TAYLOR DEVICES INC
Form 10KSB
August 29, 2006

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
F O R M 10-KSB

[X] ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the fiscal year ended May 31, 2006

[ ] TRANSITION REPORT UNDER SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the transition period from __________ to __________

Commission file number 0-3498

TAYLOR DEVICES, INC.
(Name of small business issuer as specified in its charter)

New York	16-0797789
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

90 Taylor Drive, P.O. Box 748, N. Tonawanda, New York 14120-0748
(Address of principal executive offices)

Issuer's telephone number (716) 694-0800

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

Title of each class	Name of each exchange on which registered
None	None

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

Common Stock ($.025 par value)
(Title of class)

Check whether the issuer (1) has filed all reports required to be filed by Section 13 or 15(d) of the Exchange Act of 1934 during the past twelve months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ___X___ No __

Check if there is no disclosure of delinquent filers pursuant to Item 405 of Regulation S-B contained in this form, and no disclosure will be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-KSB or any amendments to Form 10-KSB [ ].

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

Issuer's revenues for its most recent fiscal year are $14,750,699.

The aggregate market value of the Common Stock held by non-affiliates (as affiliates are defined in Rule 12b-2 of the Exchange Act) of the issuer, computed by reference to the average of the bid and asked price on August 17, 2006 was $13,711,011. In addition to shares held by affiliates, this calculation also excludes shares of the issuer's common stock that are held by Schedule 13D filers.

The number of shares outstanding of each of the registrant's classes of Common Stock, as of the latest practicable date.

Class	Outstanding at August 17, 2006
Common Stock, $.025 par value	3,142,922

TAYLOR DEVICES, INC.

DOCUMENTS INCORPORATED BY REFERENCE

Documents	Form 10-KSB Reference
Proxy Statement	Part III, Items 9-12

FORM 10-KSB INDEX

PART I

ITEM 1. DESCRIPTION OF BUSINESS

The Company was incorporated in the State of New York on July 22, 1955 and is engaged in the design, development, manufacture and marketing of shock absorption, rate control, and energy storage devices for use in various types of machinery, equipment and structures. In addition to manufacturing and selling existing product lines, the Company continues to develop new and advanced technology products.

Principal Products

The Company manufactures and sells a single group of very similar products that have many different applications for customers. These similar products are included in one of six categories; namely, Seismic Dampers, Fluidicshoks®, Crane and Industrial Buffers, Self-Adjusting Shock Absorbers, Liquid Die Springs, and Vibration Dampers. Management does not track or otherwise account for sales broken down by these categories. The following is a summary of the capabilities and applications for these products.

Seismic Dampers are designed to ameliorate the effects of earthquake tremors on structures, and represent a substantial part of the business of the Company. Fluidicshoks® are small, extremely compact shock absorbers with up to 19,200 inch-pound capacities, produced in 15 standard sizes for primary use in the defense, aerospace and commercial industry. Crane and industrial buffers are larger versions of the Fluidicshoks® with up to 60,000,000 inch-pound capacities, produced in more than 60 standard sizes for industrial application on cranes, ships, container ships, railroad cars, truck docks, ladle and ingot cars, ore trolleys and car stops. Self-adjusting shock absorbers, which include versions of Fluidicshoks® and crane and industrial buffers, automatically adjust to different impact conditions, and are designed for high cycle application primarily in heavy industry. Liquid die springs are used as component parts of machinery and equipment used in the manufacture of tools and dies. Vibration dampers are used primarily by the aerospace and defense industries to control the response of electronics and optical systems subjected to air, ship, or spacecraft vibration.

Distribution

The Company utilizes the services of more than 50 sales representatives and distributors in the United States and Canada. Specialized technical sales in aerospace and custom marketing activities are serviced by three sales agents, under the direction and with the assistance of Douglas P. Taylor, the Company's President. Sales representatives typically have non exclusive, yearly agreements with the Company, which, in most instances, provide for payment of commissions on sales at 10% of the product's net aggregate selling price. Distributors also have non exclusive, yearly agreements with the Company to purchase the Company's products for resale purposes.

Competition

The Company faces competition on mature aerospace and defense programs which may use more conventional products manufactured under less stringent government specifications. Two foreign companies are the Company's competitors in the production of crane buffers.

The Company's principal competitors for the manufacture of products in the aerospace and commercial aerospace industries field are Cleveland Pneumatic Tool Company in Cleveland, Ohio, and Menasco Manufacturing Company in Burbank, California. While the Company is competitive with these companies in the areas of pricing, warranty and product performance, due to limited financing and manufacturing facilities, the Company cannot compete in the area of volume production.

