements of historical fact. Forward-looking statements involve risks and uncertainties, some of which are not currently known to us that may cause our actual results, performance or financial condition to be materially different from the expectations of future results, performance or financial condition we express or imply in any forward-looking statements. Some of the important factors that could cause our actual results, performance or financial condition to differ materially from expectations are:

- Our ability to obtain fabrics and components from suppliers and manufacturers at competitive prices or prices that vary from quarter to quarter;
- Risks associated with our international manufacturing and start up sales operations;
- Potential fluctuations in foreign currency exchange rates;
- Our ability to respond to rapid technological change;
- Our ability to identify and complete acquisitions or future expansion;
- Our ability to manage our growth;
- Our ability to recruit and retain skilled employees, including our senior management;
- Our ability to accurately estimate customer demand;
- Competition from other companies, including some with greater resources;
- Risks associated with sales to foreign buyers;
- Restrictions on our financial and operating flexibility as a result of covenants in our credit facilities;
- Our ability to obtain additional funding to expand or operate our business as planned;
- The impact of a decline in federal funding for preparations for terrorist incidents;
- The impact of potential product liability claims;
- Liabilities under environmental laws and regulations;
- Fluctuations in the price of our common stock;
- Variations in our quarterly results of operations;
- The cost of compliance with the Sarbanes-Oxley Act of 2002 and rules and regulations relating to corporate governance and public disclosure;
- The significant influence of our directors and executive officer on our company and on matters subject to a vote of our stockholders;
- The limited liquidity of our common stock;

· The other factors referenced in this 10-Q, including, without limitation, in the sections entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and “Business.”

We believe these forward-looking statements are reasonable; however, you should not place undue reliance on any forward-looking statements, which are based on current expectations. Furthermore, forward-looking statements speak only as of the date they are made. We undertake no obligation to publicly update or revise any forward-looking statements after the date of this 10-Q, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this Form 10-Q might not occur. We qualify any and all of our forward-looking statements entirely by these cautionary factors.

Index

**LAKELAND INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**

| ASSETS  | October 31, 2006<br>(Unaudited) | January 31, 2006     |
|---|---------------------------------|----------------------|
| <b>Current assets:</b>  |                                 |                      |
| Cash  | \$ 3,442,035                    | \$ 1,532,453         |
| Accounts receivable, net of allowance for doubtful<br>accounts of \$126,000 at October 31, 2006 and \$323,000 at January 31,<br>2006                              | 13,101,408                      | 14,221,281           |
| Inventories, net of reserves of \$365,000 at October 31,<br>2006 and at January 31, 2006  | 45,178,433                      | 45,243,490           |
| Deferred income taxes   | 1,255,684                       | 917,684              |
| Other current assets  | 2,986,845                       | 1,804,552            |
| <b>Total current assets</b>   | <b>65,964,405</b>               | <b>63,719,460</b>    |
| Property and equipment, net of accumulated<br>depreciation of \$6,570,000 at October 31, 2006<br>and \$6,201,000 January 31, 2006                                 | 7,587,325                       | 7,754,765            |
| Goodwill  | 871,297                         | 871,297              |
| Other assets  | 2,790,710                       | 118,330              |
|   | <b>\$ 77,213,737</b>            | <b>\$ 72,463,852</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                                 |                      |
| <b>Current liabilities:</b>   |                                 |                      |
| Accounts payable  | \$ 3,018,064                    | \$ 2,536,756         |
| Accrued expenses and other current liabilities  | 1,186,498                       | 1,302,544            |
| <b>Total current liabilities</b>  | <b>4,204,562</b>                | <b>3,839,300</b>     |
| Pension liability   | 345,990                         | 469,534              |
| Deferred income taxes   | 86,982                          | 86,982               |
| Borrowings under revolving credit facility  | 7,878,000                       | 7,272,000            |
| Commitments and contingencies   |                                 |                      |
| <b>Stockholders' equity:</b>  |                                 |                      |
| Preferred stock, \$.01 par; authorized 1,500,000 shares<br>(none issued)  |                                 |                      |
| Common stock, \$.01 par; authorized 10,000,000 shares;<br>issued and outstanding 5,521,824 shares at October<br>31, 2006 and 5,017,046 shares at January 31, 2006 | 55,219                          | 50,170               |
| Additional paid-in capital  | 48,918,911                      | 42,431,221           |
| Retained earnings (1)   | 15,724,073                      | 18,314,645           |
| <b>Stockholders' equity</b>   | <b>64,698,203</b>               | <b>60,796,036</b>    |
|   | <b>\$ 77,213,737</b>            | <b>\$ 72,463,852</b> |

(1) A cumulative total of \$17,999,739 has been transferred from retained earnings to additional paid-in-capital and par value of common stock due to four separate stock dividends paid in 2002, 2003, 2005 and 2006. As reflected in the Condensed Consolidated Statement of Stockholders' Equity, \$6,386,916 was included in the nine months ended

October 31, 2006.

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

2

---

Index

**LAKELAND INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
**(UNAUDITED)**

|   | THREE MONTHS ENDED |               | NINE MONTHS ENDED |               |
|---|--------------------|---------------|-------------------|---------------|
|   | October 31,        |               | October 31,       |               |
|   | <u>2006</u>        | <u>2005</u>   | <u>2006</u>       | <u>2005</u>   |
| Net sales                                       | \$ 23,262,933      | \$ 22,717,196 | \$ 74,571,820     | \$ 73,515,270 |
| Cost of goods sold                              | 17,626,698         | 17,034,455    | 55,937,033        | 55,870,020    |
| Gross profit                                    | 5,636,235          | 5,682,741     | 18,634,787        | 17,645,250    |
| Operating expenses                              | 4,579,291          | 3,652,724     | 13,330,136        | 10,862,850    |
| Operating profit                                | 4,752,383          |               |                   |               |
| 4,264,519                                       | 1,056,944          | 2,030,017     | 5,304,651         | 6,782,400     |
| Interest and other income, net                  | 123,737            | 47,104        | 156,722           | 136,128       |
| Interest expense                                | (79,696)           | (38,842)      | (266,469)         | (42,854)      |
| Income before income taxes                      | 1,100,985          | 2,038,279     | 5,194,904         | 6,875,674     |
| Provision for income taxes                      | 120,935            | 725,376       | 1,398,560         | 2,201,584     |
| Net income                                      | \$ 980,050         | \$ 1,312,903  | \$ 3,796,344      | \$ 4,674,090  |
| Net income per common share*:                   |                    |               |                   |               |
| Basic   | \$ .18             | \$ .24        | \$ .69            | \$ .85        |
| Diluted   | \$ .18             | \$ .24        | \$ .69            | \$ .85        |
| Weighted average common shares<br>outstanding*: |                    |               |                   |               |
| Basic   | 5,521,824          | 5,518,751     | 5,520,567         | 5,518,751     |
| Diluted   | 5,531,497          | 5,524,109     | 5,526,561         | 5,523,632     |

\*Adjusted for the 10% stock dividend to shareholders of record on April 30, 2005 and August 1, 2006.

