FLOW INTERNATIONAL CORP
Form S-1/A
February 08, 2006
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As filed with the Securities and Exchange Commission on February 8, 2006

Registration No. 333-125113

UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

Amendment No. 4

to

Form S-1

REGISTRATION STATEMENT

UNDER

THE SECURITIES ACT OF 1933

Flow International Corporation

(Exact name of registrant as specified in its charter)

Washington	**3569**	**91-1104842**
(State or other jurisdiction of incorporation or organization)	***(Primary Standard Industrial Classification Code Number)***	***(I.R.S. Employer Identification Number)***

Stephen R. Light

President and Chief Executive Officer

23500 64th Avenue South

Kent, WA 98032

(253) 850-3500

(Address, including zip code and telephone number, including area code, of Registrant s principal executive offices)

PTSGE Corp.

925 Fourth Avenue, Suite 2900

Seattle, WA 98104

(206) 623-7580

(Name, address, including zip code and telephone number, including area code, of agent for service)

Copies to:

Robert S. Jaffe

William Gleeson

Preston Gates & Ellis LLP

925 Fourth Avenue, Suite 2900

Seattle, WA 98104

(206) 623-7580

Approximate date of commencement of proposed sale to the public:

From time to time after the effective date of this registration statement,

as determined by market conditions and other factors.

If any of the securities being registered on this Form are to be offered on a delayed or continuous basis pursuant to Rule 415 under the Securities Act of 1933, check the following box: x

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: ¨

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering: ¨

If delivery of the prospectus is expected to be made pursuant to Rule 434, please check the following box: ¨

CALCULATION OF REGISTRATION FEE

Title of Each Class of Securities to Be Registered	Amount to Be Registered(1)	Proposed Maximum Offering Price Per Security(4)	Proposed Maximum Aggregate Offering Price(4)	Amount of Registration Fee
Common Stock, $0.01 par value.	17,473,116 Shares(2)	$6.76	$118,118,264.16	$13,902.52(5)
Common Stock, $0.01 par value.	3,219,245(3)	$6.76	$17,147,078	$2,561.40(5)

(1) In accordance with Rule 416(a), the registrant is also registering hereunder an indeterminate number of shares that may be issued and resold resulting from stock splits, stock dividends or similar transactions.
(2) Represents shares of the registrant s common stock being registered for resale that have been issued to the selling shareholders named in this registration statement.
(3) Represents shares of the registrant s common stock being registered for resale that have been or may be acquired upon the exercise of warrants issued to the selling shareholders named in this registration statement.
(4) Estimated pursuant to Rule 457(c) under the Securities Act of 1933, solely for the purposes of calculating the registration fee, upon the basis of the average high and low prices of our common stock as reported on the Nasdaq National Market on May 16, 2005.
(5) Previously paid.

The Registrant hereby amends this Registration Statement on such date or dates as may be necessary to delay its effective date until the Registrant shall file a further amendment which specifically states that this Registration Statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the Registration Statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine.

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PRELIMINARY PROSPECTUS

19,987,336 Shares

Common Stock

This prospectus relates to the offer and sale of up to 17,717,718 outstanding shares of the common stock of Flow International Corporation, a Washington corporation, and up to 2,269,618 shares that may be issued on the exercise of outstanding warrants. Such shares may be offered and sold from time to time by the persons described in this prospectus under the heading Selling Shareholders or by pledgees, donees, transferees, assignees or other successors-in-interest of such persons (collectively, the Selling Shareholders). As used in this prospectus, we, us, our and similar expressions refer to Flow International Corporation and its subsidiaries.

The Selling Shareholders may offer their shares from time to time through or to one or more underwriters, brokers or dealers, on the NASDAQ Stock National Market at market prices prevailing at the time of sale, in one or more negotiated transactions at prices acceptable to the Selling Shareholders or in private transactions. We will not receive any proceeds from the sale of shares by the Selling Shareholders. In connection with any sales, the Selling Shareholders and any underwriters, agents, brokers or dealers participating in such sales may be deemed to be underwriters within the meaning of the Securities Act.

We will pay the expenses related to the registration of the shares covered by this prospectus. The Selling Shareholders will pay commissions and selling expenses, if any, incurred by them.

Our common stock trades on the NASDAQ National Market under the symbol FLOW. On January 31, 2006, the closing price of one share of our common stock was $10.49.

Investing in our securities involves risks. See Risk Factors beginning on page 7 of this prospectus.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR DETERMINED IF THIS PROSPECTUS IS TRUTHFUL OR COMPLETE. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this prospectus is , 2006.

