

BALLANTYNE OF OMAHA INC  
Form 10-Q  
May 15, 2006

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 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 March 31, 2006

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 1-13906

**BALLANTYNE OF OMAHA, INC.**

(Exact Name of Registrant as Specified in Its Charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**4350 McKinley Street, Omaha, Nebraska**  
(Address of Principal Executive Offices)

**47-0587703**  
(IRS Employer  
Identification Number)

**68112**  
Zip Code

**(402) 453-4444**

Registrant's telephone number, including area code:

Edgar Filing: BALLANTYNE OF OMAHA INC - Form 10-Q

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 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  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

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

<b>Class</b>	<b>Outstanding as of May 12, 2006</b>
Common Stock, \$.01, par value	13,542,531 shares

---

**TABLE OF CONTENTS**

**PART I. Financial Information**

<u>Item 1.</u>	<u>Financial Statements</u>
<u>Item 2.</u>	<u>Management's Discussion and Analysis of Financial Condition And Results of Operations</u>
<u>Item 3.</u>	<u>Quantitative and Qualitative Disclosures About Market Risk</u>
<u>Item 4.</u>	<u>Controls and Procedures</u>

**PART II. Other Information**

<u>Item 1.</u>	<u>Legal Proceedings</u>
<u>Item 1A.</u>	<u>Risk Factors</u>
<u>Item 6.</u>	<u>Exhibits</u>
	<u>Signatures</u>

---

**Part I. Financial Information**

**Item 1. Financial Statements**

**Ballantyne of Omaha, Inc. and Subsidiaries**

**Consolidated Balance Sheets**

**March 31, 2006 and December 31, 2005**

Edgar Filing: BALLANTYNE OF OMAHA INC - Form 10-Q

	March 31, 2006 (Unaudited)	December 31, 2005
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 22,049,763	\$ 19,628,348
Accounts receivable (less allowance for doubtful accounts of \$440,943 in 2006 and \$420,223 in 2005)	6,587,272	7,821,085
Inventories, net	11,209,687	9,942,065
Deferred income taxes	1,354,818	1,247,609
Other current assets	349,434	430,411
Total current assets	41,550,974	39,069,518
Property, plant and equipment, net	5,218,775	5,379,933
Goodwill, net	2,467,219	2,467,219
Other assets	19,257	19,257
Total assets	\$ 49,256,225	\$ 46,935,927
<b>Liabilities and Stockholders Equity</b>		
Current liabilities:		
Current portion of long-term debt	\$ 28,239	\$ 27,761
Accounts payable	3,494,727	2,212,056
Warranty reserves	690,162	680,017
Accrued group health insurance claims	190,836	275,468
Accrued bonuses	42,621	983,235
Other accrued expenses	2,155,215	1,663,708
Customer deposits	374,681	536,724
Income tax payable	515,022	63,217
Total current liabilities	7,491,503	6,442,186
Long-term debt, net of current portion	7,367	14,609
Deferred income taxes	118,574	156,912
Other accrued expenses, net of current portion	328,800	324,715
Total liabilities	7,946,244	6,938,422
Commitments and contingencies		
Stockholders equity:		
Preferred stock, par value \$.01 per share; Authorized 1,000,000 shares, none outstanding		
Common stock, par value \$.01 per share; Authorized 25,000,000 shares; issued 15,627,836 shares in 2006 and 15,495,336 shares in 2005	156,278	154,953
Additional paid-in capital	33,807,416	33,411,013
Retained earnings	22,661,741	21,746,993
	56,625,435	55,312,959
Less 2,097,805 common shares in treasury, at cost	(15,315,454)	(15,315,454)
Total stockholders equity	41,309,981	39,997,505
Total liabilities and stockholders equity	\$ 49,256,225	\$ 46,935,927

See accompanying notes to consolidated financial statements.

## Ballantyne of Omaha, Inc. and Subsidiaries

## Consolidated Statements of Operations

Three Months Ended March 31, 2006 and 2005

(Unaudited)

	2006	2005
Net revenues	\$ 12,433,338	\$ 12,511,869
Cost of revenues	9,102,371	9,117,278
Gross profit	3,330,967	3,394,591
Selling and administrative expenses:		
Selling	734,523	739,412
Administrative	1,369,684	1,194,412
Total selling and administrative expenses	2,104,207	1,933,824
Income from operations	1,226,760	1,460,767
Interest income	166,185	72,152
Interest expense	(8,022)	(8,656)
Other income (expense), net	18,880	(29,519)
Income before income taxes	1,403,803	1,494,744
Income tax expense	(489,055)	(552,830)
Net income	\$ 914,748	\$ 941,914
Basic earnings per share	\$ 0.07	\$ 0.07
Diluted earnings per share	\$ 0.07	\$ 0.07
Weighted average shares outstanding:		
Basic	13,440,500	13,050,733
Diluted	13,947,291	13,840,719

See accompanying notes to consolidated financial statements.

## Ballantyne of Omaha, Inc. and Subsidiaries

## Consolidated Statements of Cash Flows

Three Months Ended March 31, 2006 and 2005

(Unaudited)

	2006	2005
Cash flows from operating activities:		
Net income	\$ 914,748	\$ 941,914
Adjustments to reconcile net income to net cash provided by operating activities:		
Provision for doubtful accounts	18,750	(69,301)
Depreciation of property, plant and equipment	279,934	281,405
Other amortization		10,066
Deferred income taxes	(145,547)	14,360
Share-based compensation	31,723	
Excess tax benefits from stock options exercised	(180,397)	
Changes in assets and liabilities:		
Accounts receivable	1,215,063	493,592
Inventories	(1,267,622)	(257,400)
Other current assets	80,977	125,296
Accounts payable	1,282,671	546,334
Warranty reserves	10,145	8,212
Accrued group health insurance claims	(84,632)	(28,088)
Accrued bonuses	(940,614)	(628,878)
Other accrued expenses	487,650	159,279
Customer deposits	(162,043)	(122,207)
Current income taxes	632,202	476,069
Other assets		1,500
Net cash provided by operating activities	2,173,008	1,952,153
Cash flows from investing activities:		
Capital expenditures	(118,776)	(83,020)
Net cash used in investing activities	(118,776)	(83,020)
Cash flows from financing activities:		
Payments on long-term debt	(6,764)	(6,321)
Proceeds from exercise of stock options	193,550	224,625
Excess tax benefits from stock options exercised	180,397	
Net cash provided by financing activities	367,183	218,304
Net increase in cash and cash equivalents	2,421,415	2,087,437
Cash and cash equivalents at beginning of period	19,628,348	14,031,984
Cash and cash equivalents at end of period	\$ 22,049,763	\$ 16,119,421

See accompanying notes to consolidated financial statements.

**Ballantyne of Omaha, Inc. and Subsidiaries**

**Notes to Consolidated Financial Statements**

**Three Months Ended March 31, 2006 and 2005**

**(Unaudited)**

**1. Company**

Ballantyne of Omaha, Inc., a Delaware corporation ( Ballantyne or the Company ), and its wholly-owned subsidiaries Strong Westrex, Inc., and Design & Manufacturing, Inc., design, develop, manufacture and distribute commercial motion picture equipment and lighting systems and distribute restaurant products. The Company s products are distributed to movie exhibition companies, sports arenas, auditoriums, amusement parks, special venues, and the food service industry. Refer to the Business Segment Section (note 11) for further information.

**2. Summary of Significant Accounting Policies**

The principal accounting policies upon which the accompanying consolidated financial statements are based are summarized as follows:

a. Basis of Presentation and Principles of Consolidation

The consolidated financial statements included herein are presented in accordance with the requirements of Form 10-Q and consequently do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America for annual reporting purposes or those made in the Company s annual Form 10-K filing. These consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Form 10-K for fiscal 2005.