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

Index

**LAKELAND INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY**  
**(UNAUDITED)**

Nine months ended October 31, 2006

|                               | Common Stock  |               | Additional             | Retained        | Total         |
|-------------------------------|---------------|---------------|------------------------|-----------------|---------------|
|                               | <u>Shares</u> | <u>Amount</u> | <u>Paid-in Capital</u> | <u>Earnings</u> |               |
| Balance, January 31, 2006     | 5,017,046     | \$ 50,170     | \$ 42,431,221          | \$ 18,314,645   | \$ 60,796,036 |
| Net Income                    |               |               |                        | 3,796,344       | 3,796,344     |
| Exercise of Stock Options     | 2,662         | 27            | 11,849                 | ----            | 11,876        |
| 10% Stock Dividend            | 502,116       | 5,022         | 6,381,894              | (6,386,916)     | ---           |
| Stock Based Compensation      |               |               | 21,350                 |                 | 21,350        |
| Restricted Stock Compensation |               |               | 72,597                 |                 | 72,597        |
| Balance October 31, 2006      | 5,521,824     | \$ 55,219     | \$ 48,918,911          | \$ 15,724,073   | \$ 64,698,203 |

(Reflects four separate 10% stock dividends issued on July 31, 2002, 2003, April 30, 2005 and August 1, 2006, which resulted in a cumulative transfer of \$17,999,739 from retained earnings to additional paid-in capital and par value of common stock).

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



Index

**LAKELAND INDUSTRIES, INC. AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(UNAUDITED)

|  | NINE MONTHS ENDED |               |
|--|-------------------|---------------|
|  | October 31,       |               |
|  | <u>2006</u>       | <u>2005</u>   |
| <b>Cash Flows from Operating Activities:</b>   |                   |               |
| Net income   | \$ 3,796,344      | \$ 4,674,090  |
| Adjustments to reconcile net income to net cash provided<br>by (used in) operating activities: |                   |               |
| Stock based compensation   | 93,947            | --            |
| Reserve for doubtful accounts  | (197,000)         | -----         |
| Reserve for inventory obsolescence   | (40)              | (37,000)      |
| Depreciation and amortization  | 798,484           | 726,686       |
| Deferred income tax  | (338,000)         | -             |
| Changes in operating assets and liabilities:   |                   |               |
| Decrease in accounts receivable  | 1,316,873         | 605,524       |
| Decrease (Increase) in inventories   | 65,097            | (14,526,167)* |
| Increase in other assets   | (3,854,674)       | 149,822       |
| Increase in accounts payable, accrued expenses and other liabilities:                          | 241,720           | 1,010,064     |
| Net cash provided by (used in) operating activities  | 1,922,751         | (7,396,981)   |
| <b>Cash Flows from Investing Activities:</b>   |                   |               |
| Purchases of property and equipment  | (631,045)         | (4,000,457)   |
| Purchase of Mifflin Valley   |                   | (1,765,852)   |
| Net cash used in investing activities  | (631,045)         | (5,766,309)   |
| <b>Cash Flows from Financing Activities:</b>   |                   |               |
| Proceeds from exercise of stock options  | 11,876            | -----         |
| Borrowing under loan agreements  | 606,000           | 8,401,000     |
| Net cash provided by financing activities  | 617,876           | 8,401,000     |
| Net increase (decrease) in cash  | 1,909,582         | (4,762,290)   |
| Cash and cash equivalents at beginning of period   | 1,532,453         | 9,185,382     |
| Cash and cash equivalents at end of period   | \$ 3,442,035      | \$ 4,423,092  |

\*Inventory increased as production increased for the second half demand and accelerated purchases made on raw materials in anticipation of the October 1, 2005 price increase.

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



Index

**LAKELAND INDUSTRIES, INC. AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
(Unaudited)

***I.***

***Business***

Lakeland Industries, Inc. and Subsidiaries (the "Company"), a Delaware corporation, organized in April 1982, manufactures and sells a comprehensive line of safety garments and accessories for the industrial protective clothing and homeland security markets. The principal market for our products is the United States. No customer accounted for more than 10% of net sales during the nine month periods ended October 31, 2006 and 2005, respectively.

***2. Basis of Presentation***

The condensed consolidated financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission and reflect all adjustments (consisting of only normal and recurring adjustments) which are, in the opinion of management, necessary to present fairly the consolidated financial information required therein. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America ("GAAP") have been condensed or omitted pursuant to such rules and regulations. While we believe that the disclosures are adequate to make the information presented not misleading, it is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission for the year ended January 31, 2006.

The results of operations for the three and nine month periods ended October 31, 2006 is not necessarily indicative of the results to be expected for the full year.

***3. Principles of Consolidation***

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Laidlaw Adams & Peck, Inc., a Delaware Corporation and its Subsidiary MeiYang Protective Products Co., Ltd., (a Chinese corporation), Lakeland Protective Wear, Inc. (a Canadian corporation), Weifang Lakeland Safety Products Co. Ltd. (a Chinese corporation), Qing Dao Maytung Healthcare Co., Ltd. (a Chinese corporation), Lakeland Industries Europe Ltd. (a British corporation), Lakeland de Mexico S.A. de C.V (a Mexican corporation), Mifflin Valley, Inc. (a Delaware corporation) Lakeland Industries, Inc. Agencia en Chile, Lakeland India Private Ltd. (an Indian corporation) Lakeland Japan, Inc. (A Japanese Corporation) and Lakeland Protective Real Estate (a Canadian Corporation). All significant inter-company accounts and transactions have been eliminated.

Index

In January 2003, the FASB issued Interpretation No. 46, "Consolidation of Variable Interest Entities". This interpretation provides guidance with respect to the consolidation of certain entities, referred to as variable interest entities, in which an investor is subject to a majority of the risk of loss from the variable interest entity's activities, or is entitled to receive a majority of the variable interest entity's residual returns. This interpretation also provides guidance with respect to the disclosure of variable interest entities in which an investor maintains an interest but is not required to consolidate. The provisions of the interpretation were effective immediately for all variable interest entities created after January 31, 2003, or in which we obtained an interest after that date. In December 2003, the FASB issued a revision to this pronouncement, FIN 46R, which clarified certain provisions and modified the effective date from October 1, 2003 to March 15, 2004 for variable interest entities created before February 1, 2003. The two entities which leased property and buildings to the Company and were owned by related parties, were consolidated in our financial statements for the year ended January 31, 2005 are River Group Holding Co., L.L.P. and POMS Holding Co. Several of the owners of these entities were directors and officers of Lakeland. Under FIN 46, it is likely that leases between an entity and its related parties would be considered a variable interest, even if there is no residual value guarantee or purchase option. The FASB staff's view is that these elements are implied in a related-party lease even though they may not be explicitly stated in the lease agreement.

Effective February 1, 2004 we adopted this pronouncement. As a result, certain entities which leased property to the Company and were owned by related parties were determined to be Variable Interest Entities and have been consolidated since the Company's April 30, 2004 quarterly financial statements. Creditors, or beneficial interest holders, of the consolidated variable interest entities have no recourse to the general credit of the Company.

On April 25, 2005, the Company purchased property and buildings from POMS Holding Co. for a net purchase price of \$2,067,584. Reference is made to the Company's filing on Form 8-K dated April 25, 2005.