The Company competes directly against two other firms supplying seismic damping devices, as well as numerous other firms which supply alternative seismic protection technologies.

Raw Materials and Supplies

The principal raw materials and supplies used by the Company in the manufacture of its products are provided by numerous U.S. suppliers. The loss of any one of these would not materially affect the Company's operations.

Patents, Trademarks and Licenses

Under a License Agreement ("License Agreement") dated November 1, 1959, between the Company and Tayco Developments, Inc. ("Developments"), an affiliate of the Company, the Company was granted preferential rights to market, in the United States and Canada, all existing and future inventions and patents developed by Developments. The term of this License Agreement is the life of the last-to-expire patent on which the Company is paying royalties, which is the year 2021. During the life of each patent, the Company records a royalty payable to Developments, equal to five percent of sales value of patented items sold and shipped. The Company incurred royalty charges from Developments of $97,000 and $165,000 in the years ended May 31, 2006 and 2005, respectively. Under the License Agreement, payments of royalties are required to be made quarterly.

The License Agreement also provides for Developments to pay the Company 10% of the gross royalties received from third parties who are permitted to make, use and sell machinery and equipment under patents not subject to the License Agreement, as well as on apparatus and equipment subject to the License Agreement but modified by the Company, with rights to such modification having been assigned to Developments. No royalties were owed to the Company in the years ended May 31, 2006 and 2005. Royalties, if any, are paid quarterly.

Although the Company and Developments share common management and a close business relationship, as separate corporations responsible to their own shareholders, interests may diverge regarding development and licensing of future inventions and patents. In that case, Developments would be permitted to license future inventions and patents to parties other than the Company, rendering the Company's option on future inventions and patents under its License Agreement only minimally beneficial.

Terms of Sale

The Company does not carry significant inventory for rapid delivery to customers, and goods are not normally sold with return rights such as are available for consignment sales. The Company has no inventory out on consignment and no consignment sales for the years ended May 31, 2006 and 2005. No extended payment terms are offered. During the year ended May 31, 2006, delivery time after receipt of orders averaged 12 to 14 weeks for the Company's standard products. Due to the volatility of construction and aerospace/defense programs, progress payments are usually required for larger projects utilizing custom designed components of the Company.

Dependence Upon Customers\Government Contracts

The Company is not dependent on any one or a few major customers. Sales to two customers approximated 28% (14% each) of net sales for 2006.

Contracts between the Company and the federal government or its independent contractors are subject to termination at the election of the federal government. Contracts are generally entered into on a fixed price basis. From time to time, the Company has also entered into a "cost plus" defense contract. If the federal government should limit defense spending, these contracts could be reduced or terminated, which would not have a materially adverse effect on the Company.

Research and Development

The Company does not normally engage in any major product research and development activities in connection with the design of its products, except when funded by aerospace customers or the federal government. See Item 1. Description of Business, "Patents, Trademarks and Licenses". The Company, however, engages in research testing of its products. For the fiscal years ended May 31, 2006 and 2005, the Company expended $129,000 and $257,000, respectively, on manufacturing research through Developments. For the years ended May 31, 2006 and 2005, defense sponsored research and development totaled $63,000 and $176,000, respectively.

Government Regulation

Compliance with federal, state and local laws and regulations which have been enacted or adopted regulating the discharge of materials into the environment has had no material effect on the Company, and the Company believes that it is in substantial compliance with such provisions.

The Company is subject to the Occupational Safety and Health Act ("OSHA") and the rules and regulations promulgated thereunder, which establish strict standards for the protection of employees, and impose fines for violations of such standards. The Company believes that it is in substantial compliance with OSHA provisions and does not anticipate any material corrective expenditures in the near future. The Company is currently incurring only moderate costs with respect to disposal of hazardous waste and compliance with OSHA regulations.

The Company is also subject to regulations relating to production of products for the federal government. These regulations allow for frequent governmental audits of the Company's operations and fairly extensive testing of Company products. The Company believes that it is in substantial compliance with these regulations and does not anticipate corrective expenditures in the future.

Employees

Exclusive of Company sales representatives and distributors, as of May 31, 2006, the Company had 89 employees, including three executive officers, and three part time employees. The Company has good relations with its employees.

ITEM 2. DESCRIPTION OF PROPERTY

The Company's production facilities occupy approximately six acres on Tonawanda Island in North Tonawanda, New York and are comprised of four interconnected buildings and one adjacent building. The production facilities consist of a small parts plant (approximately 4,400 square feet), a large parts plant (approximately 13,500 square feet), and include a facility of approximately 7,000 square feet constructed in 1995 (see below), a test facility, storage area, pump area and the Company's general offices. The adjacent building is a 17,000 square foot seismic assembly test facility. These facilities total more than 45,000 square feet. The Company has two separate remote test facilities used for shock testing. One facility is 800 square feet, and a newer, state-of-the-art test facility is 1,225 square feet. The small parts plant consists of a complete small machine shop and tool room that produces all of the Company's product items which are less than two inches in diameter. The large parts plant consists of a complete large machine shop and tool room. Both plants contain custom-built machinery for boring, deep-hole drilling and turning of parts.