In the opinion of management, the unaudited consolidated financial statements of the Company reflect all adjustments of a normal recurring nature necessary to present a fair statement of the financial position and the results of operations and cash flows for the respective interim periods. The results for interim periods are not necessarily indicative of trends or results expected for a full year.

b. Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results and changes in facts and circumstances may alter such estimates and affect results of operations and financial



position in future periods.

c. Allowance for Doubtful Accounts

Accounts receivable are presented net of allowance for doubtful accounts of \$440,943 and \$420,223 at March 31, 2006 and December 31, 2005, respectively. This allowance is developed based on several factors including overall customer credit quality, historical write-off experience and a specific analysis that projects the ultimate collectibility of the account. As such, these factors may change over time causing the reserve level to adjust accordingly.

d. Inventories

Inventories are stated at the lower of cost (first-in, first-out) or market and include appropriate elements of material, labor and manufacturing overhead. Inventory balances are net of reserves of slow moving or obsolete inventory estimated based on management's review of inventories on hand compared to estimated future usage and sales.

e. Goodwill

The Company capitalizes and includes in intangible assets the excess of cost over the fair value of net identifiable assets of operations acquired through purchase transactions ( goodwill ) in accordance with the provisions of Statement of Financial Accounting Standards ( SFAS ) No. 142, *Goodwill and Other Intangible Assets*. SFAS No. 142 requires goodwill no longer be amortized to earnings, but instead be reviewed at least annually for impairment. An impairment loss is recognized to the extent that the carrying amount exceeds the asset's estimated fair value.

f. Property, Plant and Equipment

Significant expenditures for the replacement or expansion of property, plant and equipment are capitalized. Depreciation of property, plant and equipment is provided over the estimated useful lives of the respective assets using the straight-line method. For financial reporting purposes, assets are depreciated over the estimated useful lives of 20 years for buildings and improvements, 3 to 10 years for machinery and equipment, 7 years for furniture and fixtures and 3 years for computers and accessories. The Company generally uses accelerated methods of depreciation for income tax purposes.

g. Income Taxes

Income taxes are accounted for under the asset and liability method. The Company uses an estimate of its annual effective rate at each interim period based on the facts and circumstances at the time while the actual effective rate is calculated at year-end. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized.

h. Revenue Recognition

The Company recognizes revenue from product sales upon shipment to the customer when collectibility is reasonably assured. Revenues related to services are recognized as earned over the terms of the contracts or delivery of the service to the customer.

The Company enters into transactions that represent multiple element arrangements, which may include a combination of services and asset sales. Under EITF 00-21, *Revenue Arrangements with Multiple Deliverables*, multiple element arrangements are assessed to determine whether they can be separated into more than one unit of accounting. A multiple element arrangement is separated into more than one unit of accounting if all of the following criteria are met.

The delivered item(s) has value on a standalone basis;

There is objective and reliable evidence of the fair value of the undelivered item(s);

If the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is considered probable and substantially in the control of the Company.

If these criteria are not met, then revenue is deferred until such criteria are met or until the period(s) over which the last undelivered element is delivered. If there is objective and reliable evidence of fair value for all units of accounting in an arrangement, the arrangement consideration is allocated to the separate units of accounting based on each unit's relative fair value. There may be cases, however, in which there is objective and reliable evidence of fair value of the undelivered item(s) but no such evidence for the delivered item(s). In those cases, the residual method is used to allocate the arrangement consideration. Under the residual method, the amount of consideration allocated to the delivered item(s) equals the total arrangement consideration less the aggregate fair value of the undelivered item.

i. Fair Value of Financial Instruments

The fair value of a financial instrument is the amount at which the instruments could be exchanged in a current transaction between willing parties. All financial instruments reported in the consolidated balance sheets equal or approximate their fair values.

j. Cash and Cash Equivalents

All highly liquid financial instruments with maturities of three months or less from date of purchase are classified as cash equivalents in the consolidated balance sheets and statements of cash flows.

k. Earnings Per Common Share

The Company computes and presents earnings per share in accordance with SFAS No. 128, *Earnings Per Share*. Basic earnings per share has been computed on the basis of the weighted average number of shares of common stock outstanding. Diluted earnings per share has been computed on the basis of the weighted average number of shares of common stock outstanding after giving effect to potential common shares from dilutive stock options. The following table provides a reconciliation between basic and diluted earnings per share:

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
Basic earnings per share:		
Earnings applicable to common stock	\$ 914,748	\$ 941,914
Weighted average common shares outstanding	13,440,500	13,050,733
Basic earnings per share	\$ 0.07	\$ 0.07

Edgar Filing: BALLANTYNE OF OMAHA INC - Form 10-Q

Diluted earnings per share:			
Earnings applicable to common stock	\$	914,748	\$ 941,914
Weighted average common shares outstanding		13,440,500	13,050,733
Assuming conversion of options outstanding		506,791	789,986
Weighted average common shares outstanding, as adjusted		13,947,291	13,840,719
Diluted earnings per share	\$	0.07	\$ 0.07

At March 31, 2006, options to purchase 286,733 shares of common stock at a weighted average price of \$8.15 per share were outstanding, but were not included in the computation of diluted earnings per share for the three months ended March 31, 2006 as the options' exercise price was greater than the average market price of the common shares. These options expire between January 2007 and May 2010. At March 31, 2005, options to purchase 197,925 shares of common stock at a weighted average price of \$9.74 per share were outstanding, but were not included in the computation of diluted earnings per share for the three months ended March 31, 2005.

#### I. Share-Based Payments

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R ( SFAS 123R ), Share-Based Payments, which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. SFAS 123R supersedes the Company's previous accounting methodology using the intrinsic value method under Accounting Principles Board Opinion No. 25 ( APB 25 ), Accounting for Stock Issued to Employees. Under the intrinsic value method, no share-based compensation expense related to stock option awards granted to employees had been recognized in the Company's consolidated statements of operations, as all stock option awards granted under the plans had an exercise price equal to the market value of the common stock on the date of the grant.

The Company adopted SFAS 123R using the modified prospective transition method. Under this transition method, compensation expense recognized during the three months ended March 31, 2006 included: (a) compensation expense for all share-based awards granted prior to, but not yet vested, as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation expense for all share-based awards granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. The Company did not grant options during the three months ended March 31, 2006. In accordance with the modified prospective transition method, the Company's consolidated financial statements for prior periods have not been restated to reflect the impact of SFAS 123R.

On November 10, 2005 the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position No. 123R-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards. The Company has elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of share-based compensation pursuant to SFAS 123R. The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool ( APIC Pool ) related to the tax effects of employee share-based compensation, and to determine the subsequent impact on the APIC Pool and consolidated statements of cash flows of the tax effects of employee and director share-based awards that are outstanding upon adoption of SFAS 123R.

#### *Options*

The Company currently has a 2001 Non-Employee Directors Stock Option Plan ( 2001 Directors Plan ) and a 2005 Outside Directors Stock Option Plan ( 2005 Outside Directors Plan ) which have been approved by the Company's stockholders. The Company also had a 1995 Employee Stock Option Plan and a 1995 Directors Stock Plan which expired in 2005, however, there are outstanding stock options under these two expired plans.

All past and future grants under the Company's stock option plans are granted at prices based on the fair market value of the Company's common stock on the date of grant. The outstanding options generally vest over periods ranging from zero to three years from the grant date and expire between 5 and 10 years.



No options have been granted under the 2005 Outside Directors Plan and all options granted under the 2001 Directors Plan and the 1995 Employee Stock Option Plan were fully vested, based on their original terms, prior to January 1, 2006. As such, no compensation expense related to those options has been recognized under SFAS 123R. The 1995 Outside Directors Stock Plan had 47,250 shares outstanding not yet vested at January 1, 2006 and were subject to the recognition of compensation expense.

A total of 1,152,940 shares of common stock have been reserved for issuance pursuant to the Company's stock option plans at March 31, 2006.

The Company records compensation expense for stock options based on the estimated fair value of the options on the date of grant using the Black-Scholes option-pricing model. The Company uses historical data among other factors to estimate the expected price volatility, the expected option life and the expected forfeiture rate. The risk-free rate is based on the U.S. Treasury yield in effect at the time of grant for the estimated life of the option. The Company has not and is not expected to pay cash dividends in the future. The Company did not grant stock options during the three months ended March 31, 2006 and 2005.

The following table summarizes the Company's activities with respect to its stock options for the first three months of 2006 as follows:

	Number of Shares	Weighted Average Exercise Price Per Share	Weighted- Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 1, 2006	987,078	\$ 2.86		
Exercised	(132,500)	\$ 1.46		
Forfeited		\$		
Outstanding at March 31, 2006	854,578	\$ 3.08	3.73	\$ 2,208,023
Exercisable at March 31, 2006	807,328	\$ 2.98	3.71	\$ 2,208,023

The total intrinsic value for options exercised during the three months ended March 31, 2006 and 2005 was \$563,145 and \$550,373, respectively. As of March 31, 2006, the total unrecognized compensation cost related to non-vested stock option awards was approximately \$53,011 and is expected to be recognized over a weighted average period of 14 months.

Cash received from option exercises under all plans for the three months ended March 31, 2006 and 2005 was approximately \$193,550 and \$224,625, respectively. The actual tax benefit realized for the tax deductions from option exercises under all plans totaled approximately \$180,397 and \$189,186, respectively, for three months ended March 31, 2006 and 2005.