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You should rely only on the information contained in this prospectus. We have not authorized anyone to provide you with different information. An offer to sell these securities is not being made in any state where the offer is not permitted. You should not assume that the information contained in this prospectus or any prospectus supplement is accurate as of any date other than the date of such documents. Our business, financial condition, results of operations and prospects may have changed since that date.

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ABOUT THIS PROSPECTUS

This prospectus is part of a registration statement that we filed with the Securities and Exchange Commission using the SEC s shelf registration rules. Under the shelf registration rules, using this prospectus and, if required, one or more prospectus supplements, the Selling Shareholders may sell from time to time, in one or more offerings, the shares of common stock covered by this prospectus. The shares covered by this prospectus include 17,717,718 outstanding shares of common stock and 2,269,618 shares of common stock issuable upon the exercise of warrants.

This prospectus also covers any shares of common stock that may become issuable pursuant to anti-dilution adjustment provisions that would increase the number of shares issuable upon exercise of the warrants as a result of stock splits, stock dividends or similar transactions.

A prospectus supplement may add, update or change information contained in this prospectus. We recommend that you read carefully this entire prospectus, especially the section entitled Risk Factors beginning on page 6, together with any supplements before making a decision to invest in our common stock.

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PROSPECTUS SUMMARY

This summary highlights key aspects of the information contained elsewhere in this prospectus. This summary does not contain all the information you should consider before investing in our common stock. You should read this entire prospectus carefully, especially the risks of investing in our common stock discussed under Risk Factors beginning on page 6, current events beginning on page 22 and our consolidated financial statements and the notes to those consolidated financial statements beginning on page F-1, before making an investment decision.

THE COMPANY

We design, develop, manufacture, market, install and service ultrahigh-pressure, or UHP, water pumps and UHP water management systems. Our core competency is the design and manufacture of UHP water pumps. Our UHP water pumps pressurize water from 40,000 to over 100,000 pounds per square inch (psi) and are integrated with water delivery systems so that water can be used to cut or clean material or pressurize food. Our products include standard and specialized waterjet cutting and cleaning systems. In addition to UHP water pumps and related systems, we provide non-UHP automation and articulation systems, primarily to the automotive industry.

Our UHP technology has three broad applications: cutting, cleaning and food processing. In cutting and cleaning applications, the ultrahigh-pressure created by our pumps is released through a small orifice to create a jet of water. In food processing, we supply UHP pumps to Avure Technologies, Inc., a company we recently sold, which uses pressure to kill spoilage bacteria and pathogens in food products placed inside a pressure vessel.

On October 31, 2005, consistent with our strategy to divest operations that are not part of our core UHP water pump business, we sold our General Press operations and the non UHP portion of our Food reportable segment (the Avure Disposition). Included in the Avure Disposition were our Avure Technologies, Incorporated, Flow International FPS AB, Avure Technologies AB subsidiaries, and our 51% interest in Flow Autoclave Systems (together, the Avure Business). The Avure Business became a discontinued operation in accordance with FAS 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* at the time it was sold and has been represented that way in the Consolidated Statements of Operations in the financial statements. In connection with the sale we agreed to continue to supply UHP pumps to the Avure Business.

The primary application of our UHP water pumps is cutting. In cutting applications, pressures from 50,000 to 87,000 psi create a thin stream of water traveling at three or more times the speed of sound which can cut both metallic and nonmetallic materials. UHP water pumps are used in aerospace, automotive, disposable products, food, glass, job shop, sign, metal cutting, marble, tile and other stone cutting, and paper slitting and trimming applications. Waterjet cutting is recognized as a more flexible alternative to traditional cutting methods such as lasers, saws or plasma. It is often faster, has greater versatility in the types of materials it can cut and eliminates the need for secondary processing operations. We also manufacture a waterjet product line used in cleaning, where pressures in the range of 40,000 to 55,000 psi are used in industrial cleaning, surface preparation, construction, and petro-chemical and oil field applications.

Our principal executive offices are at 23500 64th Avenue South, Kent, WA 98032 and our telephone number is (253) 850-3500. We maintain a website at www.flowcorp.com. The contents of our website are not incorporated into this prospectus.

