

DIGITAL ANGEL CORP
Form 10-Q
August 04, 2005

**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 June 30, 2005

Or

☐

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

For the transition period from to

Commission File Number: 1-15177

DIGITAL ANGEL CORPORATION

(Exact name of registrant as specified in its charter)

DELAWARE
(State or other jurisdiction of
incorporation or organization)

52-1233960
(IRS Employer
Identification No.)

490 Villaume Avenue, South Saint Paul, Minnesota, 55075
(Address of registrant's principal executive offices)

(651) 455-1621
(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

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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 ☐

As of the close of business on August 3, 2005, there were 43,847,314 shares outstanding of the issuer's \$0.005 per share par value common stock.

DIGITAL ANGEL CORPORATION

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements.

DIGITAL ANGEL CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except par value)

	June 30, 2005 (Unaudited)	December 31, 2004
Assets		
Current Assets		
Cash	\$ 12,662	\$ 17,492
Restricted cash		327
Accounts receivable (net of allowance for doubtful accounts of \$255 in 2005 and \$241 in 2004)	8,128	7,641
Due from Verichip Corporation	66	
Inventories	8,390	6,232
Other current assets	1,374	1,235
Net assets from discontinued operations		6
Total Current Assets	30,620	32,933
Property and Equipment, net	8,161	5,947
Goodwill	53,624	48,997
Other Intangible Assets, net	3,649	4,011
Other Assets, net	598	785
	\$ 96,652	\$ 92,673
Liabilities and Stockholders' Equity		
Current Liabilities		
Line of credit and current maturities of long-term debt	\$ 1,946	\$ 99
Accounts payable	4,964	3,936
Accrued expenses and other current liabilities	3,284	4,371
Deferred revenue	1,195	1,204
Due to Applied Digital Solutions, Inc.	6	23
Net liabilities from discontinued operations	71	
Total Current Liabilities	11,466	9,633
Long-Term Debt And Notes Payable	3,505	2,285
Deferred Revenue	640	744
Total Liabilities	15,611	12,662
Commitments And Contingencies (See Note 10)		
Minority Interest	567	249

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Stockholders' Equity

Preferred stock: Authorized 1,000 shares, of \$1.75 par value, 0 outstanding in 2005 and 1 outstanding in 2004		1
Common stock: Authorized 95,000 shares, of \$.005 par value; 44,225 shares issued and 43,847 shares outstanding in 2005 and 43,475 shares issued and 43,425 outstanding in 2004	222	217
Additional paid-in capital	211,874	207,875
Accumulated deficit	(129,858)	(128,474)
Treasury stock (carried at cost, 378 in 2005 and 50 in 2004)	(1,580)	(43)
Accumulated other comprehensive (loss) income	(184)	186
Total Stockholders' Equity	80,474	79,762
	\$ 96,652	\$ 92,673

See the accompanying notes to condensed consolidated financial statements.

DIGITAL ANGEL CORPORATION AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In thousands, except per share data)

(Unaudited)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2005	2004	2005	2004
Product revenue	\$ 14,247	\$ 9,403	\$ 26,944	\$ 19,914
Service revenue	613	667	1,319	927
Total net revenue	14,860	10,070	28,263	20,841
Cost of products sold	7,918	5,479	15,021	11,608
Cost of services sold	302	435	607	548
Gross profit	6,640	4,156	12,635	8,685
Selling, general and administrative expenses	6,118	4,303	11,446	8,727
Research and development expenses	1,119	850	2,205	1,519
Operating loss	(597)	(997)	(1,016)	(1,561)
Interest income	83	8	159	16
Interest expense	(79)	(247)	(180)	(503)
Realized and unrealized losses on Applied Digital common stock		(26)		(2,612)
Other income	7	20	33	58
Loss before taxes, minority interest and discontinued operations	(586)	(1,242)	(1,004)	(4,602)
Income taxes	(86)		(86)	
Minority interest share of losses (income)	(219)	3	(294)	(3)
Net loss from continuing operations	(891)	(1,239)	(1,384)	(4,605)
Loss from discontinued operations		(750)		(1,128)
Net loss	\$ (891)	\$ (1,989)	(1,384)	\$ (5,733)
Loss per common share-basic and diluted:				
Loss from continuing operations	(0.02)	(0.04)	(0.03)	(0.15)
Loss from discontinued operations		(0.02)		(0.03)
Net loss per common share basic and diluted	\$ (0.02)	\$ (0.06)	(0.03)	\$ (0.18)
Weighted average number of common shares outstanding - basic and diluted	43,917	32,691	43,792	31,604

See the accompanying notes to condensed consolidated financial statements.

DIGITAL ANGEL CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
For The Six Months Ended June 30, 2005
(In Thousands)
(Unaudited)

	Preferred Stock		Common Stock		Additional	Accumulated	Treasury	Accumulated	Total
	Number	Amount	Number	Amount	Paid-In	Deficit	Stock	Other Comprehensive Income (Loss)	Stockholders' Equity
Balance - December 31, 2004		\$ 1	43,425	\$ 217	\$ 207,875	\$ (128,474)	\$ (43)	\$ 186	\$ 79,762
Net loss						(1,384)			(1,384)
Comprehensive loss - Foreign currency translation								(370)	(370)
Total comprehensive loss						(1,384)		(370)	(1,754)
Purchase of treasury stock							(1,537)		(1,537)
Issuance of common stock to Applied Digital Solutions, Inc.			644	3	3,497				3,500
Conversion of Series A Preferred Stock		(1)	14	1					
Exercise of stock options			20		55				55
Exercise of warrants			115	1	302				303
Stock grant to former employee			7						
Restricted stock issued to employees					145				145
Balance June 30, 2005		\$	44,225	\$ 222	\$ 211,874	\$ (129,858)	\$ (1,580)	\$ (184)	\$ 80,474

See the accompanying notes to condensed consolidated financial statements.

DIGITAL ANGEL CORPORATION AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	For the Six Months Ended June 30,	
	2005	2004
Cash Flows From Operating Activities		
Net loss from continuing operations	\$ (1,384)	\$ (4,605)
Adjustments to reconcile net loss to net cash used in operating activities:		
Loss from discontinued operations		(1,128)
Proceeds from sale of Applied Digital common stock		2,687
Equity-based compensation	145	31
Amortization of debt discount and deferred financing costs		124
Depreciation and amortization	1,179	1,157
Minority interest	294	3
Loss on Applied Digital common stock		2,612
Loss on disposal of equipment	5	39
Change in assets and liabilities:		
Decrease (increase) in restricted cash	327	(74)
Decrease (increase) in accounts receivable	1,035	(1,169)
(Increase) decrease in inventories	(1,035)	542
Increase in deferred costs		(296)
Increase in other current assets	(167)	(259)
Decrease in due to Applied Digital	(17)	(250)
Decrease in accounts payable, accrued expenses and deferred revenue	(1,837)	(113)
Net cash provided by discontinued operations	77	379
Net Cash Used In Operating Activities	(1,378)	(320)
Cash Flows From Investing Activities		
(Increase) decrease in other assets	(204)	18
Payments for property and equipment	(675)	(235)
Acquisition costs, net of cash acquired	(893)	(20)
Net cash provided by discontinued operations		383
Net Cash (Used In) Provided By Investing Activities	(1,772)	146
Cash Flows From Financing Activities		
Amounts borrowed on line of credit	1,969	18,837
Amounts paid on line of credit	(2,157)	(19,510)
Payments on notes payable and long-term debt	(367)	(355)
Exercise of stock options and warrants	358	995
Purchase of treasury stock	(1,537)	
Payments for financing costs		(20)
Net Cash Used In Financing Activities	(1,734)	(53)
Effect of Exchange Rate Changes on Cash	54	3
Net Decrease In Cash	(4,830)	(224)