In November 1994, as part of certain tax-exempt bond financing arrangements, the Company and the Niagara County Industrial Development Agency ("NCIDA") entered into a 15 year Series Lease by NCIDA to the Company of approximately 7,000 square feet of manufacturing space adjacent to the Company's existing large machine shop. The expansion partially accommodated the Company's increased need for additional manufacturing space for its seismic damper devices.

Rental payments, equivalent to payments of principal and interest due, are made quarterly by the Company over the term of the Lease, and are sufficient to amortize the $1,250,000 tax-exempt industrial development revenue Series A Bonds (the "Bond") issued by the NCIDA. The payments reimburse HSBC Bank, N.A. ("HSBC"), as issuer of the five year direct-pay irrevocable letter of credit, which is drawn upon by Deutsche Bank Trust Company, Americas, as Trustee, for the benefit of the bondholders. The letter of credit was renewed by HSBC in November, 2004 for another five-year period. The Bond bears interest at the HSBC Adjustable Rate Service ("HSBC ARS") rate, plus an incremental amount designated by HSBC Securities, Inc. (the "Remarketing Agent"). The HSBC ARS rate reflects the current bid-side yield of the highest rated short-term, federally tax exempt obligations currently being traded, announced weekly by the Remarketing Agent, not to exceed 15% per annum, and is the minimum rate of interest necessary to enable the Remarketing Agent to remarket the Bond at par. Annual principal payments by the Company in June of each year range from $25,000 to $150,000, including a final principal payment of $45,000 upon maturity of the Bond on June 1, 2009. The Bond may be redeemed in whole, or in part, on any quarterly interest payment date, without penalty or premium. The principal amount outstanding on the Bond as of May 31, 2006 is $145,000.

Rental payments are secured by the liens of the Master Indenture between the NCIDA and the Trustee, the Series Supplemental Indenture between the NCIDA and the Trustee, and the Series Mortgage from the NCIDA, the Company, and Tayco Realty Corporation, an affiliate of the Company ("Tayco Realty"), to HSBC, as well as by other collateral security arrangements. When the Bond matures on June 1, 2009, the Company must purchase the Facility from the NCIDA for $1.00.

A renewal note dated June 1, 1998 due June 1, 2008 in the face amount of $174,778 is held by HSBC and is secured by property located at 90 Taylor Drive, North Tonawanda, New York. The principal balance at May 31, 2006 is $39,001.

A mortgage note dated January 1998, due January 1, 2013 in the face amount of $400,000 is also held by HSBC on property located at 90 Taylor Drive, North Tonawanda, New York, with an interest rate equal to the bank's prime interest rate plus 1%. A monthly payment of $2,222 is due on the first of each month. The principal balance at May 31, 2006 is $180,000. All payments on the above obligations are current.

Additional information regarding the Company's long-term debt is contained in Note 9 to the Consolidated Financial Statements filed with this report.

Except for the premises leased from the NCIDA, the Company leases portions of both the building and the property on which it is located from Tayco Realty. Pursuant to the Lease Agreement between the Company and Tayco Realty, rental payments from June 1, 2005 to May 31, 2006 totaled $159,600. The Lease Agreement, which contains standard terms and conditions, was renewed on November 1, 2005 for a term of ten years. Annual rentals are renegotiated by management of the two companies. The total rent paid by the Company is determined by a base rate, subject to adjustment for increases in taxes, maintenance costs and for utilization of additional space by the Company. The Company also pays for certain expenses incurred for the operation of the facilities. In addition, the Company leases a separate warehouse for storage from an unrelated third party, consisting of approximately 3,600 square feet at $825 per month. The warehouse is located approximately one-quarter mile from the above-referenced production facilities and office space. The total rental expense incurred by the Company for this facility in fiscal 2006 was $9,900.

The Company believes it is carrying adequate insurance coverage on its facilities and their contents.

The following tables provide information regarding the properties discussed in this Item 2. Description of Property.