In April 2005, the Company entered into a real estate purchase contract with River Group Holding Co. to purchase a warehouse and the real property underlying it for \$928,686. The Company recorded the purchase on its April 30, 2005 financial statements. The purchase of this property was completed on May 25, 2005. Thus, the Company deemed the impact of FIN 46R to be de minimis for the October 31, 2005 financial statements.

There are no variable interest entities in which the "Company" is not the primary beneficiary.

**4. Business Combinations**

On August 1, 2005, the Company acquired the assets and operations and assumed certain liabilities of Mifflin Valley, Inc., ("Mifflin") of Shillington, PA for an initial purchase price of \$1.58 million, subject to certain adjustments. Final payment was made in November 2005 following the audit of a closing date balance sheet. The final price amounted to \$1.86 million and included adjustments for the payoff of a revolving loan of \$.186 million and adjustments for inventory, fixed asset values and allowance for doubtful accounts. Mifflin did approximately \$2.6 million of sales in 2004, and \$1.5 million for the six months ended June 30, 2005. Mifflin is a manufacturer of protective clothing specializing in safety and visibility, largely for the Emergency Services market, and also for the entire public safety and traffic control market. Mifflin specializes in customized garments to suit customers' needs, coupled with quality, service, price and delivery. Mifflin's products include flame retardant garments for the Fire Industry, Nomex clothing for utilities, and high visibility reflective outerwear for Departments of Transportation. The purchase was effective as of July 1, 2005 and the results of Mifflin's operations have been included since July 1 in the Company's reported results.

Index**5. Inventories:**

Inventories consist of the following:

|                 | October 31,<br><u>2006</u> | January 31,<br><u>2006</u> |
|-----------------|----------------------------|----------------------------|
| Raw materials   | \$ 22,583,473              | \$ 18,656,894              |
| Work-in-process | 2,829,145                  | 1,996,027                  |
| Finished Goods  | 19,765,815                 | 24,590,569                 |
|                 | \$ 45,178,433              | \$ 45,243,490              |

Inventories include freight-in, materials, labor and overhead costs and are stated at the lower of cost (on a first-in-first-out basis) or market.

**6. Earnings Per Share:**

Basic earnings per share are based on the weighted average number of common shares outstanding without consideration of common stock equivalents. Diluted earnings per share are based on the weighted average number of common and common stock equivalents. The diluted earnings per share calculation takes into account the shares that may be issued upon exercise of stock options, reduced by the shares that may be repurchased with the funds received from the exercise, based on the average price during the period.

The following table sets forth the computation of basic and diluted earnings per share at October 31, 2006 and 2005, adjusted, retroactively, for the 10% Stock dividends to Shareholders on April 30, 2005 and August 1, 2006.

|  | Three Months Ended<br>October 31, |              | Nine Months<br>Ended<br>October 31, |              |
|--|-----------------------------------|--------------|-------------------------------------|--------------|
|  | <u>2006</u>                       | <u>2005</u>  | <u>2006</u>                         | <u>2005</u>  |
| <b>Numerator</b>   |                                   |              |                                     |              |
| Net Income   | \$ 980,050                        | \$ 1,312,903 | \$ 3,796,344                        | \$ 4,674,090 |
| <b>Denominator</b>   |                                   |              |                                     |              |
| Denominator for basic earnings per share<br>(Weighted-average shares)            | 5,521,824                         | 5,518,751    | 5,520,567                           | 5,518,751    |
| Effect of dilutive securities  | 9,673                             | 5,358        | 5,994                               | 4,881        |
| Denominator for diluted earnings per share<br>(adjusted weighted average shares) | 5,531,497                         | 5,524,109    | 5,526,561                           | 5,523,632    |
| Basic earnings per share   | \$ .18                            | \$ .24       | \$ .69                              | \$ .85       |
| Diluted earnings per share   | \$ .18                            | \$ .24       | \$ .69                              | \$ .85       |

Index

**7. Revolving Credit Facility**

At October 31, 2006, the balance outstanding under our \$25 million five year revolving credit facility amounted to \$7.9 million. The credit facility is collateralized by substantially all of the assets of the Company. The credit facility contains financial covenants, including, but not limited to, fixed charge ratio, funded debt to EBITDA ratio, inventory and accounts receivable collateral coverage ratio, with respect to which the Company was in compliance at October 31, 2006 and for the period then ended. The weighted average interest rate for the three month and nine month periods ended October 31, 2006 was 6.09% and 5.77%, respectively.

**8. Major Supplier**

We purchased 63.7% of our raw materials from one supplier during the nine-month period ended October 31, 2006. We expect this relationship to continue for the foreseeable future. If required, similar raw materials could be purchased from other sources; however, our competitive position in the marketplace could be adversely affected.

**9. Employee Stock Compensation**

The Company's Director's Plan permits the grant of share options and shares to its Directors for up to 60,000 shares of common stock as stock compensation. All stock options under this Plan are granted at the fair market value of the common stock at the grant date. This date is fixed only once a year upon a Board Member's re-election to the Board at the Annual Shareholders' meeting which is the third Wednesday in June pursuant to the Director's Plan and our Company By-Laws. Directors' stock options vest ratably over a 6 month period and generally expire 6 years from the grant date.

Effective February 1, 2006, the Company's Plan is accounted for in accordance with the recognition and measurement provisions of Statement of Financial Accounting Standards ("FAS" No. 123 (R)), which replaces FAS No. 123, Accounting for Stock-Based Compensation, and supersedes Accounting Principles Board Opinion ("APB") No. 25, Accounting for Stock Issued to Employees, and related interpretations. FAS 123 (R) requires compensation costs related to share-based payment transactions including employee stock options, to be recognized in the financial statements. In addition, the Company adheres to the guidance set forth within Securities and Exchange Commission ("SEC") Staff Accounting Bulletin ("SAB") No. 107, which provides the Staff's views regarding the interaction between SFAS No. 123(R) and certain SEC rules and regulations and provides interpretations with respect to the valuation of share-based payments for public companies.

Prior to February 1, 2006, the Company accounted for similar transactions in accordance with APB No. 25 which employed the intrinsic value method of measuring compensation cost. Accordingly, compensation expense was not recognized for fixed stock options if the exercise price of the option equaled or exceeded the fair value of the underlying stock at the grant date.

While FAS No. 123 encouraged recognition of the fair value of all stock-based awards on the date of grant as expense over the vesting period, companies were permitted to continue to apply the intrinsic value-based method of accounting prescribed by APB No. 25 and disclose certain pro-forma amounts as if the fair value approach of SFAS No. 123 had been applied. In December 2002, FAS No. 148, Accounting for Stock-Based Compensation-Transition and Disclosure, an amendment of SFAS No. 123, was issued, which, in addition to providing alternative methods of transition for a voluntary change to the fair value method of accounting for stock-based employee compensation, required more prominent pro-forma disclosures in both the annual and interim financial statements. The Company complied with these disclosure requirements for all applicable periods prior to February 1, 2006.