#### *Restricted Stock Plan*

During 2005, the Company adopted and the stockholders approved, the 2005 Restricted Plan. Under terms of the plan, the compensation committee of the Board of Directors selects which employees of the Company are to receive restricted stock awards and the terms of such awards. The total number of shares reserved for issuance under the plan is 250,000 shares. There have been no shares issued under the plan through March 31, 2006. The plan expires in September 2010.





*Employee Stock Purchase Plan*

The Company's Employee Stock Purchase Plan, approved by the stockholders, provides for the purchase of shares of Ballantyne common stock by eligible employees at a per share purchase price equal to 85% of the fair market value of a share of Ballantyne common stock at either the beginning or end of the offering period, as defined, whichever is lower. Purchases are made through payroll deductions of up to 10% of each participating employee's salary. The number of shares that can be purchased by participants in any offering period is 2,000 shares. Additionally, the Plan has set certain limits, as defined, in regard to the number of shares that may be purchased by all eligible employees during an offering period. At March 31, 2006, 150,000 shares of common stock remained available for issuance under the Plan. The Plan expires in September 2010. The total estimated grant date fair value of purchase rights outstanding under the Employee Stock Purchase Plan was \$2.07 using the Black-Scholes option-pricing model made with the following weighted average assumptions: risk-free interest rate 4.31%; dividend yield 0%; expected volatility 43.4% and expected life in years 1. At March 31, 2006, total unrecognized estimated compensation cost was \$29,159 which is expected to be recognized over a period of 7 months.

*Share-Based Compensation Expense*

The table below shows the amounts recognized in the financial statements for the three months ended March 31, 2006 for share-based compensation related to employees and directors.

	<b>Three Months Ended March 31, 2006</b>	
Total cost of share-based compensation included in selling and administrative expenses, before income tax	\$	31,723
Amount of income tax benefit recognized		(9,240)
Amount charged against net income	\$	22,483
<b>Impact on earnings share:</b>		
Basic	\$	(0.00)
Diluted	\$	(0.00)

There were no amounts relating to share-based compensation capitalized in inventory during the three months ended March 31, 2006.

*Pro Forma Share-Based Compensation Expense*

Prior to December 31, 2005, the Company accounted for share-based compensation arrangements in accordance with the provisions and related interpretations of APB 25. Had compensation cost for share-based awards been determined consistent with SFAS No. 123R, the net income and earnings per share would have been adjusted to the following pro forma amounts:

	<b>Three Months Ended March 31, 2005</b>	
Net income, as reported	\$	941,914
Deduct: Total share-based compensation expense determined under fair value based method for all awards, net of related tax effects		(37,595)
Pro forma net income	\$	904,319
Earnings per share:		
Basic-as reported	\$	0.07
Basic-pro forma	\$	0.07
Diluted-as reported	\$	0.07
Diluted-pro forma	\$	0.07

## m. Impairment of Long-Lived Assets

The Company reviews long-lived assets, exclusive of goodwill, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable in accordance with SFAS No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount of the assets exceeds their fair value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

The Company's most significant long-lived assets subject to these periodic assessments of recoverability are property, plant and equipment, which have a net book value of \$5.2 million at March 31, 2006. Because the recoverability of property, plant and equipment is based on estimates of future undiscounted cash flows, these estimates may vary due to a number of factors, some of which may be outside of management's control. To the extent that the Company is unable to achieve management's forecasts of future income, it may become necessary to record impairment losses for any excess of the net book value of property, plant and equipment over its fair value.

## n. Warranty Reserves

The Company generally grants a warranty to its customers for a one-year period following the sale of all new equipment, and on selected repaired equipment for a one-year period following the repair. The warranty period is extended under certain circumstances and for certain products. The Company accrues for these costs at the time of sale or repair, when events dictate that additional accruals are necessary.



The following table summarizes warranty activity for the periods indicated below:

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
Balance at beginning of period	\$ 680,017	\$ 668,268
Charged to expense	57,750	69,245
Amounts written off, net of recoveries	(47,605)	(61,033)
Balance at end of period	\$ 690,162	\$ 676,480

o. Comprehensive Income

The Company's comprehensive income consists solely of net income. All other items were not material to the consolidated financial statements.

p. Litigation

During March 2006, Ballantyne settled an asbestos case entitled *Bercu v. BICC Cables Corporation, et al.*, originally filed June 27, 2003 in the Supreme Court of the State of New York. The settlement amount was not material to the Company's results of operations, financial position or cash flows.

Ballantyne is a party to various other legal actions which are ordinary routine litigation matters incidental to the Company's business, such as products liability. Based on currently available information, management believes that the ultimate outcome of these matters individually and in the aggregate, will not have a material adverse effect on the Company's results of operations, financial position or cash flows.

q. Environmental

The Company is subject to various federal, state and local laws and regulations pertaining to environmental protection and the discharge of material into the environment. During 2001, Ballantyne was informed by a neighboring company of likely contaminated soil on certain parcels of land adjacent to Ballantyne's main manufacturing facility in Omaha, Nebraska. The Environmental Protection Agency and the Nebraska Health and Human Services System subsequently determined that certain parcels of Ballantyne property had various levels of contaminated soil relating to a former pesticide company which previously owned the property and that burned down in the 1960's. During October 2004, Ballantyne agreed to enter into an Administrative Order on Consent (AOC) to resolve the matter. The AOC holds Ballantyne and two other parties jointly and severally responsible for the cleanup. In this regard, the three parties have also entered into a Site Allocation Agreement by which they will divide past, current and future costs of the EPA, the costs of remediation and the cost of long term maintenance. In connection with the AOC, the Company has paid its share of the costs. At March 31, 2006, the Company has provided for management's estimate of any future payments relating to this matter which is not material to the consolidated financial statements.



r. Concentrations

The Company's top ten customers accounted for approximately 55% of 2006 consolidated net revenues. Trade accounts receivable from these customers represented approximately 62% of net consolidated receivables at March 31, 2006. Sales to AMC Theatres, Inc. and Regal Cinema, Inc. each represented over 10% of consolidated revenues. In addition, receivables from Vari International represented approximately 27% of net consolidated receivables at March 31, 2006. While the Company believes its relationships with such customers are stable, most arrangements are made by purchase order and are terminable at will by either party. A significant decrease or interruption in business from the Company's significant customers could have a material adverse effect on the Company's business, financial condition and results of operations. The Company could also be adversely affected by such factors as changes in foreign currency rates and weak economic and political conditions in each of the countries in which the Company sells its products.

s. Recently Issued Accounting Pronouncements

The Financial Accounting Standards Board (FASB) has adopted SFAS No. 151, *Inventory Costs* an Amendment of ARB No. 43, Chapter 4. The provisions of SFAS 151 are intended to eliminate narrow differences between the existing accounting standards of the FASB and the International Accounting Standards Board (IASB) related to inventory costs, in particular, the treatment of abnormal idle facility expense, freight, handling costs and spoilage. SFAS 151 requires that these costs be recognized as current period charges regardless of the extent to which they are considered abnormal. The provisions of SFAS 151 are effective for inventory costs incurred during fiscal years beginning after June 15, 2005. The adoption of SFAS 151 did not have a significant impact on the Company's results of operations, financial position or cash flows.

During 2005, the FASB issued SFAS No. 153, *Exchanges of Nonmonetary Assets* which eliminates the exception to the fair-value principle for exchanges of similar productive assets, which had been accounted for based on the book value of the asset surrendered with no gain recognition. Nonmonetary exchanges have to be accounted for at fair-value, recognizing any gain or loss, if the transactions meet the commercial-substance criterion and fair-value determinable. The Statement reduces the differences between U.S. and international accounting standards. This Statement is effective for nonmonetary asset exchanges occurring in fiscal periods beginning after June 15, 2005. The Company adopted this Statement in the first quarter of fiscal 2006 and the pronouncement did not have a material impact on the Company's consolidated financial position, results of operations or cash flows.

During 2005, the FASB issued SFAS No. 154, *Accounting Changes and Error Corrections* (SFAS 154). SFAS 154 is a replacement of Accounting Principles Board No. 20, *Accounting Changes* and FASB Statement No. 3 *Reporting Accounting Changes in Interim Financial Statement*. SFAS 154 provides guidance on the accounting for and reporting of accounting changes and error corrections. It establishes retrospective application as the required method for reporting a change in accounting principle. SFAS 154 provides guidance for determining whether retrospective application of a change in accounting principle is impracticable and for reporting a change when retrospective application is impracticable. The reporting of a correction of an error by restating previously issued financial statements is also addressed by SFAS 154. SFAS 154 is effective for accounting changes and corrections of errors made in fiscal years beginning after December 31, 2005. The Company adopted this pronouncement in the first quarter of 2006.