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Cash - Beginning Of Period		17,492	Prepaid expenses and other current assets			
Foreign exchange contracts	non-designated					Prepaid expenses and other current assets
			1		1	
Foreign exchange contracts	net investment hedges					Prepaid expenses and other current assets
			1		1	
Total Assets		\$ 11,781	\$ 667	\$	\$ 12,448	
Foreign exchange contracts	cash flow hedges					Other current liabilities
		\$	\$ 132	\$	\$ 132	
Foreign exchange contracts	non-designated					Other current liabilities
			1		1	
Foreign currency denominated debt	net investment hedge					Long term obligations, less current maturities
			99,142		99,142	
Total Liabilities		\$	\$ 99,275	\$	\$ 99,275	
July 31, 2011:						
Trading Securities		\$ 10,897	\$	\$ 10,897		Other assets
Foreign exchange contracts	cash flow hedges					Prepaid expenses and other current assets
			16		16	
Foreign exchange contracts	non-designated					Prepaid expenses and other current assets
			3		3	
Total Assets		\$ 10,897	\$ 19	\$	\$ 10,916	
Foreign exchange contracts	cash flow hedges					Other current liabilities
		\$	\$ 830	\$	\$ 830	
Foreign exchange contracts	net investment hedges					Other current liabilities
			5,295		5,295	
Foreign exchange contracts	non-designated					Other current liabilities
			2		2	
Foreign currency denominated debt	net investment hedge					Long term obligations less current maturities
			107,985		107,985	
Total Liabilities		\$	\$ 114,112	\$	\$ 114,112	

The following methods and assumptions were used to estimate the fair value of each class of financial instrument:

Trading Securities: The Company's deferred compensation investments consist of investments in mutual funds. These investments were classified as Level 1 as the shares of these investments trade with sufficient frequency and volume to enable us to obtain pricing information on

an ongoing basis.

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Foreign currency exchange contracts: The Company's foreign currency exchange contracts were classified as Level 2, as the fair value was based on the present value of the future cash flows using external models that use observable inputs, such as interest rates, yield curves and foreign currency exchange rates. See Note K, *Derivatives and Hedging Activities* for additional information.

Foreign currency denominated debt – net investment hedge: The Company's foreign currency denominated debt designated as a net investment hedge was classified as Level 2, as the fair value was based on the present value of the future cash flows using external models that use observable inputs, such as interest rates, yield curves and foreign currency exchange rates. See Note K, *Derivatives and Hedging Activities* for additional information.

There have been no transfers of assets or liabilities between the fair value hierarchy levels, outlined above, during the six months ended January 31, 2012.

The Company's financial instruments, other than those presented in the disclosures above could include cash, notes receivable, accounts receivable, accounts payable, accrued liabilities and short-term and long-term debt. The fair values of cash, accounts receivable, accounts payable, accrued liabilities and short-term debt approximated carrying values because of the short-term nature of these instruments.

The estimated fair value of the Company's long-term obligations, based on the quoted market prices for similar issues and on the current rates offered for debt of similar maturities, was \$408,431 and \$416,694 at January 31, 2012 and July 31, 2011, respectively, as compared to the carrying value of \$384,335 and \$393,178 at January 31, 2012 and July 31, 2011, respectively.

During the three months ended January 31, 2012, goodwill with a carrying amount of \$163,702 in the North/South Asia reporting unit was written down to its estimated implied fair value of \$48,014, resulting in a non-cash impairment charge of \$115,688. The implied fair value of goodwill of \$48,014 represents a Level 3 asset measured at fair value on a nonrecurring basis subsequent to its original recognition. Refer to Note B, *Goodwill and Intangible Assets* for further information regarding the valuation inputs.

NOTE J Restructuring

In fiscal 2009, in response to the global economic downturn, the Company took several measures to address its cost structure. In addition to a company-wide salary freeze and decreased discretionary spending, the Company reduced its workforce by 25%. The Company reduced its workforce through voluntary and involuntary separation programs, voluntary retirement programs, and facility consolidations. The Company continued the execution of its restructuring actions during fiscal 2011. These actions included a reduction in its contract labor and decreased discretionary spending. As a result of these actions, the Company recorded restructuring charges of \$2,134 and \$5,775 during the three and six months ended January 31, 2011. The restructuring charges of \$5,775 during the six months ended January 31, 2011 consisted of \$3,878 of employee separation costs, \$1,714 of fixed asset write-offs, and \$183 of other facility closure related costs and contract termination costs. Of the \$5,775 of restructuring charges recorded during the six months ended January 31, 2011, \$3,575 was incurred in the Americas, \$2,128 was incurred in Europe, and \$72 was incurred in Asia-Pacific.

A reconciliation of the Company's restructuring activity during the six months ended January 31, 2012 is as follows:

	September 30, Employee Related	September 30, Asset Write-offs	September 30, Other	September 30, Total
Beginning balance, July 31, 2011	\$ 2,207	\$	\$ 49	\$ 2,256
Cash payments	(1,351)			(1,351)
Ending balance, October 31, 2011	\$ 856	\$	\$ 49	\$ 905
Cash payments	(437)		(2)	(439)
Ending balance, January 31, 2012	\$ 419	\$	\$ 47	\$ 466

NOTE K Derivatives and Hedging Activities

The Company utilizes forward foreign exchange currency contracts to reduce the exchange rate risk of specific foreign currency denominated transactions and net investments. These contracts typically require the exchange of a foreign currency for U.S. dollars at a fixed rate at a future date, with maturities of 12 months or less, which qualify as either cash flow hedges or net investment hedges under the accounting guidance for derivative instruments and hedging activities. The primary objectives of the Company's foreign currency exchange risk management are to minimize the impact of currency movements due to products purchased in other than the

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respective subsidiaries functional currency and to minimize the impact of currency movements on the Company's net investment denominated in a currency other than the U.S. dollar. To achieve this objective, the Company hedges a portion of known exposures using forward foreign exchange currency contracts. As of January 31, 2012 and July 31, 2011, the notional amount of outstanding forward exchange contracts was \$39,278 and \$80,807, respectively.

Hedge effectiveness is determined by how closely the changes in the fair value of the hedging instrument offset the changes in the fair value or cash flows of the hedged item. Hedge accounting is permitted only if the hedging relationship is expected to be highly effective at the inception of the hedge and on an on-going basis. Gains or losses on the derivative related to hedge ineffectiveness are recognized in current earnings. The amount of hedge ineffectiveness was not significant for the three-month or six-month periods ended January 31, 2012 and 2011.

The Company hedges a portion of known exposure using forward exchange contracts. Main exposures are related to transactions denominated in the British Pound, the Euro, Canadian Dollar, Australian Dollar, Singapore Dollar, Swedish Krona, Japanese Yen, Swiss Franc, and the Korean Won. Generally, these risk management transactions will involve the use of foreign currency derivatives to protect against exposure resulting from sales and identified inventory or other asset purchases.

The Company has designated a portion of its foreign exchange contracts as cash flow hedges and recorded these contracts at fair value on the Condensed Consolidated Balance Sheets. For these instruments, the effective portion of the gain or loss on the derivative is reported as a component of other comprehensive income (OCI) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. At January 31, 2012 and July 31, 2011, unrealized gains of \$807 and unrealized losses of \$1,535 have been included in OCI, respectively. All balances are expected to be reclassified from OCI to earnings during the next twelve months when the hedged transactions impact earnings.