Index

In adopting FAS 123(R), the Company applied the modified prospective approach to transition. Under the modified prospective approach, the provisions of FAS 123(R) are to be applied to new awards and to awards modified, repurchased, or cancelled after the required effective date. Additionally, compensation cost for the portion of awards for which the requisite service has not been rendered that are outstanding as of the required effective date shall be recognized as the requisite service is rendered on or after the required effective date. The compensation cost for that portion of awards shall be based on the grant-date fair value of those awards as calculated for either recognition or pro-forma disclosures under FAS 123.

The following table represents our stock options granted, exercised, and forfeited during the third quarter of 2007.

| Stock Options                   | Number of Shares | Weighted Average Exercise Price per Share | Weighted Average Remaining Contractual Term | Aggregate Intrinsic Value |
|---------------------------------|------------------|---|---|---------------------------|
| Outstanding at July 31, 2006    | 19,031           | \$12.79                                   | 3.1 years                                   | \$30,085                  |
| Outstanding at October 31, 2006 | 19,031           | \$12.79                                   | 2.9 years                                   | \$34,199                  |
| Exercisable at October 31, 2006 | 16,831           | \$12.75                                   | 2.9 years                                   | \$34,199                  |

***Restricted Stock Plan and Performance Equity Plan***

On June 21, 2006, the shareholders of the Company approved a restricted stock plan. A total of 253,000 shares of restricted stock were authorized under this plan. Under the restricted stock plan, eligible employees and directors are awarded performance-based restricted shares of the Corporation's common stock. The amount recorded as expense for the performance-based grants of restricted stock are based upon an estimate made at the end of each reporting period as to the most probable outcome of this plan at the end of the three year performance period. (e.g., baseline, minimum, maximum or zero). In addition to the grants with vesting based solely on performance, certain awards pursuant to the plan have a time-based vesting requirement, under which awards vest from three to four years after issuance, subject to continuous employment and certain other conditions. Restricted stock have the same voting rights as other common stock. Restricted stock awards do not have voting rights, and the underlying shares are not considered to be issued and outstanding until vested.

The Company has granted up to a maximum of 131,893 restricted stock awards as of October 31, 2006. All of these restricted stock awards are non-vested at October 31, 2006 (88,223 shares at "baseline" and 45,543 shares at "minimum") and have a weighted average grant date fair value of \$13.09. The Company recognizes expense related to performance-based awards over the requisite service period using the straight-line attribution method based on the outcome that is probable.

As of October 31, 2006, unrecognized stock-based compensation expense related to restricted stock awards totaled \$1,569,659, before income taxes, based on the maximum performance award level. Such unrecognized stock-based compensation expense related to restricted stock awards totaled \$1,060,699 and \$563,157 at the baseline and minimum performance levels, respectively. The cost of these non-vested awards is expected to be recognized over a weighted-average period of three years. The board has estimated its current performance level to be at the minimum level and expenses have been recorded accordingly. The performance based awards are not considered stock equivalents for EPS purposes



Index**Share-Based Compensation**

The Company adopted SFAS No. 123R on February 1, 2006, under the modified prospective method of adoption. The Corporation recognized total stock-based compensation costs of \$93,947, of which \$72,597 results from the 2006 Equity Incentive Plan, and \$21,350 results from the Non-Employee Directors Option Plan for the nine months ended October 31, 2006 and \$0 for October 31, 2005, respectively. These amounts are reflected in selling, general and administrative expenses. The total income tax benefit recognized for stock-based compensation arrangements was \$33,821 and \$0 for the nine months ended October 31, 2006 and October 31, 2005, respectively.

**Adoption of New Accounting Standards for Share-Based Payment**

As more fully disclosed in Note 1 of Notes to Consolidated Financial Statements included in Item 8 of the Corporation's Annual Report on Form 10-K for the year ended January 31, 2006, in December 2004, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004) (SFAS No. 123R), *Share-Based Payment*.

The following table illustrates the effect on net income and earnings per share as if the fair value recognition provisions of FAS No. 123 had been applied to all outstanding and unvested awards in the prior year comparable period.

|   | <b>Three Months<br/>Ended<br/>October 31,<br/>2005</b> | <b>Nine Months<br/>Ended October<br/>31,<br/>2005</b> |
|---|--|---|
| Numerator                                 |  |   |
| Net income                                | \$ 1,312,903   | \$ 4,674,090  |
| Less:                                     |  |   |
| Option expense based on fair value method | -----  | 9,627   |
| Pro forma                                 |  |   |
| Basic earnings per share:                 |  |   |
| As reported                               | \$ 1,312,903   | \$ 4,664,463  |
| Pro forma                                 | \$ .24   | \$ .85  |
| Diluted earnings per common share:        |  |   |
| As reported                               | \$ .24   | \$ .85  |
| Pro forma                                 | \$ .24   | \$ .84  |

The fair value of these options was estimated at the date of grant using the Black-Scholes option-pricing model with the following assumptions for the quarters and nine months ended October 31, 2005 expected volatility of 87% and 64%, respectively; risk-free interest rate of 3.6% and 2.93%, respectively; expected dividend yield of 0.0%; and expected life of six years. All stock-based awards were fully vested at October 31, 2005. Earnings per share and options granted have been adjusted to reflect the 10% stock dividends to stockholders of record as of April 30, 2005. During the three months ended October 31, 2005, no options were granted or exercised.



Index**10. Manufacturing Segment Data**

Domestic and international sales are as follows in millions of dollars:

|               | Three Months Ended<br>October 31, |       |             |       | Nine Months Ended<br>October 31, |       |             |       |
|---------------|-----------------------------------|-------|-------------|-------|----------------------------------|-------|-------------|-------|
|               | <u>2006</u>                       |       | <u>2005</u> |       | <u>2006</u>                      |       | <u>2005</u> |       |
| Domestic      | \$ 20.6                           | 88.4% | 20.7        | 91.2% | \$ 66.3                          | 88.9% | 65.7        | 89.4% |
| International | 2.7                               | 11.6% | 2.0         | 8.8%  | 8.3                              | 11.1% | 7.8         | 10.6% |
| Total         | \$ 23.3                           | 100%  | \$ 22.7     | 100%  | \$ 74.6                          | 100%  | \$ 73.5     | 100%  |

We manage our operations by evaluating each of our geographic locations. Our North American operations include our facilities in Decatur, Alabama (primarily the distribution to customers of the bulk of our products and the manufacture of our chemical, glove and disposable products), Celaya, Mexico (primarily disposable, glove and chemical suit production) St. Joseph, Missouri and Shillington, Pennsylvania (primarily woven products production). We also maintain three manufacturing facilities in China (primarily disposable and chemical suit production) and a glove manufacturing facilities in New Delhi, India. Our China facilities and our Decatur, Alabama facility produce the majority of the Company's products. The accounting policies of these operating entities are the same as those described in Note 1 to our Annual Report on Form 10-K for the year ended January 31, 2006. We evaluate the performance of these entities based on operating profit which is defined as income before income taxes, interest expense and other income and expenses. We have small sales forces in Canada, Europe, Chile and China which sell and distribute products shipped from the United States, Mexico or China.