In December 2004, the FASB issued FASB Staff Position No. FAS 109-1 ( FSP FAS 109-1 ), Application of FASB Statement No. 109, Accounting for Income Taxes, to the Tax Deduction on Qualified Production Activities provided by the American Jobs Creation Act of 2004. FSP FAS 109-1 clarifies that the deduction will be treated as a special deduction as described in SFAS 109, Accounting for Income Taxes. As such, the special deduction has no effect on deferred tax assets and liabilities existing at the date of enactment. The impact of the deduction will be reported in the period in which the deduction is claimed. The incentive for U.S. qualified production activities included in the Act is effective as of December 21, 2004.

### 3. Intangible Assets

The Company's intangible assets at March 31, 2006 consisted entirely of goodwill which is not amortizable in accordance with SFAS No. 142. In applying SFAS No. 142, the Company performed the annual reassessment and impairment test in the fourth quarter of 2005 and determined that goodwill was not impaired. The goodwill is recorded at a cost of \$3,720,743 reduced by accumulated amortization of \$1,253,524 at March 31, 2006 and December 31, 2005, respectively.

The Company's amortizable intangible assets became fully amortized during 2005. The Company recorded amortization expense relating to identifiable intangible assets of \$0 and \$10,066 for the three months ending March 31, 2006 and 2005, respectively.

### 4. Inventories

Inventories consist of the following:

	<b>March 31, 2006</b>	<b>December 31, 2005</b>
Raw materials and components	\$ 7,892,863	\$ 7,008,791
Work in process	1,489,628	1,339,323
Finished goods	1,827,196	1,593,951
	\$ 11,209,687	\$ 9,942,065

The inventory balances are net of reserves for slow moving or obsolete inventory of approximately \$1,270,000 and \$1,138,000 as of March 31, 2006 and December 31, 2005, respectively.



## 5. Property, Plant and Equipment

Property, plant and equipment include the following:

	<b>March 31, 2006</b>	<b>December 31 2005</b>
Land	\$ 343,500	\$ 343,500
Buildings and improvements	4,699,981	4,699,981
Machinery and equipment	9,562,615	9,511,671
Office furniture and fixtures	2,276,370	2,212,273
Construction in process	33,184	39,155
	16,915,650	16,806,580
Less accumulated depreciation	11,696,875	11,426,647
Net property, plant and equipment	\$ 5,218,775	\$ 5,379,933

Depreciation expense amounted to \$279,934 and \$281,405 for the three months ending March 31, 2006 and 2005, respectively.

## 6. Debt

The Company is a party to a revolving credit facility with First National Bank of Omaha expiring August 28, 2006. The Company expects to renew the credit facility in the ordinary course of business. The credit facility provides for borrowings up to the lesser of \$4.0 million or amounts determined by an asset based lending formula, as defined. Borrowings available under the credit facility amounted to \$4.0 million at March 31, 2006. No amounts are currently outstanding. The Company would pay interest on outstanding amounts equal to the Prime Rate plus 0.25% (8.0% at March 31, 2006) and pays a fee of 0.125% on the unused portion. The credit facility contains certain restrictive covenants primarily related to maintaining certain earnings, as defined, and restrictions on acquisitions and dividends. All of the Company's personal property and stock in its subsidiaries secure this credit facility.

Long-term debt at March 31, 2006 consisted entirely of installment payments relating to the purchase of certain intangible assets. Future maturities of long-term debt for the remainder of fiscal 2006 and the remaining year in 2007 are \$20,998 and \$14,608, respectively.

## 7. Supplemental Cash Flow Information

Supplemental disclosures to the consolidated statements of cash flows are as follows:

<b>Three Months Ended March 31, 2006</b>	<b>2005</b>
--	-------------

Edgar Filing: BALLANTYNE OF OMAHA INC - Form 10-Q

Interest paid	\$	1,938	\$	2,488
Income taxes paid	\$	2,400	\$	62,401
Income tax benefit related to stock option plans	\$	180,397	\$	
Share-based compensation expense related to liability classified awards	\$	7,942	\$	

## 8. Stockholder Rights Plan

On May 26, 2000, the Board of Directors of the Company adopted a Stockholder Rights Plan (the Rights Plan). Under terms of the Rights Plan, which expires June 9, 2010, the Company declared a distribution of one right for each outstanding share of common stock. The rights become exercisable only if a person or group (other than certain exempt persons, as defined) acquires 15 percent or more of Ballantyne common stock or announces a tender offer for 15 percent or more of Ballantyne's common stock. Under certain circumstances, the Rights Plan allows stockholders, other than the acquiring person or group, to purchase the Company's common stock at an exercise price of half the market price.

## 9. Postretirement Health Care

The Company sponsors a postretirement health care plan (the Plan) for certain current and former executives and their spouses. The Company's policy is to fund the cost of the Plan as expenses are incurred. The costs of the postretirement benefits are accrued over the employees' service lives.

In accordance with SFAS No. 132, *Disclosures About Pensions and Other Postretirement Benefits*, the following table sets forth the components of the net period benefit cost for the three months ended March 31, 2006 and 2005:

	2006	2005
Service cost	\$ 3,116	\$ 3,051
Interest cost	6,083	6,196
Amortization of prior-service cost	6,718	6,718
Amortization of loss		934
Net periodic benefit cost	\$ 15,917	\$ 16,899

The Company expects to pay \$6,045 under the plan in 2006. As of March 31, 2006, benefits of \$348 have been paid.

In December 2003, the United States enacted into law the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act). The Act established a prescription drug benefit under Medicare, known as Medicare Part D and a federal subsidy to sponsors of retired healthcare benefit plans that provide a benefit that is at least actuarially equivalent to Medicare Part D. On May 19, 2004, the FASB issued Staff Position No. FAS-106-2, *Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003* (FSP-106-2), which requires measures of the accumulated postretirement benefit obligation and net periodic postretirement benefit costs to reflect the effects of the Act in the first interim or annual period beginning after June 15, 2004. On January 21, 2005, final regulations under the Act were issued. The effects of the Act did not have a material impact on the consolidated financial statements of the Company.

## 10. Self-Insurance

## Edgar Filing: BALLANTYNE OF OMAHA INC - Form 10-Q

The Company is self-insured up to certain stop loss limits for group health insurance. Accruals for claims incurred but not paid as of March 31, 2006 and December 31, 2005 are included in accrued group health insurance claims in the accompanying consolidated balance sheets. The Company's policy is to accrue the employee health benefit accruals based on historical information along with certain assumptions about future events.

## 11. Business Segment Information

The presentation of segment information reflects the manner in which management organizes segments for making operating decisions and assessing performance.

As of March 31, 2006, the Company's operations were conducted principally through three business segments: Theatre, Lighting and Restaurant. Theatre operations include the design, manufacture, assembly and sale of motion picture projectors, xenon lamphouses and power supplies, sound systems, film handling equipment and the sale of xenon lamps and lenses. The lighting segment operations include the design, manufacture, assembly and sale of follow spotlights, stationary searchlights and computer operated lighting systems for the motion picture production, television, live entertainment, theme parks and architectural industries. The restaurant segment includes the manufacture and sale of replacement parts and the sale of seasonings, marinades and barbeque sauces. The Company allocates resources to business segments and evaluates the performance of these segments based upon reported segment gross profit. However, certain key operations of a particular segment are tracked on the basis of operating profit. There are no significant intersegment sales. All intersegment transfers are recorded at historical cost.