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The Offering

Common Stock offered by the Selling Shareholders	19,987,336 Shares(1)
Offering	The Selling Shareholders may offer their shares from time to time through one or more underwriters, brokers or dealers, on the NASDAQ Stock National Market at market prices prevailing at the time of sale, in one or more negotiated transactions at prices acceptable to the Selling Shareholders or in private transactions.
Use of Proceeds	The proceeds from the sale of the shares covered by this prospectus will be received by the Selling Shareholders. We will not receive any of the proceeds from the sales by the Selling Shareholders of the shares covered by this prospectus.
Nasdaq National Market symbol	FLOW
Risk Factors	See Risk Factors beginning on page 6 for a discussion of factors that you should consider carefully before deciding to purchase our common stock.
Offering-related Information	On March 21, 2005, in a Private Investment in Public Equity Transaction (PIPE Transaction), we sold 17,473,116 equity units at $3.72 per unit for gross proceeds of $65 million, and net proceeds of $59.3 million. A unit consists of one share of our common stock and one warrant to buy 1/10th of a share of our common stock. Ten warrants give the holder the right to purchase one share of common stock for $4.07. The closing price of our stock on Nasdaq National Market on the day before the agreement between the Company and the Selling Shareholders relating to the PIPE Transaction was entered into $3.70 per share. On the day that the agreement was entered into, the closing price was $4.28 per share. The exercise price of the warrants is a negotiated price.
	Proceeds of the PIPE were used to pay down existing debt of $59.3 million, including all of our subordinated debt. Under the terms of warrants previously issued to our senior and subordinated lenders, we are obligated to issue additional warrants if shares of our common stock are issued for prices less than market price. Because the issuance price of the common stock of the PIPE Transaction ($3.70) was less than market price ($4.28), we issued approximately 304,000 anti-dilution $0.01 warrants to our lenders. These warrants had a Black-Scholes value of approximately $1.7 million. The majority of the charges resulting from the issuance of the additional warrants, $1.6 million, were charged to interest expense in the fourth quarter of fiscal 2005 as the underlying debt associated with these warrants was retired in the fourth quarter of fiscal 2005. The remainder, $126,000, was capitalized and amortized to interest expense through August 1, 2005.

(1) Includes 2,269,618 shares of common stock issuable upon the exercise of outstanding warrants to purchase common stock.

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Under EITF 00-19 Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock (EITF 00-19), the fair value of the warrants sold to the PIPE investors will be reported initially as a liability due to liquidated damages of 1% of the gross proceeds per month ($650,000) which will be payable in the event that this Form S-1 is not be declared effective prior to December 31, 2005. Upon effectiveness of the Form S-1, the fair value of the warrants will be reclassified into Capital in Excess of Par in the Equity section of the Consolidated Balance Sheet. As of March 21, 2005, the warrants sold to the PIPE investors were valued at $6.4 million using the Black-Scholes method, and the shares have been recorded at $52.9 million, or the difference between the net proceeds and the value of the warrants. The warrants sold to the PIPE investors are considered a derivative financial instrument and will be marked to fair value quarterly until this Form S-1 is declared effective. Any changes in fair value of the warrants will be recorded through the Consolidated Statement of Operations.

Historical Stock Price

Our stock is traded on the NASDAQ National Market under the symbol FLOW. The range of high and low sales prices for our common stock for the first, second, and third quarter of fiscal 2006 and the four quarters for fiscal 2005, 2004 and 2003 is set forth in the following table.

	Fiscal Year 2006		Fiscal Year 2005		Fiscal Year 2004		Fiscal Year 2003	
	High	Low	High	Low	High	Low	High	Low
First Quarter	$ 7.74	$ 5.98	$ 3.66	$ 2.15	$ 1.94	$ 1.13	$ 10.90	$ 5.05
Second Quarter	9.13	7.40	3.55	2.70	3.11	1.36	5.60	2.12
Third Quarter	10.49	6.89	3.18	2.71	4.11	2.40	3.80	2.13
Fourth Quarter			6.60	2.85	3.74	2.20	3.28	1.08

We have not paid dividends to common shareholders in the past. Our Board of Directors intends to retain future earnings, if any, to finance development and expansion of our business and reduce debt and does not expect to declare dividends to common shareholders in the near future. The credit agreement entered into on July 8, 2005 does permit us to pay dividends, however. Prior to this date however, our credit agreements contained restrictions on our ability to pay dividends to our shareholders.

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Summary Financial Data

The following table provides summary historical financial data for the periods indicated. You should read this information in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and our financial statements and the related notes included elsewhere in this prospectus.