The table below represents information about reported manufacturing segments for the three and nine months noted therein:

|  | Three Months Ended<br>October 31,<br>(in millions of dollars) |             | Nine Months Ended October 31,<br>2006<br>(in millions of dollars) |             |
|--|---|-------------|---|-------------|
|  | <u>2006</u>   | <u>2005</u> | <u>2006</u>   | <u>2005</u> |
| <b>Net Sales:</b>  |   |             |   |             |
| North America  | \$ 24.5   | \$ 23.8     | \$ 78.3   | \$ 77.7     |
| China  | 3.0   | 2.1         | 8.6   | 6.9         |
| Less inter-segment sales   | (4.2)   | (3.2)       | (12.3)  | (11.1)      |
| Consolidated sales   | \$ 23.3   | \$ 22.7     | \$ 74.6   | \$ 73.5     |
| <b>Operating Profit:</b>   |   |             |   |             |
| North America  | \$ .57  | \$ 2.1      | \$ 4.0  | \$ 5.8      |
| China  | .5  | (-)         | 1.4   | 1.2         |
| Less inter-segment profit (loss)   | (.07)   | (.1)        | (.1)  | (.2)        |
| Consolidated profit  | \$ 1.0  | \$ 2.0      | \$ 5.3  | \$ 6.8      |
| <b>Identifiable Assets (at Balance Sheet date or change during quarter):</b> |   |             |   |             |
| North America  | \$ 2.9  | \$ 6.8      | \$ 69.7   | \$ 63.9     |
| China  | .5  | ---         | 7.5   | 9.8         |
| Consolidated assets  | \$ 3.4  | \$ 6.8      | \$ 77.2   | \$ 73.7     |
| <b>Depreciation and Amortization Expense:</b>                                |   |             |   |             |
| North America  | \$ .2   | \$ .1       | \$ .5   | \$ .4       |
| China  | .1  | .1          | .3  | .3          |
| Consolidated depreciation expense  | \$ .3   | \$ .2       | \$ .8   | \$ .7       |



Index

**11. Effects of Recent Accounting Pronouncements**

In July 2006 the FASB issued Financial Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (“FIN 48”), as an interpretation of SFAS No. 109, *Accounting for Income Taxes*. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise’s financial statements in accordance with SFAS No. 109 and prescribes a recognition threshold of more-likely-than-not to be sustained upon examination. Measurement of the tax uncertainty occurs if the recognition threshold has been met. FIN 48 also provides guidance on derecognition, classification, interest, penalties, accounting in interim periods, disclosure, and transition. FIN 48 will be effective beginning February 1, 2007. Differences between the amounts recognized in the statements of financial position prior to the adoption of FIN 48 and the amounts reported after adoption should be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The Company is still evaluating the impact, if any, the adoption of this interpretation will have on the Company’s financial position, cash flows, and results of operations.

In September 2006, the Securities and Exchange Commission (“SEC”) issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (“SAB 108”). SAB 108 provides interpretive guidance on how the effects of the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective for the Company’s fiscal year ending January 31, 2007. We do not expect SAB 108 to have a material impact on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which clarifies the definition of fair value, establishes guidelines for measuring fair value, and expands disclosures regarding fair value measurements. SFAS No. 157 does not require any new fair value measurements and eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS No. 157 will be effective for the Company on February 1, 2008. The Company is currently evaluating the impact of adopting SFAS No. 157 on the Company’s financial position, cash flows, and results of operations.

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans*, an amendment of FASB Statements No. 87, 88, 106, and 132(R) (FAS 158). FAS 158 requires an employer to recognize the over-funded or under-funded status of a defined benefit postretirement plan as an asset or liability in its balance sheet and to recognize changes in funded status in the year in which the changes occur through comprehensive income. Additionally, FAS 158 requires an employer to measure the funded status of a plan as of the date of its year-end balance sheet, with limited exceptions. The Company will be required to adopt the recognition and disclosure provisions of FAS 158 as of January 31, 2007.

**12. Real Estate Purchases**

The Company entered into an agreement to construct distribution facilities in Brantford, Ontario at a cost of approximately \$2,200,000. In order to finance the acquisition, the Company has arranged a term loan in the amount of \$2,000,000 bearing interest at the Business Development Bank of Canada’s floating base rate minus 1.25% and is repayable in monthly principal installments of \$8,350 plus interest.

**13. Related Party Transactions**

In connection with the asset purchase agreement, dated August 1, 2005, between the Company and Mifflin Valley, Inc., the Company entered into a five year lease agreement with the seller (now an employee of the Company) to rent the manufacturing facility owned by the seller an annual rental of \$55,560, or a per square foot rental of \$3.00. This

amount was obtained prior to the acquisition from an independent appraisal of the fair market rental value per square feet. In addition the Company has, starting January 1,

13

---

Index

2006 rented 12,000 sq ft of warehouse space in PA from this employee, on a month by month basis, for the monthly amount of \$3.35 per square foot.

**14. Formation of New Subsidiaries**

On March 13, 2006 Lakeland Industries, Inc. Agencia en Chile was formed to facilitate the opening of a new sales and warehousing operation in Santiago, Chile to service South American markets. On May 26, 2006, Lakeland Protective Real Estate was formed to obtain a \$2 million mortgage for a new warehouse to be built in Canada.

**15. Contingencies - Tax Audit**

The Company's Federal Income Tax returns for the fiscal years ended January 31, 2003 and 2004 are currently under audit by the Internal Revenue Service. The final results of these audits cannot be estimated by management. It is anticipated that the audits will be concluded by late Fiscal 2007.

**16. Mexican Tax Situation**

In August 2001, Guanajuato Mexico, Secretaria de Hacienda Credito Publico ("Hacienda") began an audit of our wholly-owned subsidiary Lakeland de Mexico de SA de CV. The audit resulted in a claim by Hacienda for 9,195,254 Mexican Pesos (approximately \$800,000 USD, based on exchange rate on June 7, 2006) in December 2002 alleging that it was not proven that Lakeland's imports into Mexico were re-exported, and therefore, no tariffs or taxes were due. In June 2002 Hacienda's own Legal Department in an administrative opinion dismissed this deficiency in total. In December 2003 the Hacienda Audit Department changed tactics and reinstated the deficiency based on new legal theories. In response to this second claim, in March 2004 Lakeland de Mexico filed a Nullity Proceeding against Hacienda at the Tribunal Federal de Justicia Fiscal Administrativa, Celaya, Guanajuato to nullify Hacienda's tax liens and deficiencies. On August 4, 2006 we were officially notified that the above described legal proceedings was decided in Lakeland's favor by a three judge panel. It is standard procedure for the opposing side to ask for a review from a higher court judge. This review was requested, and we anticipate it will be concluded in early 2007.

**17. Foreign Currency Exposure**

The Company has foreign currency exposure, principally through sales in Canada and the UK and production in Mexico and China. Management has commenced a hedging program to offset this risk by purchasing forward contracts to sell the Canadian Dollar, Euro, Great Britain Pound, and Mexican Peso. Such contracts are largely timed to expire with the last day of the fiscal quarter, with a new contract purchased on the first day of the following quarter, to match the operating cycle of the company. Management has decided not to hedge its long position in the Chinese Yuan. There were no material open foreign currency hedge contracts at October 31, 2006.