At January 31, 2012 and July 31, 2011, the Company had \$665 and \$16 of forward exchange contracts designated as cash flow hedges included in Prepaid expenses and other current assets on the accompanying Condensed Consolidated Balance Sheets. At January 31, 2012 and July 31, 2011, the Company had \$132 and \$830, respectively, of forward exchange contracts designated as cash flow hedges included in Other current liabilities on the accompanying Condensed Consolidated Balance Sheets. At January 31, 2012 and July 31, 2011, the U.S. dollar equivalent of these outstanding forward foreign exchange contracts totaled \$18,462 and \$30,519, respectively, including contracts to sell Euros, Canadian Dollars, Australian Dollars, British Pounds, U.S. Dollars, and Swiss Franc.

The Company has also designated intercompany and third party foreign currency denominated debt instruments as net investments hedges. During the six months ended January 31, 2012, the Company designated 4,581 of intercompany loans as net investment hedges to hedge portions of its net investment in European foreign operations. No intercompany loans were designated as net investment hedges as of July 31, 2011. On May 13, 2010, the Company completed the private placement of 75.0 million aggregate principal amount of senior unsecured notes to accredited institutional investors. This Euro-denominated debt obligation was designated as a net investment hedge to hedge portions of the Company's net investment in Euro-denominated foreign operations. As net investment hedges, the currency effects of the debt obligations are reflected in the foreign currency translation adjustments component of accumulated other comprehensive income where they offset gains and losses recorded on the Company's net investment in Euro-denominated operations. The Company's foreign denominated debt obligations are valued under a market approach using publicized spot prices.

Additionally, the Company utilizes forward foreign exchange currency contracts designated as hedge instruments to hedge portions of the Company's net investments in foreign operations. For hedges that meet the effectiveness requirements, the net gains or losses attributable to changes in spot exchange rates are recorded in cumulative translation within other comprehensive income. Any ineffective portions are to be recognized in earnings. Recognition in earnings of amounts previously recorded in cumulative translation is limited to circumstances such as complete or substantially complete liquidation of the net investment in the hedged foreign operation. At January 31, 2012 and July 31, 2011, the Company had \$1 and \$0, respectively, of forward exchange currency contracts designated as net investment hedges included in Prepaid expenses and other current assets on the Condensed Consolidated Balance Sheets. At January 31, 2012 and July 31, 2011, the Company had \$0 and \$5,295, respectively, of forward foreign exchange currency contracts designated as net investment hedges included in Other current liabilities on the Condensed Consolidated Balance Sheet. At January 31, 2012 and July 31, 2011, the U.S. dollar equivalent of these outstanding forward foreign exchange contracts totaled \$10,000 and \$50,000, respectively, including contracts to sell Euros and Singapore Dollars.

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Fair values of derivative instruments in the Condensed Consolidated Balance Sheets were as follows:

Derivatives designated as	Asset Derivatives				Liability Derivatives			
	January 31, 2012		July 31, 2011		January 31, 2012		July 31, 2011	
	Balance		Balance		Balance		Balance	
	Sheet Location	Fair Value	Sheet Location	Fair Value	Sheet Location	Fair Value	Sheet Location	Fair Value
hedging instruments								
Cash flow hedges								
Foreign exchange contracts	Prepaid expenses and other current assets	\$ 665	Prepaid expenses and other current assets	\$ 16	Other current liabilities	\$ 132	Other current liabilities	\$ 830
Net investment hedges								
Foreign exchange contracts	Prepaid expenses and other current assets	\$ 1	Prepaid expenses and other current assets	\$	Other current liabilities	\$	Other current liabilities	\$ 5,295
Foreign currency denominated debt	Prepaid expenses and other current assets	\$	Prepaid expenses and other current assets	\$	Long term obligations, less current maturities	\$ 99,142	Long term obligations, less current maturities	\$ 107,985
Total derivatives designated as hedging instruments		\$ 666		\$ 16		\$ 99,274		\$ 114,110
Derivatives not designated as hedging instruments								
Foreign exchange contracts	Prepaid expenses and other current assets	\$	Prepaid expenses and other current assets	\$ 3	Other current liabilities	\$ 1	Other current liabilities	\$ 2
Total derivatives not designated as hedging instruments		\$		\$ 3		\$ 1		\$ 2

The pre-tax effects of derivative instruments designated as cash flow hedges on the Condensed Consolidated Statements of Income consisted of the following:

Derivatives in Cash Flow Hedging Relationships	Sep 30,	Sep 30,	Sep 30,	Sep 30,	Sep 30,	Sep 30,	Sep 30,	Sep 30,
	Amount of Gain	or (Loss)	Location of Gain or (Loss) Reclassified From Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified From Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified From Accumulated OCI into Income (Effective Portion)	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)
	Six months ended January 31, 2012	Six months ended January 31, 2011		Six months ended January 31, 2012	Six months ended January 31, 2011		Six months ended January 31, 2012	Six months ended January 31, 2011
Foreign exchange contracts	\$ 807	\$ (1,296)	Cost of goods sold	\$ (635)	\$ (282)	Cost of goods sold	\$	\$

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Total	\$	807	\$	(1,296)	\$	(635)	\$	(282)	\$		\$
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The pre-tax effects of derivative instruments designated as net investment hedges on the Condensed Consolidated Balance Sheet consisted of the following:

	September 30,	September 30,	September 30,	September 30,	September 30,	September 30,	September 30,	September 30,
Derivatives in Net								
Investment Hedging								
Relationships	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) Six months ended January 31, 2012	Amount of Gain or (Loss) Recognized in OCI on Derivative (Effective Portion) Six months ended January 31, 2011	Location of Gain or (Loss) Reclassified From Accumulated OCI into Income (Effective Portion)	Amount of Gain or (Loss) Reclassified From Accumulated OCI into Income (Effective Portion) Six months ended January 31, 2012	Amount of Gain or (Loss) Reclassified From Accumulated OCI into Income (Effective Portion) Six months ended January 31, 2011	Location of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion)	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) Six months ended January 31, 2012	Amount of Gain or (Loss) Recognized in Income on Derivative (Ineffective Portion) Six months ended January 31, 2011
Foreign currency			Investment and other			Investment and other		
Intercompany debt	\$ 129	\$	income net	\$	\$	income net	\$	\$
Foreign currency			Investment and other			Investment and other		
denominated debt	8,843	(4,935)	income net			income net		
Foreign exchange			Investment and other			Investment and other		
contracts	(1,013)	(5,082)	income net			income net		
Total	\$ 7,959	\$ (10,017)		\$	\$		\$	\$

The pre-tax effects of derivative instruments not designated as hedge instruments on the Condensed Consolidated Statements of Income consisted of the following:

	September 30,	September 30,	September 30,
		Amount of Gain or (Loss) Recognized in	Amount of Gain or (Loss) Recognized in
		Income on Derivative	Income on Derivative
Derivatives Not Designated as Hedging Instruments	Location of Gain or (Loss) Recognized in Income on Derivative	Six months ended January 31, 2012	Six months ended January 31, 2011
Foreign exchange contracts	Other income (expense)	\$ 57	\$ 717
Total		\$ 57	\$ 717

NOTE L Acquisitions and Divestitures

The comparability of the operating results for the three and six months ended January 31, 2012, to the three and six months ended January 31, 2011, have been impacted by the prior year acquisition of ID Warehouse. In November 2010, the Company acquired ID Warehouse, based in New South Wales, Australia for \$7,970. ID Warehouse offers security identification and visitor management products including identification card printers, access control cards, wristbands, tamper-evident security seals and identification accessories. The business is included in the Company's Asia Pacific segment.

The comparability of the operating results for the three and six months ended January 31, 2012, to the three and six months ended January 31, 2011, have been impacted by the prior year divestiture of Teklynx. In December 2010, the Company sold its Teklynx business, a barcode software company. The Teklynx business had operations primarily in the Company's Americas and Europe segments. The Company received proceeds of \$12,979, net of cash retained in the business. The transaction resulted in a pre-tax gain of \$4,394, which was accounted for in Selling, general, and administrative expenses (SG&A) on the Condensed Consolidated Statement of Income for the three and six month periods ended January 31, 2011. The divestiture of Teklynx was part of the Company's continued long-term growth strategy to focus the Company's

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energies and resources on growth of the Company's core business.