TAYLOR DEVICES, INC. AND SUBSIDIARY
DISCLOSURE FOR REG. 228.102(c) FOR FILING 10-KSB

05/31/06

Reg. 228.102(c)-Real Estate

Property Location / Description 90 & 100 Taylor Drive N. Tonawanda, NY 14120 (see below)	Cost	Book Accumulated Depreciation 5/31/2006	Net Book Value 5/31/2006	Percentage of Total Assets
Land	$ 141,483	$ -	$ 141,483	
Buildings	1,154,353	746,642	407,711	
Improvements	2,631,231	841,578	1,789,653	
Total	$ 3,927,067	$ 1,588,220	$ 2,338,847	13.5%
90 Taylor Drive				
Land	$ 107,363	$ -	$ 107,363	
Building	428,506	428,506	-	
Building Improvements-Realty	297,664	62,316	235,348	
Building Improvements-Devices	2,333,567	779,262	1,554,305	
Total	$ 3,167,100	$ 1,270,084	$ 1,897,016	10.9%
100 Taylor Drive				
Land	$ 34,120	$ -	$ 34,120	
Building	725,847	318,136	407,711	
Total	$ 759,967	$ 318,136	$ 441,831	2.5%
Taylor Devices, Inc. & Subsidiary Total Assets as of May 31, 2006		$ 17,384,705		

Reg. 228.102(c)(3)

Pursuant to the Lease Agreement dated July 1, 2000 between the Company and Developments, the Company, which leases the parcel from Tayco Realty, sub-leases approximately 800 square feet of office and research and development space located at 100 Taylor Drive, North Tonawanda, to Developments at a base annual rental of $12,000. The rate of any rental increase may not exceed 10% annually and may be waived by both parties in writing. The sublease automatically renews on each anniversary of its commencement date, unless either party gives three months' written notice to the other of termination. The sublease provides that on April 1 of each year, management of both companies will review the agreement to determine possible increases for expenses due to increased taxes, maintenance costs, or for additional space utilized by Developments. In fiscal 2006, the Company received total rental payments of $12,000 from Developments.

Reg.228.102(c)(7)(vi)(A-D)

Property Location / Description 90 & 100 Taylor Drive N. Tonawanda, NY 14120 (see below)	Federal Tax Depreciation Methods	Federal Tax Life Claim	Federal Tax Cost	Federal Tax Accumulated Depreciation	Net Tax Basis 5/31/2006
Building	Straight Line, MACRS	15-40 Yrs.	$ 1,154,353	$ 778,621	$ 375,732
Building Improvements	Straight Line ACRS, MACRS	7-40 Yrs.	2,631,231	893,040	1,738,191
Total			$ 3,785,584	$ 1,671,661	$ 2,113,923
90 Taylor Drive					
Building	Straight Line, MACRS	15-31.5 Yrs.	$ 428,506	$ 428,506	$ -
Building Improvements-Realty	Straight Line	7-39 Yrs.	297,664	69,830	227,834

Building Improvements-Devices	Straight Line ACRS, MACRS	15-40 Yrs.	2,333,567	823,210	1,510,357
Total			$ 3,059,737	$ 1,321,546	$ 1,738,191
100 Taylor Drive					
Building	Straight Line	19-40 Yrs.	$ 725,847	$ 350,115	$ 375,732

Reg. 228.102(c)(7)(vii)

The Company recorded $43,000 expense during the year for real property taxes and payments in lieu of taxes. This represents a combined tax rate of $37.77 per $1,000 of assessed valuation including a 50% reduction in taxes for the property leased from the NCIDA. This reduction will cease upon payment in full of the Bond and the Company's purchase for $1.00 of the land leased from the NCIDA.

ITEM 3. LEGAL PROCEEDINGS

None except for routine litigation incidental to the business.

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

None.

PART II

ITEM 5. MARKET FOR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Market Information

The Company's Common Stock trades on the Small Cap Market tier of the National Association of Securities Dealers Automated Quotation ("NASDAQ") stock market under the symbol TAYD. The high and low market prices noted below for the quarters of FY06 and FY05 are obtained from NASDAQ.

	Fiscal 2006		Fiscal 2005	
	High	Low	High	Low
First Quarter	3.750	2.630	2.570	2.020
Second Quarter	4.680	2.838	2.900	2.020
Third Quarter	6.200	3.080	9.190	2.200
Fourth Quarter	8.250	5.000	6.440	2.560

Holders

As of August 17, 2006, the number of issued and outstanding shares of Common Stock was 3,142,922, and the approximate number of record holders of the Company's Common Stock was 892. Due to a substantial number of shares of the Company's Common Stock held in street name, the Company believes that the total number of beneficial owners of its Common Stock exceeds 2,000.

Dividends

No cash or stock dividends have been declared during the last two fiscal years. Except as described below, under the terms of the Company's credit arrangement with its major lender, the Company is prohibited from issuing cash dividends.