**18. Subsequent Event**

In November, 2006, the Company closed on its contract to buy the Industrial Glove assets of RFB Latex, Ltd. (RFB) of New Delhi, India for a purchase price of approximately \$3.4 million, subject to reconciliation of operations over the prior year and an audit. Such assets consist of long-term land leases, buildings and equipment. This purchase price is in addition to the cumulative outlay of approximately \$1.5 million through November 15, 2006 which consists of the cost of the purchase option, inventory, receivables, operating losses to date and working capital. The company may, subject to Indian law, liquidate its existing subsidiary and set up a new subsidiary which will consummate the purchase transaction.





Index

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

*You should read the following summary together with the more detailed business information and consolidated financial statements and related notes that appeared in our Form 10-K and Annual Report and in the documents that were incorporated by reference into our Form 10-K for the year ended January 31, 2006. This Form 10-Q may contain certain "forward-looking" information within the meaning of the Private Securities Litigation Reform Act of 1995. This information involves risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements.*

**Overview**

We manufacture and sell a comprehensive line of safety garments and accessories for the industrial protective clothing and homeland security markets. Our products are sold by our in-house sales force and independent sales representatives to a network of over 800 safety and mill supply distributors. These distributors in turn supply end user industrial customers such as chemical/petrochemical, automobile, steel, glass, construction, smelting, janitorial, pharmaceutical and high technology electronics manufacturers, as well as hospitals and laboratories. In addition, we supply federal, state and local governmental agencies and departments such as fire and police departments, airport crash rescue units, the Department of Defense, the Centers for Disease Control, and numerous other agencies of the federal and state governments..

We have operated manufacturing facilities in Mexico since 1995 and in China since 1996. Beginning in 1995, we moved the labor intensive sewing operation for our limited use/disposable protective clothing lines to these facilities. Our facilities and capabilities in China and Mexico allow access to a less expensive labor pool than is available in the United States and permit us to purchase certain raw materials at a lower cost than they are available domestically. As we have increasingly moved production of our products to our facilities in Mexico and China, we have seen improvements in the profit margins for these products. We are at the half way point of moving production of our reusable woven garments and gloves to these facilities and expect to continue this process through fiscal 2008. As a result, we expect to see continuing profit margin improvements for these product lines over time.

**Critical Accounting Policies and Estimates**

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, net sales and expenses, and disclosure of contingent assets and liabilities. We base estimates on our past experience and on various other assumptions that we believe to be reasonable under the circumstances and we periodically evaluate these estimates.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our consolidated financial statements.

*Revenue Recognition.* We derive our sales primarily from our limited use/disposable protective clothing and secondarily from our sales of high-end chemical protective suits, reusable woven garments, fire fighting and heat protective apparel, and gloves and arm guards.. Sales are recognized when goods are shipped to our distributors at which time title and the risk of loss passes. Sales are reduced for sales returns and allowances. Payment terms are generally net 30 days for United States sales and net 90 days for international sales.

*Inventories.* Inventories include freight-in, materials, labor and overhead costs and are stated at the lower of cost (on a first-in, first-out basis) or market. Provision is made for slow-moving, obsolete or unusable inventory.

*Allowance for Doubtful Accounts.* We establish an allowance for doubtful accounts to provide for accounts receivable that may not be collectible. In establishing the allowance for doubtful accounts, we analyze the collectibility of individual large or past due accounts customer-by-customer. We establish reserves for accounts that we determine to be doubtful of collection.

*Income Taxes and Valuation Reserves.* We are required to estimate our income taxes in each of the jurisdictions in which we operate as part of preparing our consolidated financial statements. This involves estimating the actual current tax in addition to assessing temporary differences resulting from differing treatments for tax and financial accounting purposes. These differences, together with net operating loss

Index

carry forwards and tax credits, are recorded as deferred tax assets or liabilities on our balance sheet. A judgment must then be made of the likelihood that any deferred tax assets will be realized from future taxable income. A valuation allowance may be required to reduce deferred tax assets to the amount that is more likely than not to be realized. In the event we determine that we may not be able to realize all or part of our deferred tax asset in the future, or that new estimates indicate that a previously recorded valuation allowance is no longer required, an adjustment to the deferred tax asset is charged or credited to net income in the period of such determination. The Company's Federal Income Tax returns for the fiscal years ended January 31, 2003 and 2004 are currently under audit by the Internal Revenue Service. The final results of these audits cannot be estimated by management at this time, but management does not believe the results of the audit will have a material effect on the financial condition of the Company.

*Valuation of Goodwill and Other Intangible Assets.* On February 1, 2002, we adopted Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," which provides that goodwill and other intangible assets are no longer amortized, but are assessed for impairment annually and upon occurrence of an event that indicates impairment may have occurred. Goodwill impairment is evaluated utilizing a two-step process as required by SFAS No. 142. Factors that we consider important that could identify a potential impairment include: significant underperformance relative to expected historical or projected future operating results; significant changes in the overall business strategy; and significant negative industry or economic trends. When we determine that the carrying value of intangibles and goodwill may not be recoverable based upon one or more of these indicators of impairment, we measure any potential impairment based on a projected discounted cash flow method. Estimating future cash flows requires our management to make projections that can differ materially from actual results.

*Self-Insured Liabilities.* We have a self-insurance program for certain employee health benefits. The cost of such benefits is recognized as expense based on claims filed in each reporting period, and an estimate of claims incurred but not reported during such period. Our estimate of claims incurred but not reported is based upon historical trends. If more claims are made than were estimated or if the costs of actual claims increases beyond what was anticipated, reserves recorded may not be sufficient and additional accruals may be required in future periods. We maintain separate insurance to cover the excess liability over set single claim amounts and aggregate annual claim amounts.

### **Significant Balance Sheet Fluctuation October 31, 2006 as compared to January 31, 2006**

Cash increased by \$1.9 million as borrowings under the revolving credit facility increased by \$0.60 million at October 31, 2006. Accounts receivable decreased by \$1.1 million as sales for the three months ended October 31, 2006 decreased by 7.8% from the three months ended January 31, 2006. Deferred income taxes increased by a \$0.338 million tax benefit for the India operations. Other current assets increased principally due to prepaid income taxes of \$1.5 million for the US and Canada. Other assets includes \$2.7 million related to the purchases of the Indian operations.

At October 31, 2006 the Company had an outstanding loan balance of \$7.878 million under its facility with Wachovia Bank, N.A. compared with \$7.272 million at January 31, 2006. Total stockholder's equity increased by the net income for the period of \$3.9 million.

### **Nine months ended October 31, 2006 as compared to the nine months ended October 31, 2005**

*Net Sales.* Net sales increased \$1.06 million, or 1.4% to \$74.6 million for the nine months ended October 31, 2006 from \$73.5 million for the nine months ended October 31, 2005. The increase was primarily due to growth in sales by our UK subsidiary of \$670,000, new revenue from India and Chile of \$709,000 and the acquired Mifflin Valley, Inc., of \$1,193,000 which had revenue in the 9 months ending October 2006 of \$2,308,000 compared with \$1,115,000 for the nine months ending October 2005, and growth in China external sales of \$533,000, offset significantly by decreased sales in disposable, chemical protection garments and woven garments and lower selling prices in these

three categories to meet competitive market conditions. Sales in these three product lines decreased by \$2,137,000 over the prior nine month period.