NOTE M Subsequent Events

On February 1, 2012, the Company and certain of its subsidiaries entered into an unsecured \$300 million revolving credit agreement with a group of six banks that replaced and terminated the Company's previous \$200 million revolving credit agreement that had been entered into on October 5, 2006 and amended on March 18, 2008.

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Under the new credit agreement, which has a final maturity date of February 1, 2017, the Company has the option to select either a base interest rate (based upon the higher of the federal funds rate plus one-half of 1% or the prime rate of Bank of America plus a margin based on the Company's consolidated leverage ratio) or a Eurocurrency interest rate (at the LIBOR rate plus a margin based on the Company's consolidated leverage ratio). The new credit agreement is guaranteed by the Company's domestic subsidiaries and contains various financial covenants, including a debt-to-EBITDA ratio of 3.25-to-1.0 and an interest coverage ratio of 3.0-to-1.0. The Company intends to use the flexibility provided by the new credit agreement to fund future acquisitions, for general corporate purposes, and to refinance existing debt.

On February 15, 2012, the Board of Directors declared a quarterly cash dividend to shareholders of the Company's Class A and Class B Common Stock of \$0.185 per share payable on April 30, 2012, to shareholders of record at the close of business on April 10, 2012.

Table of Contents**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Overview**

Brady, a Wisconsin corporation founded in 1914, is an international manufacturer and marketer of identification solutions and specialty materials that identify and protect premises, products, and people. Its products include facility identification products; safety and complementary products; wire and cable identification products; sorbent materials; people identification products; regulatory publishing products; high-performance identification products for product identification and work-in-process identification; and bar-code labels and precision die-cut components for mobile telecommunications devices, hard disk drives, medical devices and supplies, and automotive and other electronics. The Company serves customers in general manufacturing, maintenance and safety, process industries, construction, electrical, telecommunications, electronics, laboratory/healthcare, airline/transportation, brand protection, education, governmental, public utility, and a variety of other industries. The Company manufactures and sells products domestically and internationally through multiple channels including distributors, resellers, business-to-business direct marketing, direct sales and e-commerce capabilities. The Company believes that its reputation for innovation, commitment to quality and service, and dedicated employees have made it a world leader in the markets it serves. The Company operates in Australia, Belgium, Brazil, Canada, the Cayman Islands, China, Denmark, France, Germany, Hong Kong, India, Italy, Japan, Luxembourg, Malaysia, Mexico, the Netherlands, Norway, the Philippines, Poland, Singapore, Slovakia, South Korea, Spain, Sweden, Thailand, Turkey, the United Arab Emirates, the United Kingdom and the United States. Brady sells through subsidiaries or sales offices in these countries, with additional sales through a dedicated team of international sales representatives in New Zealand, Russia, Taiwan, Vietnam, Central Europe, the Middle East, Africa and South America.

Sales for the quarter ended January 31, 2012 decreased 2.6% to \$320.6 million, compared to \$329.0 million in the same period of fiscal 2011. Organic sales decreased 1.8%, divestitures net of acquisitions reduced sales 0.4%, and the effects of fluctuations in the exchange rates used to translate financial results into the United States dollar reduced sales 0.4%. The net loss for the quarter ended January 31, 2012, was \$90.0 million or \$1.72 per diluted Class A Nonvoting Common Share, down from net income of \$24.2 million, or \$0.46 per diluted Class A Nonvoting Common Share reported in the second quarter of last fiscal year. The net loss was a result of a \$115.7 million non-cash goodwill impairment charge recorded during the quarter ended January 31, 2012, related to the North/South Asia reporting unit within the Asia-Pacific reporting segment. Refer to Note B, Goodwill and Intangible Assets in the Notes to the Condensed Consolidated Financial Statements for further discussion regarding the goodwill impairment charge.

Sales for the six months ended January 31, 2012 increased 1.7% to \$670.1 million, compared to \$658.6 million in the same period of fiscal 2011. Organic sales increased 0.9%, divestitures net of acquisitions reduced sales 0.3%, and the effects of fluctuations in the exchange rates used to translate financial results into the United States dollar increased sales 1.1%. The net loss for the six months ended January 31, 2012 was \$57.2 million or \$1.09 per diluted Class A Nonvoting Common Share, down from net income of \$50.5 million, or \$0.95 per diluted Class A Nonvoting Common Share reported in the same period of the prior fiscal year. The net loss was a result of a \$115.7 million non-cash goodwill impairment charge recorded during the quarter ended January 31, 2012, related to the North/South Asia reporting unit within the Asia-Pacific reporting segment. Refer to Note B, Goodwill and Intangible Assets in the Notes to the Condensed Consolidated Financial Statements for further discussion regarding the goodwill impairment charge.

Results of Operations

The comparability of the operating results for the three and six months ended January 31, 2012, to the three and six months ended January 31, 2011, have been impacted by the following acquisition and divestiture completed in fiscal 2011:

Fiscal 2011

	Segment	Date Completed
<u>Acquisition</u>		
ID Warehouse	Asia Pacific	November 2010
<u>Divestiture</u>		
Teklynx	Americas Europe	December 2010

Gross margin as a percentage of sales decreased to 47.8% from 48.3% for the quarter and decreased to 47.9% from 49.1% for the six months ended January 31, 2012, compared to the same periods of the previous year. This decrease in gross margin percentage was primarily due to the Asia-Pacific region compared to the prior year.

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Research and development (R&D) expenses decreased 15.0% to \$10.0 million for the three months ended January 31, 2012, compared to \$11.7 million for the same period in the prior year, and decreased 8.7% to \$19.8 million for the six months ended January 31, 2012, compared to \$21.7 million for the same period in the prior year. As a percentage of sales, R&D expenses decreased to 3.1% from 3.6% for the quarter and decreased to 3.0% from 3.3% for the six months ended January 31, 2012, compared to the same periods of the previous year, respectively. The moderate decline in R&D expenses was primarily due to the timing of R&D project expenditures.

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Selling, general and administrative (SG&A) expenses decreased 3.0% to \$104.8 million for the three months ended January 31, 2012, compared to \$108.1 million for the same period in the prior year, and decreased 1.7% to \$213.8 million for the six months ended January 31, 2012, compared to \$217.4 million for the same period in the prior year. As a percentage of sales, SG&A expenses decreased to 32.7% from 32.8% for the second quarter, and decreased to 31.9% from 33.0% for the six months ended January 31, 2012, compared to the same periods in the prior year. The Company has continued to focus on reducing its SG&A expenses as a percentage of sales through ongoing productivity initiatives, which was achieved during both the three and six months ended January 31, 2012, despite the \$4.4 million pre-tax gain on the divestiture of Teklynx recognized during the three months ended January 31, 2011.

Restructuring charges were \$2.1 million and \$5.8 million for the three and six months ended January 31, 2011, respectively.

Other income decreased slightly to \$0.8 million from \$1.2 million for the three months ended January 31, 2012, compared to the same period in the prior year, and decreased to \$0.6 million from \$1.5 million for the six months ended January 31, 2012 compared to the same period in the prior year. The decrease was primarily due to foreign exchange losses, partially offset by an increase in interest income.

Interest expense decreased to \$4.9 million from \$5.9 million for the quarter and to \$10.0 million from \$11.5 million for the six months ended January 31, 2012, compared to the same periods in the prior year. The decrease was due to the Company's lower principal balance under its outstanding debt agreements.