## Summary by Business Segments

	Three Months Ended March 31,	
	2006	2005
<b>Net revenues</b>		
Theatre	\$ 11,132,206	\$ 11,471,203
Lighting	1,120,424	829,364
Restaurant	180,708	211,302
Total net revenues	\$ 12,433,338	\$ 12,511,869
<b>Gross profit</b>		
Theatre	\$ 2,932,970	\$ 3,060,270
Lighting	318,643	254,994
Restaurant	79,354	79,327
Total gross profit	3,330,967	3,394,591
Selling and administrative expenses	(2,104,207)	(1,933,824)
Operating income	1,226,760	1,460,767
Net interest income	158,163	63,496
Other income (expense), net	18,880	(29,519)
Income before income taxes	\$ 1,403,803	\$ 1,494,744
<b>Expenditures on capital equipment</b>		
Theatre	\$ 112,082	\$ 78,297
Lighting	6,694	4,723
Total	\$ 118,776	\$ 83,020
<b>Depreciation and amortization</b>		
Theatre	\$ 258,353	\$ 275,759
Lighting	21,581	15,712
Total	\$ 279,934	\$ 291,471
<b>Identifiable assets</b>		
	<b>March 31,</b>	<b>December 31,</b>
	<b>2006</b>	<b>2005</b>
Theatre	\$ 44,139,302	\$ 42,866,118
Lighting	4,362,660	3,382,738
Restaurant	754,263	687,071
Total	\$ 49,256,225	\$ 46,935,927

Summary by Geographical Area	Three Months Ended March 31,	
	2006	2005
Net revenue		
United States	\$ 9,297,051	\$ 8,600,561
Canada	70,622	264,346
Asia	1,641,048	1,965,814
Mexico and South America	1,098,280	1,427,934
Europe	310,077	223,150
Other	16,260	30,064
Total	\$ 12,433,338	\$ 12,511,869

Identifiable assets	March 31,	December 31,
	2006	2005
United States	\$ 47,747,423	\$ 44,910,526
Asia	1,508,802	2,025,401
Total	\$ 49,256,225	\$ 46,935,927

Net revenues by business segment are to unaffiliated customers. Net sales by geographical area are based on destination of sales. Identifiable assets by geographical area are based on location of facilities.

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

The following discussion and analysis should be read in conjunction with the consolidated financial statements and notes thereto appearing elsewhere in this report. Management's discussion and analysis contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 and Section 21E of the Securities Exchange Act of 1934 that involve risks and uncertainties, including but not limited to: quarterly fluctuations in results; customer demand for the Company's products; the development of new technology for alternate means of motion picture presentation; domestic and international economic conditions; the achievement of lower costs and expenses; the continued availability of financing in the amounts and on the terms required to support the Company's future business; credit concerns in the theatre exhibition industry; and other risks detailed from time to time in the Company's other Securities and Exchange Commission filings. Actual results may differ materially from management's expectations. The risks included here are not exhaustive. Other sections of this report may include additional factors which could adversely affect the Company's business and financial performance. Moreover, the Company operates in a very competitive and rapidly changing environment. New risk factors emerge from time to time and it is not possible for management to predict all such risk factors, nor can it assess the impact of all such risk factors on the Company's business or the extent to which any factor, or combination of factors, may cause actual results to differ materially from those contained in any forward-looking statements. Given these risks and uncertainties, investors should not place undue reliance on forward-looking statements as a prediction of actual results.

Investors should also be aware that while the Company does communicate with securities analysts from time to time, it is against its policy to disclose to them any material non-public information or other confidential information. Accordingly, investors should not assume that the Company agrees with any statement or report issued by any analyst irrespective of the content of the statement or report. Furthermore, the Company has a policy against issuing or confirming financial forecast or projections issued by others. Therefore, to the extent that reports issued by securities analysts contain any projections, forecasts or opinions, such reports are not the responsibility of the Company.

**Overview**

The Company designs, develops, manufactures and distributes commercial motion picture equipment and lighting systems and also distributes restaurant products. The Company business was founded in 1932.

The Company has three reportable core operating segments: theatre, lighting and restaurant. Approximately 90% of first quarter 2006 revenues were theatre products, 9% were lighting products and 1% were restaurant products.

**Critical Accounting Policies and Estimates**

**General**

Management's Discussion and Analysis of Financial Condition and Results of Operations is based upon the consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and the related disclosure of contingent assets and liabilities. Management bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the



Edgar Filing: BALLANTYNE OF OMAHA INC - Form 10-Q

carrying values of assets and liabilities that are not readily apparent from other sources. Senior management has discussed the development, selection and disclosure of these estimates with the Audit Committee of the Board of Directors. Actual results may differ from these estimates under different assumptions or conditions.

An accounting policy is deemed to be critical if it requires an accounting estimate to be made based on

assumptions about matters that are uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the consolidated financial statements.

The Company's accounting policies are discussed in note 2 to the consolidated financial statements in this report. Management believes the following critical accounting policies reflect its more significant estimates and assumptions used in the preparation of the consolidated financial statements.

### **Revenue Recognition**

The Company normally recognizes revenue upon shipment of goods or delivery of the service to customers when collectibility is reasonably assured. In certain circumstances revenue is not recognized until the goods are received by the customer or upon installation and customer acceptance based on the terms of the sale agreement. During 2003, the Company adopted the provisions of EITF 00-21, *Revenue Arrangements With Multiple Deliverables* (EITF 00-21). EITF 00-21 addresses certain aspects of revenue recognition on contracts with multiple deliverable elements.

### **Allowance for Doubtful Accounts**

The Company makes judgments about the credit worthiness of both current and prospective customers based on ongoing credit evaluations performed by the Company's credit department. These evaluations include, but are not limited to, reviewing customers' prior payment history, analyzing credit applications, monitoring the aging of receivables from current customers and reviewing financial statements, if applicable. The allowance for doubtful accounts is developed based on several factors including overall customer credit quality, historical write-off experience and a specific account analysis that project the ultimate collectibility of the accounts. As such, these factors may change over time causing the reserve level to adjust accordingly. When it is determined that a customer is unlikely to pay, a charge is recorded to bad debt expense in the consolidated statements of operations and the allowance for doubtful accounts is increased. When it becomes certain the customer cannot pay, the receivable is written off by removing the accounts receivable amount and reducing the allowance for doubtful accounts accordingly.

At March 31, 2006, there were approximately \$7.0 million in gross outstanding accounts receivable and \$0.4 million recorded in the allowance for doubtful accounts. At December 31, 2005, there were approximately \$8.2 million in gross outstanding accounts receivable and \$0.4 million recorded in the allowance for doubtful accounts to cover potential future customer non-payments. If economic conditions deteriorate significantly or if one of the Company's large customers were to declare bankruptcy, a larger allowance for doubtful accounts might be necessary.

### **Inventory Valuation**

Inventories are stated at the lower of cost (first-in, first-out) or market and include appropriate elements of material, labor and overhead. The Company's policy is to evaluate all inventory quantities for amounts on-hand that are potentially in excess of estimated usage requirements, and to write down any excess quantities to estimated net realizable value. Inherent in the estimates of net realizable values are management's estimates related to the Company's future manufacturing schedules, customer demand and the development of digital technology, which could

make the Company's theatre products obsolete, among other items. Management has managed these risks in the past and believes that it can manage them in the future, however, operating margins may suffer if they are unable to effectively manage these risks. At March 31, 2006 the Company had recorded gross inventory of approximately \$12.5 million and \$1.3 million of inventory reserves. This compared to \$11.0 million and \$1.1 million, respectively, at December 31, 2005.

### **Warranty**

The Company's products must meet certain product quality and performance criteria. In addition to known claims or warranty issues, the Company estimates future claims on recent sales. The Company

relies on historical product claims data to estimate the cost of product warranties at the time revenue is recognized. In determining the accrual for the estimated cost of warranty claims, the Company considers experience with: 1) costs for replacement parts; 2) costs of scrapping defective products; 3) the number of product units subject to warranty claims and 4) other direct costs associated with warranty claims. If the cost to repair a product or the number of products subject to warranty claims is greater than originally estimated, the Company's accrued cost for warranty claims would increase.

At March 31, 2006, the warranty accrual amounted to \$0.7 million and the amount charged to expense for the three months ending March 31, 2006 was approximately \$58,000. At March 31, 2005, the warranty accrual amounted to \$0.7 million and the amount charged to expense for the three months ending March 31, 2005 was approximately \$69,000.

### **Long-lived Assets**

The Company reviews long-lived assets, exclusive of goodwill, for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds their fair value. Assets to be disposed of are reported at the lower of the carrying amount or fair value less costs to sell.

The Company's most significant long-lived assets subject to these periodic assessments of recoverability are property, plant and equipment, which have a net book value of \$5.2 million at March 31, 2006. Because the recoverability of property, plant and equipment is based on estimates of future undiscounted cash flows, these estimates may vary due to a number of factors, some of which may be outside of management's control. To the extent that the Company is unable to achieve management's forecasts of future income, it may become necessary to record impairment losses for any excess of the net book value of property, plant and equipment over its fair value.