*Gross Profit.* Gross profit increased \$.99 million or 5.6% to \$18.6 million for the nine months ended October 31, 2006 from \$17.6 million for the nine months ended October 31, 2005. Gross profit as a percentage of net sales increased to 25.0% for the nine months ended October 31, 2006 from 24.0% for the

Index

nine months ended October 31, 2005, primarily due to aggressive raw material purchasing in the latter part of FY 06 and in FY 07 which benefited the Company as lower costs through approximately the end of June 2006, ongoing cost reduction programs in component and service-purchasing, shifting production from the US to China and Mexico, the reassignment of certain personnel to SGA departments from COGS departments as described below and the inclusion of Mifflin Valley, Inc. results which has higher gross profit margins than most of Lakeland's other product lines have overall, partially offset by rising raw material costs.

*Operating Expenses.* Operating expenses increased \$2.4 million or 22.7% to \$13.3 million for the nine months ended October 31, 2006 from \$10.9 million for the nine months ended October 31, 2005. As a percentage of sales, operating expenses increased to 17.8% for the nine months ended October 31, 2006 from 14.8% for the nine months ended October 31, 2005. The \$2.4 million increase in operating expenses in the nine months ended October 31, 2006 as compared to the nine months ended October 31, 2005 is comprised of:

- o \$0.30 million of Mifflin Valley operating expenses included for the full nine months ended October 2006 in excess of the four months through October included in the nine months ended October 2005.
- o \$0.24 million of labor costs resulting from personnel reassigned to SGA departments who had been assigned to COGS departments in 2005.
  - o \$0.75 million of SGA costs from new entities in India, Chile and Japan.
- o \$0.51 million net increases in sales salaries and commissions, mainly in Disposables, Wovens and Canada and related payroll taxes. Several senior level sales personnel were added to support lagging sales in Disposables, support new woven product introductions and coordinate international sales efforts.
- o \$0.22 million of net increases in insurance and employee benefits mainly resulting from a more negative experience in our self insured medical plan.
  - o \$0.07 million increase in administrative payroll.
  - o \$0.04 million in foreign currency fluctuation.
  - o \$0.09 million in share-based compensation.
- o \$0.06 million in higher professional and consulting fees, largely resulting from audit fees.
- o \$0.09 million in increased bad debt expense resulting from two large accounts reserved against.
  - o \$0.03 million miscellaneous net expense increases.

Operating Profit decreased 21.8% to \$5.3 million for the nine months ended October 31, 2006 from \$6.8 million for the nine months ended October 31, 2005. Operating margins were 7.1% for the nine months ended October 31, 2006 compared to 9.2% for the nine months ended October 31, 2005.

*Interest Expenses.* Interest expenses increased by \$0.224 million for the nine months ended October 31, 2006 as compared to the nine months ended October 31, 2005 because of higher amounts borrowed at increasing interest rates under our credit facility.

*Income Tax Expense.* Income tax expenses consist of federal, state, and foreign income taxes. Income tax expenses decreased \$0.803 million, or 36.5%, to \$1.40 million for the nine months October 31, 2006 from \$2.20 million for the nine months ended October 31, 2005. Our effective tax rates were 26.9% and 32.0% for the nine months ended October 31, 2006 and 2005, respectively. Our effective tax rate varied from the federal statutory rate of 34% due primarily to lower foreign taxes, primarily resulting from greater profits from outsourced production, partially offset by state taxes and by losses in Chile and Japan which are not eligible for tax credits and for India in which a U.S. tax benefit of \$338,000 was recorded at October 31, 2006.

*Net Income.* Net income decreased \$0.878 million, or 18.8% to \$3.8 million for the nine months ended October 31, 2006 from \$4.7 million for the nine months ended October 31, 2005. The decrease in net income primarily resulted from lower sales volumes in our disposable and chemical protective suit lines and meeting competitive market prices

in our disposable garment division in the second quarter, the increased operating expenses described above, and the combined operating losses of \$1,017,000 of the new foreign operations. Earnings per share were

17

---

Index

\$0.69 for the nine months ended October 31, 2006 compared to \$0.85 for the nine months ended October 31, 2005 (after reflecting adjustments resulting from the 10% stock dividend payable to holders of record August 1, 2006).

**Three months ended October 31, 2006 as compared to the three months ended October 31, 2005**

*Net Sales.* Net sales increased \$.546 million, or 2.4% to \$23.3 million for the three months ended October 31, 2006 from \$22.7 million for the three months ended October 31, 2005. The net increase was comprised of increased sales in disposable garments of \$321,000, lower government spending in our Chemical Protective garments \$39,000, growth in sales in our Canadian and UK subsidiaries of \$453,000, new revenue from India and Chile of \$359,000, and a decrease in Mifflin Valley, Inc. of \$167,000 (acquired in July 2005) which had revenue in the quarter ended October 2006 of \$694,000 compared with \$861,000 for the quarter ended October 2005. Sales in our Wovens, Gloves and fire suits declined by \$380,000 compared to the same period last year.

*Gross Profit.* Gross profit decreased \$0.046 million or 0.8% to \$5.64 million for the three months ended October 31, 2006 from \$5.68 million for the three months ended October 31, 2005. Gross profit as a percentage of net sales decreased to 24.2% for the three months ended October 31, 2006 from 25.0% for the three months ended October 31, 2005, primarily due to higher raw material cost, costs related to the new foreign subsidiaries partially offset by ongoing cost reduction programs in component and service-purchasing, shifting production from the US to China and Mexico, the reassignment of certain personnel to SGA departments from COGS departments as described below.

*Operating Expenses.* Operating expenses increased \$0.93 million, or 25.4% to \$4.6 million for the three months ended October 31, 2006 from \$3.7 million for the three months ended October 31, 2005. As a percentage of sales, operating expenses increased to 19.7% for the three months ended October 31, 2006 from 16.1% for the three months ended October 31, 2005. The \$0.93 million increase in operating expenses in the three months ended October 31, 2006 as compared to the three months ended October 31, 2005 were comprised of:

- o \$0.65 million of SGA costs from new entities in India, Chile and Japan.
- o \$0.06 million of net increases in insurance and employee benefits mainly resulting from a more negative experience in our self insured medical plan.
  - o (\$0.05) million lower freight out costs resulting from slight relief in prevailing carrier rates.
  - o \$0.05 million in share-based compensation.
  - o \$0.13 million in higher professional and consulting fees, largely resulting from audit fees.
- o (\$0.03) million in reduced bank charges resulting from reduced use of credit cards and a re-negotiation of the fee structure.
  - o \$0.08 million in increased bad debt exposure resulting from two large accounts reserved against.
  - o \$0.04 million miscellaneous increases.

Operating profit decreased 45.9% to \$1.10 million for the three months ended October 31, 2006 from \$2.03 million for the three months ended October 31, 2005. Operating margins were 4.7% for the three months ended October 31, 2006 compared to 8.9% for the three months ended October 31, 2005.

*Interest Expenses.* Interest expenses increased by \$0.041 million for the three months ended October 31, 2006 as compared to the three months ended October 31, 2005 because of higher amounts borrowed and increasing interest rates under our credit facility.