The Company's effective tax rate decreased to (10.6%) from 25.3% for the quarter and to (52.7%) from 26.4% for the six months ended January 31, 2012, compared to the same periods in the prior year. The effective tax rate was significantly impacted by the non-deductible North/South Asia goodwill impairment charge of \$115.7 million recognized during the three months ended January 31, 2012. Refer to Note B, Goodwill and Intangible Assets in the Notes to the Condensed Consolidated Financial Statements for further discussion. Excluding the goodwill impairment charge, the effective tax rate was 25.1% for the quarter and 25.2% for the six months ended January 31, 2012. The Company expects the full year income tax rate for fiscal 2012 to be in the mid 20% range.

The Company's net loss was \$90.0 million for the quarter and \$57.2 million for the six months ended January 31, 2012, compared to net income of \$24.2 million for the quarter and \$50.5 million for the six months ended January 31, 2011. The net loss is a result of the goodwill impairment charge of \$115.7 million recorded during the three months ended January 31, 2012. Refer to Note B, Goodwill and Intangible Assets in the Notes to the Condensed Consolidated Financial Statements for further discussion. Net income before the current period impairment charge was \$25.7 million for the quarter and \$58.5 million for the six months ended January 31, 2012. Net income before restructuring-related expenses was \$25.7 million for the quarter and \$54.6 million for the six months ended January 31, 2011.

Business Segment Operating Results

The Company is organized and managed on a geographic basis by region. Each of these regions, Americas, Europe and Asia-Pacific, has a President that reports directly to the Company's chief operating decision maker, its Chief Executive Officer. Each region has its own distinct operations, is managed locally by its own management team, maintains its own financial reports and is evaluated based on regional segment profit. The Company has determined that these regions comprise its operating and reportable segments based on the information used by the Chief Executive Officer to allocate resources and assess performance.

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Following is a summary of segment information for the three and six months ended January 31, 2012 and 2011:

	September 30,	September 30,	September 30,	September 30,	September 30,	September 30,
	Americas	Europe	Asia-Pacific	Total Regions	Corporate and Eliminations	Total
(Dollars in thousands)						
SALES TO EXTERNAL CUSTOMERS						
Three months ended:						
January 31, 2012	\$ 138,405	\$ 95,593	\$ 86,586	\$ 320,584	\$	\$ 320,584
January 31, 2011	\$ 136,011	\$ 104,041	\$ 88,957	\$ 329,009	\$	\$ 329,009
Six months ended:						
January 31, 2012	\$ 292,267	\$ 192,949	\$ 184,876	\$ 670,092	\$	\$ 670,092
January 31, 2011	\$ 281,999	\$ 196,091	\$ 180,507	\$ 658,597	\$	\$ 658,597
SALES INFORMATION						
Three months ended						
January 31, 2012						
Organic	2.9%	(5.7)%	(4.4)%	(1.8)%		(1.8)%
Currency	(0.7)%	(1.5)%	1.7%	(0.4)%		(0.4)%
Acquisitions/Divestitures	(0.4)%	(0.9)%	0.0%	(0.4)%		(0.4)%
Total	1.8%	(8.1)%	(2.7)%	(2.6)%		(2.6)%
Six months ended						
January 31, 2012						
Organic	4.4%	(1.3)%	(2.3)%	0.9%		0.9%
Currency	(0.2)%	1.0%	3.6%	1.1%		1.1%
Acquisitions/Divestitures	(0.5)%	(1.3)%	1.1%	(0.3)%		(0.3)%
Total	3.7%	(1.6)%	2.4%	1.7%		1.7%
SEGMENT PROFIT						
Three months ended:						
January 31, 2012	\$ 35,798	\$ 26,562	\$ 7,733(1)	\$ 70,093	\$ (2,359)	\$ 67,734
January 31, 2011	\$ 31,015	\$ 29,165	\$ 11,524	\$ 71,704	\$ (5,088)	\$ 66,616
Percentage increase (decrease)	15.4%	(8.9)%	(32.9)%	(2.2)%		1.7%
Six months ended:						
January 31, 2012	\$ 79,028	\$ 52,861	\$ 21,037(1)	\$ 152,926	\$ (5,622)	\$ 147,304
January 31, 2011	\$ 70,374	\$ 53,226	\$ 28,353	\$ 151,953	\$ (8,525)	\$ 143,428
Percentage increase (decrease)	12.3%	(0.7)%	(25.8)%	0.6%		2.7%

- (1) The Company recognized a goodwill impairment charge of \$115.7 million during the quarter ended January 31, 2012, related to the North/South Asia reporting unit within the Asia-Pacific reporting segment, which is excluded from segment profit as presented in the table above. Refer to Note B, Goodwill and Intangible Assets in the Notes to the Condensed Consolidated Financial Statements for further discussion.

NET INCOME RECONCILIATION

September 30, September 30, September 30, September 30,
Three months ended: Six months ended:
January 31, January 31,

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(Dollars in thousands)	2012	2011	2012	2011
Total profit from reportable segments	\$ 70,093	\$ 71,704	\$ 152,926	\$ 151,953
Corporate and eliminations	(2,359)	(5,088)	(5,622)	(8,525)
Unallocated amounts:				
Administrative costs	(29,244)	(27,402)	(59,724)	(58,970)
Restructuring charges		(2,134)		(5,775)
Impairment charge	(115,688)		(115,688)	
Investment and other income	812	1,174	610	1,464
Interest expense	(4,933)	(5,850)	(9,980)	(11,537)
(Loss) income before income taxes	(81,319)	32,404	(37,478)	68,610
Income taxes	(8,635)	(8,205)	(19,744)	(18,130)
Net (loss) income	\$ (89,954)	\$ 24,199	\$ (57,222)	\$ 50,480

The Company evaluates short-term segment performance based on segment profit or loss and customer sales. Segment profit or loss does not include certain administrative costs, such as the cost of finance, information technology and human resources, which are managed as global functions. Restructuring charges, impairment charges, stock options, interest, investment and other income and income taxes are also excluded when evaluating performance.

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Americas:

Americas sales increased 1.8% to \$138.4 million for the quarter and 3.7% to \$292.3 million for the six months ended January 31, 2012, compared to \$136.0 million and \$282.0 million for the same periods in the prior year. Organic sales increased 2.9% and 4.4% during the quarter and year-to-date, respectively, as compared to the same periods in the prior year. Fluctuations in the exchange rates used to translate financial results into the United States dollar resulted in a negative impact on sales of 0.7% in the quarter, and 0.2% in the six-month period. The decrease in sales resulting from the fiscal year 2011 divestiture of Teklynx was 0.4% in the quarter and 0.5% in the six-month period.

The increases in organic sales of 2.9% for the quarter and 4.4% for the six-month period were driven primarily by the Brady business through new product launches, price increases, and strong demand for custom OEM products in Brazil. In addition, the direct marketing business demonstrated modest growth, mainly driven by regulatory publishing products.

Segment profit increased 15.4% to \$35.8 million from \$31.0 million for the quarter and increased 12.3% to \$79.0 million from \$70.4 million for the six months ended January 31, 2012, compared to the same periods in the prior year. As a percentage of sales, segment profit increased to 25.9% from 22.8% for the quarter and increased to 27.0% from 25.0% for the six months ended January 31, 2012, compared to the same periods in the prior year.

The profit improvement for the quarter and six-month periods was mainly driven by the Brady business, which experienced double digit percentage profit improvement for the quarter and six months ended January 31, 2012, compared to the same periods in the prior year. The profit improvement was due to increased volumes, price increases implemented at the beginning of fiscal year 2012, and leveraging the Company's sales structure. In the direct marketing business, the profit improvement for the quarter ended January 31, 2012, was partially offset by investments in initiatives to drive customer growth.