On October 5, 1998, the Company's Board of Directors adopted a shareholder rights plan designed to deter coercive or unfair takeover tactics and prevent an acquirer from gaining control of the Company without offering a fair price to shareholders. Under the plan, certain rights ("Rights") were distributed as a dividend on each share of Common Stock (one Right for each share of Common Stock) held as of the close of business on or after October 19, 1998. Each whole Right entitles the holder, under certain defined conditions, to buy one two-thousandths (1/2000) of a newly issued share of the Company's Series A Junior Participating Preferred Stock ("Series A Preferred Stock") at an exercise price of $5.00. Rights attach to and trade with the shares of Common Stock, without being evidenced by a separate certificate. No separate Rights certificates will be issued unless and until the Rights detach from Common Stock and become exercisable for shares of the Series A Preferred Stock.

Such an event will occur if (1) a person or group acquires beneficial ownership of 30% or more of the Company's Common Stock (except through a tender or exchange offer for all shares which the Board determines is fair and in the best interests of the Company and its shareholders); or (2) a person or group commences a tender or exchange offer which will result in the person or group beneficially owning 24% or more of the Common Stock; or (3) the Board determines that a person or group holding at least 24% of the Common Stock intends to cause or pressure the Company into taking actions adverse to its or its shareholders' interests, or that the person or group is causing or is likely to cause a material adverse impact on the business or prospects of the Company. The Rights expire on October 5, 2008.

Equity Compensation Plan Information

The following table sets forth information regarding equity compensation plans of the Company as of May 31, 2006.

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants, and rights *(a)*	Weighted-average exercise price of outstanding options, warrants and rights *(b)*	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column *(a)*) *(c)*
Equity compensation plans approved by security holders			
1994 Stock Option Plan	1,000	$5.56	-
1998 Stock Option Plan	30,000	$3.79	-
2001 Stock Option Plan	40,000	$3.56	-
2005 Stock Option Plan	14,250	$5.89	125,750
Equity compensation plans not approved by security holders			
2004 Employee Stock Purchase Plan (1)	-	-	249,339
Total	85,250		375,089

(1) The Company's 2004 Employee Stock Purchase Plan (the "Employee Plan") permits eligible employees to purchase shares of the Company's common stock at fair market value through payroll deductions and without brokers' fees. Such purchases are without any contribution on the part of the Company. As permitted by its terms, the Employee Plan had been suspended by the Board of Directors from August 10, 2004 until August 4, 2005. As of May 31, 2006, 249,339 shares were available for issuance.

ITEM 6. MANAGEMENT'S DISCUSSION AND ANALYSIS OR PLAN OF OPERATION

Cautionary Statement

The Private Securities Litigation Reform Act of 1995 provides a "safe harbor" for forward-looking statements. Information in this Item 6, "Management's Discussion and Analysis or Plan of Operation," and elsewhere in this 10-KSB that does not consist of historical facts, are "forward-looking statements." Statements accompanied or qualified by, or containing words such as "may," "will," "should," "believes," "expects," "intends," "plans," "projects," "estimates," "predicts," "potential," "outlook," "forecast," "anticipates," "presume," and "assume" constitute forward-looking statements and, as such, are not a guarantee of future performance. The statements involve factors, risks and uncertainties, the impact or occurrence of which can cause actual results to differ materially from the expected results described in such statements. Risks and uncertainties can include, among others, fluctuations in general business cycles and changing economic conditions; changing product demand and industry capacity; increased competition and pricing pressures; advances in technology that can reduce the demand for the Company's products, as well as other factors, many or all of which may be beyond the Company's control. Consequently, investors should not place undue reliance on forward-looking statements as predictive of future results. The Company disclaims any obligation to update the forward-looking statements in this report.

Results of Operations

A summary of the period to period changes in the principal items included in the consolidated statements of income is shown below:

Summary comparison of the years ended May 31, 2006 and 2005

	Increase / (Decrease)
Sales, net	$ 3,535,000
Cost of goods sold	$ 2,729,000
Selling, general and administrative expenses	$ 365,000
Income before provision for income taxes, equity in net income of affiliate and minority stockholder's interest	$ 443,000
Provision for income taxes	$ 131,000
Income before equity in net income of affiliate and minority stockholder's interest	$ 312,000
Equity in net income (loss) of affiliate	$ (28,000)
Net income	$ 284,000

Sales under certain fixed-price contracts, requiring substantial performance over several periods prior to commencement of deliveries, are accounted for under the percentage-of-completion method of accounting whereby revenues are recognized based on estimates of completion prepared on a ratio of cost to total estimated cost basis. Costs include all material and direct and indirect charges related to specific contracts.

Adjustments to cost estimates are made periodically and any losses expected to be incurred on contracts in progress are charged to operations in the period such losses are determined. However, any profits expected on contracts in progress are recognized over the life of the contract.