*Income Tax Expense.* Income tax expenses consist of federal, state, and foreign income taxes. Income tax expenses decreased \$0.604 million, or 83%, to \$0.121 million for the three months October 31, 2006 from \$0.725 million for the three months ended October 31, 2005. Our effective tax rates were 10.9% and 35.6% for the three months ended October 31, 2006 and 2005, respectively. Our effective tax rate varied from the federal statutory rate of 34% due

primarily to lower foreign taxes, primarily resulting from greater profits resulting from outsourced production partially offset by state taxes and by start up losses in Chile and Japan which are not eligible for tax credits and for India in which a U.S. tax benefit of \$338,000 was

18

---



Index

recorded at October 31, 2006. Included in this was approximately \$90,000 of tax benefit attributable to losses incurred in periods prior to the third fiscal quarter. These losses became eligible for the tax benefit as a result of the planned liquidation of the existing Indian subsidiary.

*Net Income.* Net income decreased \$0.33 million, or 25.3% to \$0.980 million for the three months ended October 31, 2006 from \$1.31 million for the three months ended October 31, 2005. The decrease in net income primarily resulted from lower sales volumes in our gloves and fire suit lines and meeting competitive conditions in our disposable garment division, the increased operating expenses described above, and the combined operating losses of \$695,000 of the new foreign operations. Earnings per share were \$0.18 for the three months ended October 31, 2006 compared to \$0.24 for the three months ended October 31, 2005 (after reflecting adjustments resulting from the 10% stock dividend payable to holders of record August 1, 2006).

**Liquidity and Capital Resources**

**Cash Flows**

As of October 31, 2006 we had cash and cash equivalents of \$3.4 million and working capital of \$61.7 million, increases of \$1.91 million and \$1.9 million, respectively, from January 31, 2006. Our primary sources of funds for conducting our business activities have been cash flow provided by operations and borrowings under our credit facilities described below. We require liquidity and working capital primarily to fund increases in inventories and accounts receivable associated with our net sales and, to a lesser extent, for capital expenditures.

Net cash provided by operating activities of \$1.9 million for the nine months ended October 31, 2006 was due primarily to net income from operations of \$3.9 million, an increase in accounts payable of \$0.24 million, a decrease in inventories of \$0.065 million and a decrease in accounts receivable of \$1.3 million. Net cash used in investing activities of \$0.631 million in the nine months ended October 31, 2006, was due to purchases of property and equipment.

Net cash used in operating activities of \$7.4 million for the nine months ended October 31, 2005 was due primarily to net income from operations of \$4.7 million, an increase in inventories of \$14.5 million, an decrease in accounts receivable of \$0.61 million, an increase in accounts payable of \$1.0 million. Net cash used in investing activities of \$5.8 million in the nine months ended October 31, 2005, was due to purchases of property and equipment and the acquisition of Mifflin Valley.

We currently have one credit facility - a \$25 million revolving credit, of which \$7.9 million of borrowings were outstanding as of October 31, 2006. Our credit facility requires that we comply with specified financial covenants relating to fixed charge ratio, debt to EBIDTA coverage, and inventory and accounts receivable collateral coverage ratios. These restrictive covenants could affect our financial and operational flexibility or impede our ability to operate or expand our business. Default under our credit facility would allow the lender to declare all amounts outstanding to be immediately due and payable. Our lender has a security interest in substantially all of our assets to secure the debt under our credit facility. As of October 31, 2006, we were in compliance with all covenants contained in our credit facility.

We believe that our current cash position of \$3.4 million, our cash flow from operations along with borrowing availability under our \$25 million revolving credit facility will be sufficient to meet our currently anticipated operating, capital expenditures and debt service requirements for at least the next 12 months.

**Capital Expenditures**

Our capital expenditures principally relate to purchases of manufacturing equipment, computer equipment, and leasehold improvements, as well as payments related to the construction of our facilities in China. Our facilities in China are not encumbered by commercial bank mortgages and thus Chinese commercial mortgage loans may be available with respect to these real estate assets if we need additional liquidity. Our capital expenditures are expected to be approximately \$1.2 million for capital equipment, primarily computer equipment and apparel manufacturing equipment in fiscal 2007, and approximately \$2

Index

million for a new Canadian facility (some of which will be incurred in FY 08).

*Foreign Currency Exposure.* The Company has foreign currency exposure, principally through sales in Canada and the UK and production in Mexico and China. Management has commenced a hedging program to offset this risk by purchasing forward contracts to sell the Canadian Dollar, Euro, Great Britain Pound and Mexican Peso. Such contracts are largely timed to expire with the last day of the fiscal quarter, with a new contract purchased on the first day of the following quarter, to match the operating cycle of the company. Management has decided not to hedge its long position in the Chinese Yuan. There were no material open foreign currency hedge contracts at October 31, 2006.

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

There have been no significant changes in market risk from that disclosed in our Annual Report on Form 10-K for the fiscal year ended January 31, 2006.

**Item 4. Controls and Procedures**

*Evaluation of Disclosure Controls and Procedures* - Lakeland Industries, Inc.'s Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of Lakeland Industries, Inc.'s disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(c) under the Securities Exchange Act) as of the end of the period covered by this report, have concluded that, based on the evaluation of these controls and procedures, the Company's disclosure controls and procedures were effective.

*Changes in Internal Control Over Financial Reporting* - Lakeland Industries, Inc.'s management, with the participation of Lakeland Industries, Inc.'s Chief Executive Officer and Chief Financial Officer, has evaluated whether any change in the Company's internal control over financial reporting occurred during the third quarter of fiscal 2007. Based on that evaluation, management concluded that there has been no change in Lakeland Industries, Inc.'s internal control over financial reporting during the third quarter of fiscal 2007 that has materially affected, or is reasonably likely to materially affect, Lakeland Industries, Inc.'s internal control over financial reporting.

Through the thirty three months ended October 31, 2006 additional expense has been incurred relating to documenting and testing the systems of internal controls. The Company hired internal auditors in 2004 and 2005 and has contracted with an independent consultant for services related to overall Sarbanes-Oxley Act compliance and more specifically Section 404, in February 2004. The total cumulative amount expensed so far is approximately \$1,032,000 including \$83,250 in additional director fees.

**PART II. OTHER INFORMATION**

Items 1, 2, 3, 4 and 5 are not applicable

**Item 6. Exhibits and Reports on Form 8-K:**

- a - On August 31, 2006, the Company filed a Form 8-K under Item 2.02, relating to a Notice of Teleconference call for 4:30 PM September 7, 2006.

On September 7, 2006, the Company filed a Form 8-K for the purpose of furnishing under Items 2.02 and 9.01 a press release announcing results of operations for the 2nd quarter ended July 31, 2006.



Index

**SIGNATURES**

Pursuant to the requirements of Section 13 or 15 (d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

**LAKELAND INDUSTRIES,  
INC.**

(Registrant)

Date: December 7, 2006

/s/ Christopher J. Ryan  
Christopher J. Ryan,  
Chief Executive Officer,  
President,  
Secretary and General Counsel  
(Principal Executive Officer and  
Authorized Signatory)

Date: December 7, 2006

/s/Gary Pokrassa  
Gary Pokrassa,  
Chief Financial Officer  
(Principal Accounting Officer  
and  
Authorized Signatory)