Europe:

Europe sales decreased 8.1% to \$95.6 million for the quarter and 1.6% to \$192.9 million for the six months ended January 31, 2012, compared to \$104.0 million and \$196.1 million for the same periods in the prior year. Organic sales decreased 5.7% and 1.3% for the quarter and six-month period, respectively, compared to the same periods in the prior year. Fluctuations in the exchange rates used to translate financial results into the United States dollar resulted in a negative impact on sales of 1.5% in the quarter, and a positive impact on sales of 1.0% in the six-month period. The decrease in sales resulting from the fiscal year 2011 divestiture of Teklynx was 0.9% in the quarter, and 1.3% in the six-month period.

The decrease in organic sales of 5.7% in the quarter was primarily due to the difficult comparable to the quarter ended January 31, 2011, which included \$5.0 million of winter product sales within the direct marketing business attributable to the unusually harsh winter in Western Europe. During the quarter ended January 31, 2012, sales decline between the Brady and direct marketing businesses were similar. The Brady business experienced a mid-single digit percentage decline in organic sales, which was primarily driven by the depressed economic conditions within the region, specifically southern Europe and the Sweden die-cut business. Excluding the strong winter product sales within the direct marketing business for the prior year's quarter ended January 31, 2011, the Company would have experienced a mid-single digit percentage increase in organic sales growth within southern Europe and Germany, the Company's two largest direct marketing businesses. The decrease in organic sales of 1.3% for the six months ended January 31, 2012 was a result of strong growth within all businesses for the first quarter ended October 31, 2011, and a moderate decline in organic sales for the second quarter ended January 31, 2012. Organic sales growth for the first quarter ended October 31, 2011 was 3.7%, and the organic sales decline for the second quarter ended January 31, 2012 was 5.7%, as discussed above.

Segment profit decreased 8.9% to \$26.6 million from \$29.2 million for the quarter, and decreased 0.7% to \$52.9 million from \$53.2 million for the six months ended January 31, 2012, compared to the same periods in the prior year. As a percentage of sales, segment profit decreased to 27.8% from 28.0% for the quarter and increased to 27.4% from 27.1% for the six months ended January 31, 2012, compared to the same periods in the prior year.

The decrease in segment profit for the quarter was primarily attributable to the difficult comparable to the quarter ended January 31, 2011, which included an incremental \$5.0 million of winter product sales in the direct marketing business, as discussed above. Within the Brady business, the level of segment profit as a percentage of sales for the quarter ended January 31, 2012, was consistent with the same period in the prior year, because the sales decline was partially offset by the benefits from the prior year reorganization.

Asia-Pacific:

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Asia-Pacific sales decreased 2.7% to \$86.6 million from \$89.0 million for the quarter, and increased 2.4% to \$184.9 million from \$180.5 million for the six months ended January 31, 2012, compared to the same periods in the prior year. Organic sales decreased 4.4% in the quarter and decreased 2.3% for the six-month period, compared to the same periods in the prior year. Fluctuations in the exchange rates used to translate financial results into the U.S. dollar increased sales within the segment by 1.7% for the quarter and 3.6% for the six-month period ended January 31, 2012. Segment sales increased 1.1% during the six months ended January 31, 2012, due to the fiscal 2011 acquisition of ID Warehouse, which had no effect on sales for the quarter ended January 31, 2012.

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The decrease in organic sales for both the quarter and six-month period ended January 31, 2012 was primarily a result of the flooding in Thailand, which caused a significant disruption to the hard disk drive supply chain, as well as the impact from the typically slow period associated with the Chinese New Year, which occurred in the second quarter this year. These sales declines were partially offset by increased sales within the mobile handset market.

Segment profit decreased 32.9% to \$7.7 million from \$11.5 million for the quarter, and decreased 25.8% to \$21.0 million from \$28.4 million for the six months ended January 31, 2012, compared to the same periods in the prior year. As a percentage of sales, segment profit decreased to 8.9% from 13.0% in the quarter and decreased to 11.4% from 15.7% for the six-month period, compared to the same periods in the prior year.

The decrease in segment profit for the quarter and six-month periods ended January 31, 2012, was primarily due to a lower margin sales mix within the mobile handset and other computing devices markets. The primary contributing factor to the lower margin sales mix was the loss of market share by one of the Company's largest mobile handset customers. In an effort to refill plant capacity, the Company aggressively pursued other opportunities and while the Company continues to capture similar dollar value sales, it has been unable to capture opportunities at the same margin level as those sales that were lost. The reasons for this are as follows: increased competition from local companies who are driving down unit prices; the increased complexity of the product which results in longer run times and higher labor costs; and decreased product lifecycle which results in a shorter period to recoup tooling investments. The Company continues to focus on cost reduction and material procurement strategies to reduce cost of goods sold to mitigate the impact on profitability. These decreases were partially offset by margin improvement and mix impact from the growing and more profitable Australia businesses.

In addition to the factors described above, the quarter ended January 31, 2012, was negatively impacted by the Thailand flood, which resulted in lower absorption of fixed costs within this business. The Thailand flood reduced earnings per share on a diluted basis by approximately \$0.04 in the quarter ended January 31, 2012. Losses caused by the flooding are expected to be partially covered by property and business interruption insurance. The timing of the insurance recoveries could fall into subsequent periods beyond fiscal year 2012.

Financial Condition

Cash and cash equivalents were \$380.3 million at January 31, 2012 and \$390.0 million at July 31, 2011, a decline of \$9.6 million as summarized below:

(Dollars in thousands)	September 30, Six months ended: January 31,	
	2012	2011
Net cash flow provided by (used in):		
Operating activities	\$ 43,301	\$ 57,609
Investing activities	(14,605)	(5,509)
Financing activities	(28,894)	(13,686)
Effect of exchange rate changes on cash	(9,442)	9,048
Net (decrease) increase in cash and cash equivalents	\$ (9,640)	\$ 47,462

Net cash provided by operating activities was \$43.3 million for the six months ended January 31, 2012, a decrease of \$14.3 million from cash provided by operating activities of \$57.6 million for the six months ended January 31, 2011. Cash flows from operating activities are generated primarily from operating income and managing the components of working capital. The decrease in cash flows from operating activities during the six months ended January 31, 2012 compared to the same period of the prior year was primarily due to an unfavorable change in trade accounts payable and accrued liabilities.

Net cash used in investing activities was \$14.6 million for the six months ended January 31, 2012, an increase of \$9.1 million from cash used in investing activities of \$5.5 million for the six months ended January 31, 2011. The increase in cash used in investing activities for the six months ended January 31, 2012, was primarily a result of the cash received from the divestiture of Teklynx business during the six months ended January 31, 2011. Capital expenditures were \$11.1 million for the six months ended January 31, 2012, compared to \$9.0 million in the same period last year and \$20.5 million during the twelve months ended July 31, 2011. The Company expects capital expenditures of approximately \$25.0 million for the year ending July 31, 2012.

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Net cash used in financing activities was \$28.9 million for the six months ended January 31, 2012, an increase of \$15.2 million from cash used in financing activities of \$13.7 million during the six months ended January 31, 2011. The change was primarily due to \$12.3 million used to repurchase common shares during the six months ended January 31, 2012.

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On October 26, 2011, the Company filed a shelf registration statement on Form S-3 with the Securities and Exchange Commission (SEC), which will allow the Company to issue and sell, from time to time in one or more offerings, an indeterminate amount of Class A Nonvoting Common Stock and debt securities as it deems prudent or necessary to raise capital at a later date. The shelf registration statement became effective upon filing with the SEC. The Company plans to use the proceeds from any future offerings under the shelf registration for general corporate purposes, including, but not limited to, acquisitions, capital expenditures, and refinancing of debt.