For financial statement presentation purposes, the Company nets progress billings against the total costs incurred on uncompleted contracts. The asset, "costs and estimated earnings in excess of billings," represents revenues recognized in excess of amounts billed. The liability, "billings in excess of costs and estimated earnings," represents billings in excess of revenues recognized.

For the year ended May 31, 2006 (All figures being discussed are for the year ended May 31, 2006 as compared to the year ended May 31, 2005.)

	Year ended		**Change**	
	May 31, 2006	**May 31, 2005**	**Increase / (Decrease)**	**Percent Change**
Net Revenue	$14,751,000	$11,216,000	$ 3,535,000	*32%*
Cost of sales	10,438,000	7,709,000	2,729,000	*35%*

Gross profit	$ 4,313,000	$3,507,000	$ 806,000	*23%*
...as a percentage of net revenues	*29%*	*31%*		

The Company's consolidated results of operations showed a 32% increase in net revenues and an increase in net income of 140%. Gross profit increased by 23%. Revenues recorded in the current period for long-term construction projects increased by 84% over the unusually low level recorded in the prior year. The increase in revenue in the current year is primarily attributable to 1.) a 42% increase in the quantity of long-term construction projects this year compared to last year, and 2.) a 23% increase in the average total sales value of long-term construction projects this year compared to last year. Management has noticed an increase in the global level of construction activity of structures requiring seismic protection, primarily in Asia. This has resulted in an increased number of inquiries and quotes for our products. Many of our bids to supply our products for these projects have been successful this year. These current year's projects contributed a gross profit margin of 33% as compared to 29% in the prior year's period. The overall gross profit as a percentage of net revenues for the current and prior year periods was 29% and 31%. Management is optimistic that the level of construction activity of structures requiring seismic protection will remain strong through the next fiscal year. The Company's revenues and net income fluctuate from period to period. The increases in the current period, compared to the prior period, are not necessarily representative of future results.

Selling, General and Administrative Expenses

	Year ended		**Change**	
	May 31, 2006	**May 31, 2005**	**Increase / (Decrease)**	**Percent Change**
Outside Commissions	$ 875,000	$ 461,000	$ 414,000	*90%*
Royalties	97,000	165,000	(68,000)	*-41%*
Other SG&A	2,423,000	2,405,000	18,000	*1%*
Total SG&A	$3,395,000	$3,031,000	$ 364,000	*12%*
...as a percentage of net revenues	*23%*	*27%*		

Selling, general and administrative expenses increased by 12% from the prior year. Commission expense increased by 90% over last year's level. Commission expense was higher in this period due to higher commission rates on a few large, long-term construction projects in production, in addition to a higher volume of sales subject to commission. Royalty expense is 41% less than the amount recorded in the prior year period. There were fewer shipments that were subject to royalty during the current year. Other selling, general and administrative expenses increased by only 1% from last year to this.

The above factors resulted in operating income of $918,000 for the year ended May 31, 2006, up 93% from the $476,000 in the same period of the prior year.

Interest expense of $164,000 is slightly less than in the prior year. The average level of use of the Company's operating line of credit decreased by approximately 18% while the average interest rate on the line increased by approximately 2 percentage points as compared to last year. The line of credit is used primarily to fund the production of larger projects that do not allow for advance payments or progress payments.

Capital Resources, Line of Credit and Long-Term Debt

The Company's primary liquidity is dependent upon its working capital needs. These are primarily inventory, accounts receivable, costs and estimated earnings in excess of billings, accounts payable, accrued commissions, billings in excess of costs and estimated earnings, and debt service. The Company's primary sources of liquidity have been operations and bank financing.

Capital expenditures for the year ended May 31, 2006 were $253,000 compared to $140,000 in the prior year. The Company has commitments to pay $22,000 for production machinery in the fiscal year ending May 31, 2007.

The Company has a $5,000,000 line of credit with a bank. There is a $3,011,000 principal balance outstanding as of May 31, 2006, which is up from the $1,390,000 balance outstanding as of May 31, 2005. The outstanding balance on the line of credit will fluctuate as the Company's various long-term projects progress. The Company is in compliance with restrictive covenants under the line of credit and other financing arrangements, including the NCIDA Bond financing. In these covenants, the Company agrees to:

- Maintain a minimum working capital position of $2,000,000 at all times;
- limit annual capital expenditures to $650,000;
- maintain a minimum debt service coverage ratio of no less than 1:1; and
- advise the bank of any litigation where the claim amount is $100,000 or greater.

Additional information regarding the Company's long-term debt appears in Part I, item 2 of this Report.