### **Goodwill**

In accordance with SFAS No. 142, the Company evaluates its goodwill for impairment on an annual basis based on values at the end of the fourth quarter or whenever indicators of impairment exist. The Company has evaluated its goodwill for impairment in the fourth quarter of fiscal 2005 and determined that the fair value of the reporting units exceeded their carrying value, so no impairment of goodwill was recognized. Goodwill of approximately \$2.5 million is included in the consolidated balance sheets at March 31, 2006 and December 31, 2005. Management's assumptions about future cash flows for the reporting units require significant judgment and actual cash flows in the future may differ significantly from those forecasted today.

### **Deferred Income Taxes**

Income taxes are accounted for under the asset and liability method. The Company uses an estimate of its annual effective rate at each interim period based on the facts and circumstances known at the time, while the actual effective rate is calculated at year-end. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are

Edgar Filing: BALLANTYNE OF OMAHA INC - Form 10-Q

measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

### **Self-insurance Reserves**

The Company is partially self-insured for certain employee health benefits. The related liabilities are included in the accompanying consolidated financial statements. The Company's policy is to accrue the liabilities based on historical information along with certain assumptions about future events.

### **Share-based Compensation**

Effective January 1, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 123R ( SFAS 123R ), Share-Based Payments, which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors based on estimated fair values. SFAS 123R supersedes the Company's previous accounting methodology using the intrinsic value method under Accounting Principles Board Opinion No. 25 ( APB 25 ), Accounting for Stock Issued to Employees. Under the intrinsic value method, no share-based compensation expense related to stock option awards granted to employees had been recognized in the Company's consolidated statements of operations, as all stock option awards granted under the plans had an exercise price equal to the market value of the common stock on the date of the grant.

The Company adopted SFAS 123R using the modified prospective transition method. Under this transition method, compensation expense recognized during the three months ended March 31, 2006 included: (a) compensation expense for all share-based awards granted prior to, but not yet vested, as of December 31, 2005, based on the grant date fair value estimated in accordance with the original provisions of SFAS 123, and (b) compensation expense for all share-based awards granted subsequent to December 31, 2005, based on the grant date fair value estimated in accordance with the provisions of SFAS 123R. In accordance with the modified prospective transition method, the Company's consolidated financial statements for prior periods have not been restated to reflect the impact of SFAS 123R. The Company recorded \$31,723 of share-based compensation expense during the three months ended March 31, 2006 upon adoption of SFAS 123R.

On November 10, 2005 the Financial Accounting Standards Board ( FASB ) issued FASB Staff Position No. 123R-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards. The Company has elected to adopt the alternative transition method provided in the FASB Staff Position for calculating the tax effects of share-based compensation pursuant to SFAS 123R. The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool ( APIC Pool ) related to the tax effects of employee share-based compensation, and to determine the subsequent impact on the APIC Pool and consolidated statements of cash flows of the tax effects of employee and director share-based awards that are outstanding upon adoption of SFAS 123R.

### **Recent Accounting Pronouncements**

See note 2 to the consolidated financial statements for a full description of recent accounting pronouncements including the respective expected dates of adoption and effects on results of operations and financial condition.

**Three Months Ended March 31, 2006 Compared to the Three Months Ended March 31, 2005****Revenues**

Net revenues in 2006 decreased to \$12.4 million from \$12.5 million in 2005. As discussed in further detail below, the decrease resulted primarily from lower theatre revenues.

	<b>Three Months Ended March 31,</b>	
	<b>2006</b>	<b>2005</b>
Theatre	\$ 11,132,206	\$ 11,471,203
Lighting	1,120,424	829,364
Restaurant	180,708	211,302
Total net revenues	\$ 12,433,338	\$ 12,511,869

Theatre Segment

Sales of theatre products decreased 3.0% from \$11.5 million in 2005 to \$11.1 million in 2006 due to lower demand for projection equipment which decreased to \$7.3 million in 2006 from \$8.1 million in 2005. The Company has begun to see the theatre exhibition industry's transition to digital cinema. Theatre owners appear to be evaluating their options as they plan capital expenditures relative to new or used film projectors or digital equipment. In large part, the decrease in theatre revenues pertain to this uncertainty as certain customers have either delayed or cancelled previous film projector orders with the Company. While digital cinema remains a critical component of the Company's long-term growth strategy, management is unsure how the transition will affect revenues during the rest of fiscal 2006.

Sales of xenon lamps rose 33.5% in 2006 to \$1.4 million from \$1.1 million a year ago primarily a result of the Company gaining market share and a general improvement of the theatre exhibition industry.

Sales of lenses rose 7.8% in 2006 to \$0.6 million from \$0.5 million a year ago.

Sales of theatre replacement parts amounted to \$1.8 million in 2006 compared to \$1.7 million in 2005.

The Company's top ten theatre customers accounted for approximately 53% of total theatre revenues compared to 52% in 2005.

Lighting Segment

Sales of lighting products rose 35.1% to \$1.1 million in 2006 from \$0.8 million a year ago. The increase primarily pertains to higher revenues from britelights, sky-trackers and replacement parts. Spotlight sales were flat at \$0.4 million for both 2006 and 2005 periods. The increase in britelight sales was due to a \$0.2 million sale of 10K lights to be used by NASA. Sky-tracker revenues rose to approximately \$0.2 million in 2006 from \$0.1 million in 2005 due to higher demand for these large lights. Replacement parts also rose to \$0.2 million from \$0.1 million a year-ago due primarily to improved industry conditions.

Sales of all other lighting products, including but not limited to, xenon lamps and nocturns fell to \$0.1 million from \$0.2 million a year-ago, as the Company experienced weaker demand for xenon lamps in the lighting segment.



Restaurant Segment

Sales of restaurant products amounted to \$0.2 million in both 2006 and 2005 as sales of both replacement parts and marinades were comparable to last year.

**Export Revenues**

Sales outside the United States (mainly theatre sales) declined to \$3.1 million in 2006 from \$3.9 million in 2005, due to lower demand in Mexico, South America, Asia and Canada. Export sales are sensitive to worldwide economic and political conditions that can lead to volatility. Additionally, certain areas of the world are more cost conscious than the U.S. market and there are instances where Ballantyne's products are priced higher than local manufacturers making it more difficult to generate sufficient profit to justify selling into these regions. Additionally, foreign exchange rates and excise taxes sometimes make it difficult to market the Company's products overseas at reasonable selling prices.

**Gross Profit**

Consolidated gross profit decreased to \$3.3 million in 2006 from \$3.4 million in 2005 and as a percent of revenue declined to 26.8% from 27.1% in 2005.

Gross profit in the theatre segment fell to \$2.9 million in 2006 from \$3.1 million in 2005 and as a percentage of sales declined to 26.3% from 26.7% a year ago. The results reflect lower production demand in the manufacturing plant in Omaha which resulted in the Company not covering fixed overhead costs in a productive manner and certain manufacturing inefficiencies. The Company has reduced production personnel and is working towards bringing in other products to manufacture to offset expected lower demand for analog projectors in the future.

Gross profit in the lighting segment was approximately \$0.3 million in both 2006 and 2005 but as a percent of revenues fell to 28.4% from 30.7%. The results reflect a less favorable product mix consisting of higher revenues of lighting equipment as opposed to higher-margin replacement part sales. The Company also experienced manufacturing inefficiencies as the decline in theatre projection equipment sales had a ripple effect throughout the manufacturing plant in Omaha.

Restaurant margins were at approximately \$0.1 million for both the 2006 and 2005 periods. The results were expected as the Company is now only selling coater, marinades and replacement parts.

**Selling and Administrative Expenses**

## Edgar Filing: BALLANTYNE OF OMAHA INC - Form 10-Q

Selling and administrative expenses amounted to \$2.1 million in 2006 compared to \$1.9 million in 2005 and as a percent of revenue rose to 16.9% in 2006 from 15.5% in 2005.

Administrative costs rose to \$1.4 million or 11.0% of revenue compared to \$1.2 million or 9.5% a year ago. The increase was primarily due to employee severance costs incurred as a result of planned workforce reductions as well as for legal expenses to settle the Company's remaining asbestos lawsuit. Compliance and compensation costs were also higher during 2006 but were offset to a degree by lower bonus expenses.

Selling expenses amounted to \$0.7 million in both 2006 and 2005 periods and as a percent of revenues remained at 5.9%.

**Other Financial Items**

Net other income amounted to \$18,900 in 2006 compared to net other expense of \$29,500 in 2005 as the Company received an insurance settlement during 2006 and gave fewer cash discounts to customers in 2006.

During 2006, the Company recorded interest income of \$166,000 compared to \$72,000 in 2005 as the Company earned interest from higher cash levels. Interest expense declined to \$8,000 in 2006 from \$8,700 in 2005.