During fiscal 2004 through fiscal 2007, the Company completed three private placement note issuances totaling \$500 million in ten-year fixed rate notes with varying maturity dates to institutional investors at interest rates varying from 5.14% to 5.33%. The notes must be repaid equally over seven years, with initial payment due dates ranging from 2008 to 2011, with interest payable on the notes due semiannually on various dates throughout the year, which began in December 2004. The private placements were exempt from the registration requirements of the Securities Act of 1933. The notes were not registered for resale and may not be resold absent such registration or an applicable exemption from the registration requirements of the Securities Act of 1933 and applicable state securities laws. The notes have certain prepayment penalties for repaying them prior to the maturity date.

On May 13, 2010, the Company completed a private placement of 75.0 million aggregate principal amount of senior unsecured notes to accredited institutional investors. The 75.0 million of senior notes consists of 30.0 million aggregate principal amount of 3.71% Series 2010-A Senior Notes, due May 13, 2017, and 45.0 million aggregate principal amount of 4.24% Series 2010-A Senior Notes, due May 13, 2020, with interest payable on the notes semiannually. This private placement was exempt from the registration requirements of the Securities Act of 1933. The notes were not registered for resale and may not be resold absent such registration or an applicable exemption from the registration requirements of the Securities Act of 1933 and applicable state securities laws. The notes have certain prepayment penalties for prepaying them prior to maturity. The notes have been fully and unconditionally guaranteed on an unsecured basis by the Company's domestic subsidiaries. These unsecured notes were issued pursuant to a note purchase agreement, dated May 13, 2010.

On October 5, 2006, the Company entered into a \$200 million multi-currency revolving loan agreement with a group of five banks, which was replaced on February 1, 2012 by the new credit facility described below. At the Company's option, and subject to certain conditions, the available amount under the previous credit facility was able to be increased from \$200 million up to \$300 million. Under the previous credit agreement, the Company had the option to select either a base interest rate (based upon the higher of the federal funds rate plus one-half of 1% or the prime rate of Bank of America) or a Eurocurrency interest rate (at the LIBOR rate plus a margin based on the Company's consolidated leverage ratio). The previous credit agreement restricted the amount of certain types of payments, including dividends, which could be made annually to \$50 million plus an amount equal to 75% of consolidated net income for the prior fiscal year of the Company. On March 18, 2008, the Company entered into an amendment to the revolving loan agreement which extended the maturity date from October 5, 2011 to March 18, 2013. All other terms of the revolving loan agreement remained the same.

On February 1, 2012, the Company and certain of its subsidiaries entered into an unsecured \$300 million multi-currency revolving loan agreement with a group of six banks that replaced and terminated the Company's previous credit agreement that had been entered into on October 5, 2006, and amended on March 18, 2008. Under the new credit agreement, which has a final maturity date of February 1, 2017, the Company has the option to select either a base interest rate (based upon the higher of the federal funds rate plus one-half of 1% or the prime rate of Bank of America plus a margin based on the Company's consolidated leverage ratio) or a Eurocurrency interest rate (at the LIBOR rate plus a margin based on the Company's consolidated leverage ratio). At the Company's option, and subject to certain conditions, the available amount under the new credit facility may be increased from \$300 million up to \$450 million. As of January 31, 2012, there were no outstanding borrowings under the previous revolving credit agreement. No borrowings have occurred under the new credit facility dated February 1, 2012.

The Company's debt and revolving loan agreements require it to maintain certain financial covenants. The Company's June 2004, February 2006, March 2007, and May 2010 private placement debt agreements require the Company to maintain a ratio of debt to the trailing twelve months EBITDA, as defined in the debt agreements, of not more than a 3.5 to 1.0 ratio (leverage ratio). As of January 31, 2012, the Company was in compliance with the financial covenant of these debt agreements, with the ratio of debt to EBITDA, as defined by the agreements, equal to 1.7 to 1.0. As previously noted, the Company's October 2006 revolving loan agreement was terminated effective February 1, 2012 and replaced with a new revolving loan agreement. The new agreement requires the Company to maintain a ratio of debt to trailing twelve months EBITDA, as defined by the debt agreement, of not more than a 3.25 to 1.0 ratio. The new revolving loan agreement requires the Company's trailing twelve months earnings before interest and taxes (EBIT) to interest expense of not less than a 3.0 to 1.0 ratio (interest expense coverage). Due to the replacement of the Company's previous credit agreement on February 1, 2012, the financial ratios in the previous credit agreement were not applicable to the Company with respect to financial results for the quarter ended January 31, 2012. The Company has computed and was in compliance with the financial covenants of the new credit facility dated February 1, 2012 with respect to financial results for the quarter ended January 31, 2012.

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Long-term obligations, less current obligations, as a percentage of long-term obligations, less current obligations, plus stockholders' investment were 23.6% at January 31, 2012, and 22.3% at July 31, 2011. Long-term obligations decreased by \$8.8 million from July 31, 2011 to January 31, 2012 due to the impact of foreign currency translation on the Company's Euro-denominated debt, while stockholders' investment decreased as a result of the goodwill impairment charge recorded during the quarter ended January 31, 2012.

Stockholders' investment decreased \$109.2 million during the six months ended January 31, 2012 as a result of the Company's net loss of \$57.2 million, as well as the decrease in accumulated other comprehensive income of \$28.6 million due to the impact of foreign currency translation, and the payment of dividends on Class A and Class B Common Stock of \$18.2 million and \$1.3 million, respectively.

The Company's cash balances are generated and held in numerous locations throughout the world. At January 31, 2012 and July 31, 2011, approximately 60% and 69% of the Company's cash and cash equivalents was held outside the United States, respectively. The Company's growth has historically been funded by a combination of cash provided by operating activities and debt financing. The Company believes that its cash flow from operating activities, in addition to its borrowing capacity, are sufficient to fund its anticipated requirements for working capital, capital expenditures, restructuring activities, acquisitions, common stock repurchases, scheduled debt repayments, and dividend payments. The Company believes that its current credit arrangements are sound and that the strength of its balance sheet will allow financial flexibility to respond to both internal growth opportunities and those available through acquisition.

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Subsequent Events Affecting Financial Condition

On February 1, 2012, the Company and certain of its subsidiaries entered into an unsecured \$300 million revolving credit agreement with a group of six banks that replaced and terminated the Company's previous \$200 million revolving credit agreement that had been entered into on October 5, 2006, and amended on March 18, 2008.

Under the new credit agreement, which has a final maturity date of February 1, 2017, the Corporation has the option to select either a base interest rate (based upon the higher of the federal funds rate plus one-half of 1% or the prime rate of Bank of America plus a margin based on the Company's consolidated leverage ratio) or a Eurocurrency interest rate (at the LIBOR rate plus a margin based on the Company's consolidated leverage ratio). The new credit agreement is guaranteed by the Corporation's domestic subsidiaries and contains various financial covenants, including a debt-to-EBITDA ratio of 3.25-to-1.0 and an interest coverage ratio of 3.0-to-1.0. A commitment fee is payable on the unused amount of the credit facility. The Corporation intends to use the flexibility provided by the new credit agreement to fund future acquisitions, for general corporate purposes, and to refinance existing debt.

On February 15, 2012, the Board of Directors declared a quarterly cash dividend to shareholders of the Company's Class A and Class B Common Stock of \$0.185 per share payable on April 30, 2012, to shareholders of record at the close of business on April 10, 2012.

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Off-Balance Sheet Arrangements The Company does not have material off-balance sheet arrangements or related-party transactions. The Company is not aware of factors that are reasonably likely to adversely affect liquidity trends, other than the risk factors described in this and other Company filings. However, the following additional information is provided to assist those reviewing the Company's financial statements.

Operating Leases These leases generally are entered into for investments in facilities such as manufacturing facilities, warehouses and office space, computer equipment and Company vehicles.