Principal maturities of long-term debt for the subsequent five years are as follows: 2007 - $248,000; 2008 - $232,000; 2009 - $138,000; 2010 - $72,000; and 2011 - $27,000.

Inventory and Maintenance Inventory

	May 31, 2006		May 31, 2005		Increase	
Raw Materials	$ 413,000		$ 404,000		$ 9,000	*2%*
Work in process	3,404,000		4,029,000		(625,000)	*-16%*
Finished goods	400,000		338,000		62,000	*18%*
Inventory	4,217,000	*88%*	4,771,000	*88%*	(554,000)	*-12%*
Maintenance and other inventory	543,000	*12%*	662,000	*12%*	(119,000)	*-18%*
Total	$4,760,000	*100%*	$5,433,000	*100%*	$ (673,000)	*-12%*
Inventory turnover	2.0		1.5			

Inventory, at $4,217,000 as of May 31, 2006, is 12% lower than the prior year-end. Of this, approximately 81% is work in process, 9% is finished goods, and 10% is raw materials.

Maintenance and other inventory represent stock that is estimated to have a product life cycle in excess of twelve months. This stock represents certain items that the Company is required to maintain for service of products sold and items that are generally subject to spontaneous ordering. This inventory is particularly sensitive to technical obsolescence in the near term due to its use in industries characterized by the continuous introduction of new product lines, rapid technological advances and product obsolescence. Management of the Company has recorded an allowance for potential inventory obsolescence. The provision for potential inventory obsolescence was $140,000 for the year ended May 31, 2006 and $87,000 for the same period last year. The Company continues to rework slow-moving inventory, where applicable, to convert it to product to be used on customer orders. There was an insignificant amount of slow-moving inventory used during the year ended May 31, 2006. The Company disposed of approximately $310,000 of obsolete inventory during the year ended May 31, 2006.

Accounts Receivable, Costs and Estimated Earnings in Excess of Billings,

and Billings in Excess of Costs and Estimated Earnings

	May 31, 2006	May 31, 2005	Increase /(Decrease)	
Accounts receivable	$2,423,000	$2,719,000	$ (296 ,000)	*-11%*
Costs and estimated earnings in excess of billings	5,062,000	1,657,000	3,405,000	*205%*
Less: Billings in excess of costs and estimated earnings	95,000	288,000	(193,000)	*-67%*
Net	$7,390,000	$4,088,000	$ 3,302,000	*81%*

The Company combines the totals of accounts receivable, the asset "costs and estimated earnings in excess of billings", and the liability, "billings in excess of costs and estimated earnings", to determine how much cash the Company will eventually realize from revenue recorded to date. As the accounts receivable figure rises in relation to the other two figures, the Company can anticipate increased cash receipts within the ensuing 30-60 days.

Accounts receivable of $2,423,000 as of May 31, 2006 includes approximately $374,000 of amounts retained by customers on long-term construction projects. The Company expects to collect all of these amounts, including the retainage, during the next twelve months.

As noted above, the current asset, "costs and estimated earnings in excess of billings," represents revenues recognized in excess of amounts billed. Whenever possible, the Company negotiates a provision in sales contracts to allow the Company to bill, and collect from the customer, payments in advance of shipments. Unfortunately, provisions such as this are often not possible. The $5,062,000 balance in this account at May 31, 2006 is a 205% increase from the prior year-end. This significant increase from last year-end is a reflection of 1.) the increase in the number of projects in progress at the two balance sheet dates (25 at May 31, 2006 compared to 16 at May 31, 2005) and 2.) the amount of progress billings permitted per the terms of the various sales agreements for the projects (19% of the aggregate order value of the projects in progress at May 31, 2006 has been invoiced to the customers compared to 41% at May 31, 2005). In the aggregate, the projects in progress at May 31, 2006 are 53% complete at that date while the projects in progress at May 31, 2005 were 59% complete at that date. The average total sales value of long-term construction projects in process at the end of this year is 45% higher than the end of last year. Generally, if progress billings are permitted under the terms of a project sales agreement, then the more complete the project is, the more progress billings will be permitted. The Company expects to bill the entire amount during the next twelve months.

The year-end balances in this account are comprised of the following components:

	May 31, 2006	May 31, 2005
Costs	$ 4,792,000	$ 1,794,000
Estimated earnings	2,760,000	1,291,000
Less: Billings to customers	2,490,000	1,428,000
Costs and estimated earnings in excess of billings	$ 5,062,000	$ 1,657,000
Number of projects in progress	23	12

As noted above, the current liability, "billings in excess of costs and estimated earnings", represents billings to customers in excess of revenues recognized. The $95,000 balance in this account at May 31, 2006 is a $193,000 decrease from the balance at the end of the prior year. The balance in this account fluctuates in the same manner and for the same reasons as the account "costs and estimated earnings in excess of billings", discussed above. Final delivery of product under these contracts is expected to occur during the next twelve months.