The Company recorded income tax expense of \$0.5 million in 2006 compared to \$0.6 million in 2005. The effective tax rate declined to 34.8% in 2006 compared to 37.0% a year-ago due primarily to the Company investing in more tax-free municipal bonds during 2006.

For the reasons outlined herein, the Company earned net income of \$0.9 million and basic and diluted earnings per share of \$0.07 in both 2006 and 2005, respectively.

**Three Months Ended March 31, 2005 Compared to the Three Months Ended March 31, 2004****Revenues**

Net revenues in 2005 increased 10.7% to \$12.5 million from \$11.3 million in 2004. As discussed in further detail below, the increase resulted primarily from higher revenues from theatre products.

	<b>Three Months Ended March 31,</b>	
	<b>2005</b>	<b>2004</b>
Theatre	\$ 11,471,203	\$ 10,384,132
Lighting	829,364	605,202
Restaurant	211,302	308,078
Total net revenue	\$ 12,511,869	\$ 11,297,412

**Theatre Segment**

Sales of theatre products increased 10.5% from \$10.4 million in 2004 to \$11.5 million in 2005. In particular, sales of projection equipment increased to \$8.1 million in 2005 from \$7.2 million in 2004, due to a combination of improved demand domestically coupled with higher sales in Asia and Mexico and South America. The Company's top ten theatre customers accounted for approximately 52% of total theatre revenues compared to 59% in 2004.

Sales of theatre replacement parts declined 2.7% from approximately \$1.8 million in 2004 to approximately \$1.7 million in 2005 but are expected to increase as the year progresses.

Sales of xenon lamps to the theatre industry rose 28.3% to \$1.1 million from \$0.8 million a year-ago primarily as a result of the continuing improvement of the theatre industry in general, increased marketing of the product line and increased sales to the larger theatre exhibitors. The Company has also increased exposure by selling these lamps via an internet website.

Sales of lenses to theatre customers were flat at \$0.5 million for both 2005 and 2004 periods.

#### Lighting Segment

Sales of lighting products increased 37.0% to \$0.8 million from \$0.6 million a year-ago primarily due to sales of follow spotlights which rose to \$0.4 million from \$0.1 million a year-ago. The Company is developing or marketing new spotlight products that are less expensive, smaller and more user-friendly to respond to the changing nature of the spotlight industry. The Company is also modifying how its core

spotlight products, the Super Trouper® and Gladiator®, are marketed as it believes these industry leading products still have a long market life ahead.

Sales of Skytracker® products declined to \$0.1 million in 2005 from \$0.3 million in 2004 primarily as a result of a special sale of lights for the Staples Center in Los Angeles during 2004 which did not reoccur in 2005.

Sales of all other lighting products, including but not limited to, replacement parts, xenon lamps, Nocturns® and Britelights®, increased to \$0.3 million in 2005 from \$0.2 million in 2004.

#### Restaurant Segment

Restaurant sales fell to \$0.2 million in 2005 from \$0.3 million in 2004, a result of the Company's decision to phase out its unprofitable equipment product line comprised of smokers, ventilation hoods and pressure fryers. The only sales pertaining to the equipment product line consist of divesting the remaining inventory on hand. The Company continues to supply parts to its installed customer base and also continues to distribute its Flavor Crisp® marinade and breading products as well as support its Chicken-On-The-Run and BBQ-On-The-Run programs.

#### **Export Revenues**

Sales outside the United States (mainly theatre sales) rose to \$3.9 million in 2005 from \$3.4 million in 2004, as the Company experienced stronger demand in Asia, Mexico and South America. However, sales into Europe were lower than expected. Export sales are sensitive to worldwide economic and political conditions that can lead to volatility. Additionally, certain areas of the world are more cost conscious than the U.S. market and there are instances where the Company's products are priced higher than local manufacturers making it more difficult to generate sufficient profit to justify selling into these regions. Additionally, foreign exchange rates and excise taxes sometimes make it difficult to market the Company's products overseas at reasonable selling prices.

#### **Gross Profit**

Consolidated gross profit increased to \$3.4 million in 2005 from \$3.2 million in 2004 but as a percent of revenue decreased to 27.1% in 2005 from 28.0% in 2004.

Gross profit in the theatre segment increased to \$3.1 million in 2005 from \$3.0 million in 2004 but as a percent of sales decreased to 26.7% from 28.5% a year-ago. The results reflect projection equipment and lamp sales representing a higher percentage of sales in 2005 and which generally carry a lower margin than the other products within the segment, namely replacement parts and lenses. In addition, the Company is experiencing the effects of rising raw material and component parts prices for certain of its products.

## Edgar Filing: BALLANTYNE OF OMAHA INC - Form 10-Q

Gross profit in the lighting segment rose to \$0.3 million in 2005 from \$0.1 million in 2004 due to lower manufacturing costs and also higher margin replacement parts accounting for a larger percent of revenues.

Restaurant margins were flat at approximately \$0.1 million for both the 2005 and 2004 periods.

### **Selling and Administrative Expenses**

Selling and administrative expenses amounted to \$1.9 million in 2005 compared to \$1.8 million in 2004 but as a percent of revenue declined to 15.5% from 15.7% in 2004. The favorable change as a percentage of revenue pertains to; 1) covering certain fixed costs with higher revenues during 2005, despite incurring additional costs pertaining to compliance with the Sarbanes-Oxley Act of 2002 and those pertaining to the Company's bonus plan, 2) lower bad debt expenses and 3) managing selling expenses in an effective manner.

### Other Financial Items

During 2005, the Company recorded interest income of approximately \$72,200 compared to \$12,400 in 2004 as the Company earned interest from higher cash levels and invested in higher yield commercial paper. Interest expense declined to approximately \$8,700 in 2005 from approximately \$11,100 in 2004 resulting from the fee on the Company's unused portion of its credit facility being renegotiated to 0.125% from 0.375% during 2004.

The Company recorded income tax expense in 2005 of \$0.6 million compared to \$0.5 million in 2004 reflecting higher taxable income. The Company's effective tax rate remained comparable to 2004.

For the reasons outlined herein, the Company earned net income in 2005 of \$942,000 compared to \$855,000 in 2004. This translated into net income per share basic and diluted of \$0.07 in 2005 compared to \$0.07 and \$0.06, respectively, in 2004.

### Liquidity and Capital Resources

The Company is a party to a revolving credit facility with First National Bank of Omaha expiring August 28, 2006. The Company plans on renewing the credit facility in the ordinary course of business. The credit facility provides for borrowings up to the lesser of \$4.0 million or amounts determined by an asset-based lending formula, as defined. Borrowings available under the credit facility amounted to \$4.0 million at March 31, 2006. No amounts are currently outstanding. The Company pays interest on outstanding amounts equal to the Prime Rate plus 0.25% (8.0% at March 31, 2006) and pays a fee of 0.125% on the unused portion. The credit facility contains certain restrictive covenants mainly related to maintaining certain earnings, as defined, and restrictions on acquisitions and dividends. All of the Company's personal property and stock in its subsidiaries secure this credit facility.

Net cash provided by operating activities rose to \$2.2 million in 2006 from \$2.0 million a year-ago, despite operating income decreasing \$0.2 million. The Company was able to increase cash flows by decreasing accounts receivable balances by \$1.2 million from the end of fiscal 2005. In addition, the timing of income tax payments increased cash flow by an additional \$0.2 million compared to the first quarter of 2005. Certain items reduced cash flows including inventory purchases and bonus payments. Inventories rose \$1.3 million during the quarter due to a slowdown in demand, cancellation of an order and purchasing more digital projectors for consignment and sales purposes. Offsetting the impact of the higher inventory balances was an increase in accounts payable balances of \$1.3 million due to the timing of paying for certain of the aforementioned inventory purchases. Finally, the Company paid out \$0.9 million in bonus payments accrued for at December 31, 2005.

Net cash used in investing activities amounted to \$118,000 in 2006 compared to \$83,000 in 2005 and related entirely to capital expenditures in both periods.

Net cash provided by financing activities amounted to \$0.4 million compared to \$0.2 million in 2005. The Company received proceeds of \$0.2 million from its employee stock option plans in 2006, recorded a \$0.2 million income tax benefit pertaining to these exercises and made debt payments of \$6,800. During 2005, the Company received proceeds of \$0.2 million from its stock plans and made debt payments of \$6,300.

**Transactions with Related and Certain Other Parties**

There were no significant transactions with related and certain other parties during 2006.