Purchase Commitments The Company has purchase commitments for materials, supplies, services, and property, plant and equipment as part of the ordinary conduct of its business. In the aggregate, such commitments are not in excess of current market prices and are not material to the financial position of the Company. Due to the proprietary nature of many of the Company's materials and processes, certain supply contracts contain penalty provisions for early termination. The Company does not believe a material amount of penalties will be incurred under these contracts based upon historical experience and current expectations.

Other Contractual Obligations The Company does not have material financial guarantees or other contractual commitments that are reasonably likely to adversely affect liquidity.

Related-Party Transactions The Company evaluated its related party transactions for the period ended January 31, 2012. Based on the evaluation the Company does not have material related party transactions that affect the results of operations, cash flow or financial condition.

Forward-Looking Statements

Brady believes that certain statements in this Form 10-Q are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. All statements related to future events included in this Form 10-Q, including, without limitation, statements regarding Brady's future financial position, business strategy, targets, projected sales, costs, earnings, capital expenditures, debt levels and cash flows, and plans and objectives of management for future operations are forward-looking statements. When used in this Form 10-Q, words such as may, will, expect, intend, estimate, anticipate, believe, should, project or plan or similar terminology are generally interpreted as forward-looking statements. These forward-looking statements by their nature address matters that are, to different degrees, uncertain and are subject to risks, assumptions and other factors, some of which are beyond Brady's control, that could cause actual results to differ materially from those expressed or implied by such forward-looking statements. For Brady, uncertainties arise from the length or severity of the current worldwide economic downturn or timing or strength of a subsequent recovery; future financial performance of major markets Brady serves, which include, without limitation, telecommunications, manufacturing, electrical, construction, laboratory, education, governmental, public utility, computer, transportation; difficulties in making and integrating acquisitions; risks associated with newly acquired businesses; Brady's ability to develop and successfully market new products; changes in the supply of, or price for, parts and components; increased price pressure from suppliers and customers; fluctuations in currency rates versus the US dollar; unforeseen tax consequences; potential write-offs of Brady's substantial intangible assets; Brady's ability to retain significant contracts and customers; risks associated with international operations; Brady's ability to maintain compliance with its debt covenants; technology changes; business interruptions due to implementing business systems; environmental, health and safety compliance costs and liabilities; future competition; interruptions to sources of supply; Brady's ability to realize cost savings from operating initiatives; difficulties associated with exports; risks associated with restructuring plans; risks associated with obtaining governmental approvals and maintaining regulatory compliance; and numerous other matters of national, regional and global scale, including those of a political, economic, business, competitive and regulatory nature contained from time to time in Brady's U.S. Securities and Exchange Commission filings, including, but not limited to, those factors listed in the Risk Factors section located in Item 1A of Part I of the Company's most recently filed Form 10-K for the year ended July 31, 2011. These uncertainties may cause Brady's actual future results to be materially different than those expressed in its forward-looking statements. Brady does not undertake to update its forward-looking statements.

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ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The Company's business operations give rise to market risk exposure due to changes in foreign exchange rates. To manage that risk effectively, the Company enters into hedging transactions, according to established guidelines and policies that enable it to mitigate the adverse effects of this financial market risk.

The global nature of the Company's business requires active participation in the foreign exchange markets. As a result of investments, production facilities and other operations on a global scale, the Company has assets, liabilities and cash flows in currencies other than the U.S. Dollar. The primary objective of the Company's foreign currency exchange risk management is to minimize the impact of currency movements on intercompany transactions and foreign raw-material imports. To achieve this objective, the Company hedges a portion of known exposures using forward contracts. Main exposures are related to transactions denominated in the British Pound, the Euro, Canadian Dollar, Australian Dollar, Singapore Dollar, Japanese Yen, and the Swiss Franc. As of January 31, 2012, the notional amount of outstanding forward contracts designated as cash flow hedges was \$18.5 million. The Company also hedged portions of its net investments in its foreign operations using forward foreign exchange currency contracts of \$10.0 million, intercompany foreign currency denominated debt instruments of \$6.1 million and Euro-denominated debt of \$99.1 million designated as a hedge instrument.

The Company could be exposed to interest rate risk through its corporate borrowing activities. The objective of the Company's interest rate risk management activities is to manage the levels of the Company's fixed and floating interest rate exposure to be consistent with the Company's preferred mix. The interest rate risk management program allows the Company to enter into approved interest rate derivatives, with the approval of the Board of Directors, if there is a desire to modify the Company's exposure to interest rates. As of January 31, 2012, the Company had no interest rate derivatives.

The Company is subject to the risk of changes in foreign currency exchange rates due to its operations in foreign countries. The Company has manufacturing facilities and sells and distributes its products throughout the world. As a result, the Company's financial results could be significantly affected by factors such as changes in foreign currency exchange rates or weak economic conditions in the foreign markets in which the Company manufactures, distributes and sells its products. The Company's operating results are principally exposed to changes in exchange rates between the U.S. Dollar and the European currencies, primarily the Euro, changes between the U.S. Dollar and the Australian Dollar, changes between the U.S. Dollar and the Canadian Dollar, and changes between the U.S. Dollar and the Chinese Yuan. Changes in foreign currency exchange rates for the Company's foreign subsidiaries reporting in local currencies are generally reported as a component of shareholders' equity. The Company's currency translation adjustments recorded for the three and six months ended January 31, 2012, were \$11.7 million and \$30.8 million unfavorable, respectively. The Company's currency translation adjustments recorded for the three and six months ended January 31, 2011, were \$0.3 million unfavorable and \$29.8 million favorable, respectively. As of January 31, 2012 and 2011, the Company's foreign subsidiaries had net current assets (defined as current assets less current liabilities) subject to foreign currency translation risk of \$415.8 million and \$367.1 million, respectively. These amounts were offset by net investment hedges of \$115.2 million as of January 31, 2012, and \$202.7 million as of January 31, 2011. The potential increase in the net current assets as of January 31, 2012, from a hypothetical 10 percent adverse change in quoted foreign currency exchange rates would be \$41.6 million. This sensitivity analysis assumes a parallel shift in foreign currency exchange rates. Exchange rates rarely move in the same direction relative to the U.S. Dollar. This assumption may overstate the impact of changing exchange rates on individual assets and liabilities denominated in a foreign currency.

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ITEM 4. CONTROLS AND PROCEDURES

Brady Corporation maintains a set of disclosure controls and procedures that are designed to ensure that information required to be disclosed by the Company in the reports filed by the Company under the Securities Exchange Act of 1934, as amended (the "Exchange Act"), is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by the Company in the reports the Company files under the Exchange Act is accumulated and communicated to the Company's management, including the Company's principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. The Company carried out an evaluation, under the supervision and with the participation of its management, including its President and Chief Executive Officer and its Senior Executive Vice President and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-15 of the Exchange Act. Based on that evaluation, the Company's President and Chief Executive Officer and Senior Executive Vice President and Chief Financial Officer concluded that the Company's disclosure controls and procedures are effective as of the end of the period covered by this report.

There were no changes in the Company's internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) that occurred during the Company's most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 6. Exhibits

(a) Exhibits

31.1 Rule 13a-14(a)/15d-14(a) Certification of Frank M. Jaehnert

31.2 Rule 13a-14(a)/15d-14(a) Certification of Thomas J. Felmer

32.1 Section 1350 Certification of Frank M. Jaehnert

32.2 Section 1350 Certification of Thomas J. Felmer

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Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

SIGNATURES

Date: March 8, 2012

Date: March 8, 2012

BRADY CORPORATION

/s/ Frank M. Jaehnert
Frank M. Jaehnert
President & Chief Executive Officer

/s/ Thomas J. Felmer
Thomas J. Felmer
Senior Vice President & Chief Financial Officer

(Principal Financial Officer)