The year-end balances in this account are comprised of the following components:

	May 31, 2006	May 31, 2005
Billings to customers	$ 254,000	$ 1,195,000
Less: Costs	110,000	705,000
Less: Estimated earnings	49,000	202,000
Billings in excess of costs and estimated earnings	$ 95,000	$ 288,000
Number of projects in progress	2	4

Summary of factors affecting the year-end balances in the asset "costs and estimated earnings in excess of billings", and the liability, "billings in excess of costs and estimated earnings":

	2006	2005
Number of projects in progress at year-end	25	16
Aggregate percent complete at year-end	53%	59%
Average total value of projects in progress at year-end	$578,000	$399,000
Percentage of total value invoiced to customer	19%	41%

The Company's backlog of sales orders at May 31, 2006 is $12.4 million, up from the backlog at the end of the prior year of $7.3 million. $6.7 million of the current backlog is on projects already in progress.

Accounts payable, at $1,315,000 as of May 31, 2006, is approximately $545,000 more than the prior year-end. This significant increase is primarily attributable due to the increase in production activity for manufacture of the products subject to sales orders.

Commission expense on applicable sales orders is recognized at the time revenue is recognized. The commission is paid following receipt of payment from the customers. Accrued commissions as of May 31, 2006 are $983,000. This is 70% higher than the $577,000 accrued at the prior year-end. This significant increase is reasonable due to the increase in the current asset, "costs and estimated earnings in excess of billings". Commission expense related to long-term construction projects is recorded at the same time as revenue on the projects is recorded. This liability will not decrease until progress billings on the projects have been issued by the Company and are paid by our customers. The Company expects the current accrued amount to be paid during the next twelve months. Other current liabilities increased by only $57,000 from the prior year-end, to $394,000.

The Company paid $329,000 to Developments during the year ended May 31, 2006, reducing the principal balance on the note payable to $242,000.

Management believes that the Company's cash flows from operations and borrowing capacity under the bank line of credit will be sufficient to fund ongoing operations, capital improvements and share repurchases for the next twelve months.

ITEM 7.FINANCIAL STATEMENTS

For information concerning this Item, see the Company's balance sheet and related financial statements at Item 13.

ITEM 8.CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURES

There have been no disagreements between the Company and its accountants as to matters which require disclosure.

ITEM 8A. CONTROLS AND PROCEDURES

(a) *Evaluation of disclosure controls and procedures.*

The Company's principal executive officer and principal financial officer have evaluated the Company's disclosure controls and procedures as of May 31, 2006 and have concluded that as of the evaluation date, the disclosure controls and procedures were effective to ensure that material information relating to the Company was accumulated and communicated to the Company's management, including its principal executive officer and principal financial officer, to allow for timely decisions regarding required disclosure.

(b) *Changes in internal controls.*

There have been no changes in the Company's internal controls over financial reporting that occurred during the fiscal quarter ended May 31, 2006 that have materially affected, or are reasonably likely to materially affect, the Company's control over financial reporting.

ITEM 8B. OTHER INFORMATION

None.

PART III

The information required by Items 9, 10, 11 and 12 of this part will be presented in the Company's Proxy Statement to be issued in connection with the Annual Meeting of Shareholders to be held on November 10, 2006, which information is hereby incorporated by reference into this Annual Report. The proxy materials, including the Proxy Statement and Annual Report to Shareholders, will be filed within 120 days after the Company's fiscal year end.

ITEM 13.EXHIBITS

DOCUMENTS FILED AS PART OF THIS REPORT:

Index to Financial Statements:

(i) Report of Independent Registered Public Accounting Firm

(ii) Consolidated Balance Sheets May 31, 2006 and 2005

(iii) Consolidated Statements of Income for the years ended May 31, 2006 and 2005

(iv) Consolidated Statements of Stockholders' Equity for the years ended May 31, 2006 and 2005

(v) Consolidated Statements of Cash Flows for the years ended May 31, 2006 and 2005

(vi) Notes to Consolidated Financial Statements May 31, 2006 and 2005

(a) EXHIBITS:

(3) Articles of incorporation and by-laws

(i) Restated Certificate of Incorporation incorporated by reference to Exhibit (3)(i) of Annual Report on Form 10-K, dated August 24, 1983.

(ii) Amendment to Certificate of Incorporation incorporated by reference to Exhibit (3)(iv) to Form 8 [Amendment to Application or Report], dated September 24, 1993.

(iii) Amendment to