### **Internal Controls Over Financial Reporting**

Current SEC rules implementing Section 404 of the Sarbanes-Oxley Act of 2002 will require the Company's Annual Report on Form 10-K for fiscal 2007 to include a report on management's assessment of the effectiveness of the Company's internal controls over financial reporting and a statement that the Company's independent registered public accounting firm has issued an attestation report on management's assessment of the Company's internal controls over financial reporting and a report on the effectiveness of the Company's internal controls over financial reporting. However, it is possible that the Company will become an accelerated filer as defined in Rule 12b-2 of the Exchange Act and if so this report and statement will need to be included in its Form 10-K for fiscal 2006. The Company will not know whether it will become an accelerated filer until June 30, 2006, which is the next date at which this status is determined. While the Company has not yet identified any material weaknesses in internal controls over financial reporting, there are no assurances that the Company will not discover deficiencies in its internal controls as it implements new documentation and testing procedures to comply with the Section 404 reporting requirement. If the Company discovers deficiencies or is unable to complete the work necessary to properly evaluate its internal controls over financial reporting, there is a risk that management and/or the Company's independent registered public accounting firm may not be able to conclude that the Company's internal controls over financial reporting are effective.

### **Concentrations**

The Company's top ten customers accounted for approximately 55% of 2006 consolidated net revenues. Trade accounts receivable from these customers represented approximately 52% of net consolidated receivables at March 31, 2006. Sales to AMC Theatres, Inc. and Regal Cinemas, Inc., each represented over 10% of consolidated revenues. Additionally, receivables from Vari International represented 27% of net consolidated receivables at March 31, 2006. While the Company believes its relationships with such customers are stable, most arrangements are made by purchase order and are terminable at will by either party. A significant decrease or interruption in business from the Company's significant customers could have a material adverse effect on the Company's business, financial condition and results of operations. The Company could also be adversely affected by such factors as changes in foreign currency rates and weak economic and political conditions in each of the countries in which the Company sells its products. In addition, advancing technologies, such as digital cinema, could disrupt historical customer relationships.

Financial instruments that potentially expose the Company to a concentration of credit risk principally consist of accounts receivable. The Company sells product to a large number of customers in many different geographic regions. To minimize credit concentration risk, the Company performs ongoing credit evaluations of its customers' financial condition or uses letters of credit.

Increased competition also results in continued exposure to the Company. If the Company loses market share or encounters more competition relating to the development of new technology for alternate means of motion picture presentation such as digital technology, the Company may be unable to lower its cost structure quickly enough to offset the lost revenue. To counter these risks, the Company has initiated a cost reduction program, continues to streamline its manufacturing processes and is formulating a strategy to respond to the digital marketplace. The Company also is focusing on a growth and diversification strategy to find alternative product lines to become less dependent on the theatre exhibition industry. However, no assurances can be given that this strategy will succeed or that the Company will be able to obtain adequate financing to take advantage of potential opportunities.

The principal raw materials and components used in the Company's manufacturing processes include aluminum, reflectors, electronic subassemblies and sheet metal. The Company utilizes a single contract manufacturer for each of its intermittent movement components, reflectors, certain aluminum castings, lenses and xenon lamps. Although the Company has not to-date experienced a significant difficulty in obtaining these components, no assurance can be given that shortages will not arise in the future. The loss of any one or more of such contract manufacturers could have a short-term adverse effect on the Company until alternative manufacturing arrangements were secured. The Company is not dependent upon any one contract manufacturer or supplier for the balance of its raw materials and components. The Company believes that there are adequate alternative sources of such raw materials and components of sufficient quantity and quality.

#### Hedging and Trading Activities

The Company does not engage in any hedging activities, including currency-hedging activities, in connection with its foreign operations and sales. To date, all of the Company's international sales have been denominated in U.S. dollars, exclusive of Strong Westrex, Inc. sales, which are denominated in Hong Kong dollars. In addition, the Company does not have any trading activities that include non-exchange traded contracts at fair value.

#### Off Balance Sheet Arrangements and Contractual Obligations

The Company's off balance sheet arrangements consist principally of leasing various assets under operating leases. The future estimated payments under these arrangements are summarized below along with the Company's other contractual obligations:

Contractual Obligations	Total	Payments Due by Period Remaining in 2006	Thereafter
Long-term debt	\$ 37,250	22,350	14,900
Postretirement benefits	254,941	5,647	249,294
Operating leases	151,882	66,300	85,582
Less sublease receipts	(14,551)	(14,551)	
Net contractual cash obligations	\$ 429,522	79,746	349,776

There were no other contractual obligations other than inventory and property, plant and equipment purchases in the ordinary course of business.



### **Seasonality**

Generally, the Company's business exhibits a moderate level of seasonality as sales of theatre products typically increase during the third and fourth quarters. The Company believes that such increased sales reflect seasonal increases in the construction of new motion picture screens in anticipation of the holiday movie season.

### **Environmental and Legal**

See note 2 to the consolidated financial statements for a full description of all environmental and legal matters.

### **Inflation**

The Company believes that the relatively moderate rates of inflation in recent years have not had a significant impact on its net revenues or profitability. The Company did experience higher than normal prices on certain raw materials during fiscal 2005 coupled with higher freight costs as freight companies passed on a portion of higher gas and oil costs. Historically, the Company has been able to offset any inflationary effects by either increasing prices or improving cost efficiencies.

### **2006 Outlook**

The Company has begun to see evidence of the theatre exhibition industry's expected transition to digital cinema during 2006. Theatre owners are now evaluating their options as they plan capital expenditures relative to new or used film projectors or digital equipment. However, the extent and timing of the impact to Ballantyne's 2006 revenues and operations is currently unclear. Digital cinema remains an important component of the Company's long-term growth strategy, and it continues to work closely with its partner, NEC Solutions (America), Inc., to launch this next generation technology within the exhibition industry.

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

The Company markets its products throughout the United States and the world. As a result, the Company could be adversely affected by such factors as changes in foreign currency rates and weak economic conditions. In particular, the Company was impacted by the downturn in the North American theatre exhibition industry in fiscal years 2000 to 2002 in the form of lost revenues and bad debts. Additionally, as a majority of sales are currently denominated in U.S. dollars, a strengthening of the dollar can and sometimes has made the Company's products less competitive in foreign markets. As stated above, the majority of the Company's foreign sales are denominated in U.S. dollars except for its subsidiary in Hong Kong. The Company purchases the majority of its lenses from a German manufacturer. Based on forecasted purchases during 2006, an average 10% devaluation of the dollar compared to the Euro would cost the Company approximately \$0.2 million per annum.

The Company has also evaluated its exposure to fluctuations in interest rates. If the Company would borrow up to the maximum amount available under its variable interest rate credit facility, a one percent increase in the interest rate would increase interest expense by \$40,000 per annum. No amounts are currently outstanding under the credit facility. Interest rate risks from the Company's other interest-related accounts such as its postretirement obligations are deemed to not be significant.

The Company has not historically and is not currently using derivative instruments to manage the above risks.

**Item 4. Controls and Procedures**

The Company carried out an evaluation under the supervision and with the participation of the Company's management, including the Company's Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Securities Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of the end of the period covered by this report, the Company's disclosure controls and procedures are effective at ensuring that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 (as amended) is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. There have been no changes in the Company's internal control over financial reporting during the fourth fiscal quarter for the period covered by this report that have materially affected, or are reasonably likely to materially affect, such internal control over financial reporting.

**PART II. Other Information**

**Item 1. Legal Proceedings**



A review of the Company's current litigation is disclosed in note 2 to the consolidated financial statements.

**1A. Risk Factors**

Item 1A, Risk Factors of the Company's 2005 Annual Report on Form 10-K includes a detailed discussion of the Company's risk factors. There have been no material changes to the risk factors as previously disclosed in Item 1A of the Form 10-K.

**Item 6. Exhibits**

See the Exhibit Index on page 33.



**SIGNATURES**

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

BALLANTYNE OF OMAHA, INC.

By: /s/ JOHN WILMERS  
John Wilmers, President,  
Chief Executive Officer, and Director  
Date: May 12, 2006

By: /s/ BRAD FRENCH  
Brad French, Secretary/Treasurer and  
Chief Financial Officer  
Date: May 12, 2006

**EXHIBIT INDEX**

- 31.1 Rule 13a-14(a) Certification of Chief Executive Officer.\*
- 31.2 Rule 13a-14(a) Certification of Chief Financial Officer.\*
- 32.1 18 U.S.C. Section 1350 Certification of Chief Executive Officer.\*
- 32.2 18 U.S.C. Section 1350 Certification of Chief Financial Officer.\*

---

\* - Filed herewith