The summary statement of operations data for each of the fiscal years ended April 30, 2005, 2004 and 2003 and the summary balance sheet data as of April 30, 2005 and 2004 are derived from our audited financial statements, which are included elsewhere in this prospectus. The summary statement of operations data for the fiscal years ended April 30, 2002 and 2001 and the summary balance sheet data as of April 30, 2003, 2002, and 2001 are derived from our unaudited financial statements which are not included in this prospectus. The summary statement of operations data for the six months ended October 31, 2005 and the summary balance sheet data as of October 31, 2005 are derived from our unaudited financial statements which are included in this prospectus.

	Six Months Ended October 31,	Year Ended April 30,				
	2005	2005	2004(5)	2003(3)(5)	2002(2)(5)	2001(1)(5)
(In thousands, except per share amounts)	(restated)(4)(5)	(restated)(4)(5)	(restated)(4)	(restated)(4)	(restated)(4)	(restated)(4)
	(unaudited)				(unaudited)	(unaudited)
Statement of Operations Data:						
Sales	$ 92,671	$ 172,966	$ 132,861	$ 121,833	$ 116,386	$ 132,797
Income (Loss) Before Cumulative Effect of Change in Accounting Principles and Discontinued Operations	1,221	(12,174)	(10,668)	(43,965)	(7,966)	1,882
Net Income (Loss)	1,040	(21,197)	(11,274)	(67,813)	(8,024)	1,304
Basic Income (Loss) Per Share Before Cumulative Effect of Change in Accounting Principles and Discontinued Operations	0.04	(0.69)	(0.69)	(2.86)	(0.52)	0.13
Basic Earnings (Loss) Per Share	0.03	(1.19)	(0.73)	(4.42)	(0.53)	0.09
Diluted Income (Loss) Per Share Before Cumulative Effect of Change in Accounting Principles and Discontinued Operations	0.03	(0.69)	(0.69)	(2.86)	(0.52)	0.12
Diluted Income (Loss) Per Share	0.03	(1.19)	(0.73)	(4.42)	(0.53)	0.09

	October 31,	April 30,				
	2005	2005	2004	2003	2002	2001
	(restated)(4)	(restated)(4)	(restated)(4)	(restated)(4)	(restated)(4)	(restated)(4)
	(unaudited)			(unaudited)	(unaudited)	(unaudited)
Balance Sheet Data:						
Working Capital	$ 35,343	$ 6,154	$ (8,757)	$ (6,709)	$ 84,556	$ 95,322

Total Assets	108,862	118,467	129,272	147,088	205,572	206,270
Short-Term Debt	1,437	13,443	48,727	61,056	5,237	8,464
Long-Term Obligations, net	23,538	5,704	38,081	29,023	83,453	85,652
Shareholders Equity (Deficit)	28,499	29,464	(8,217)	5,959	69,967	67,839

(1) The Statement of Operations for fiscal 2001 includes the adoption of SEC Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements , as amended by SAB101A and 101B. We reflected this change in policy as a Cumulative Effect of Change in Accounting Principle.

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(2) The Statement of Operations for fiscal 2002 includes the adoption of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (FAS 142). See Note 1 to the Consolidated Financial Statements for the year ended April 30, 2005 for further discussion of the impact of this adoption.

(3) The Statement of Operations for fiscal 2003 includes the impact of management s launch of its restructuring program and resulting focus on cash generation. See the Fiscal 2003 Comprehensive Financial Review at the end of the Fiscal 2004 Compared to Fiscal 2003 financial analysis in the Management s Discussion and Analysis section for further discussion of the impact on our financial results.

(4) As described in Note 2 to the April 30, 2005 Consolidated Financial Statements included elsewhere in this prospectus, we have restated our consolidated financial statements for the year ended April 30, 2005 in Amendment No. 1 to our April 30, 2005 Form 10-K to reflect additional charges in the Consolidated Statement of Operations associated with 1) the impairment of goodwill, 2) the revised valuation of anti-dilution warrants issued to our senior and subordinated lenders, 3) the revision of estimated losses on long-term contracts, 4) the correction of compensation expense for performance based equity awards and stock awards for services and 5) straight-line rent expense for leases with escalating rents. We identified errors in the Consolidated Financial Statements related to the presentation of percentage-of-completion related balances on the Consolidated Balance Sheet. Specifically, we noted inconsistencies between our divisions in the balance sheet presentation of accounts receivable and cash receipts relating to contracts accounted for using the percentage-of-completion method. We have, therefore, adjusted the financial statements to reflect a consistent presentation and comply with the provisions of SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts for all years presented. In addition, we restated certain balances for incorrect classification on our Consolidated Balance Sheet as of April 30, 2005 and 2004 and Consolidated Statement of Operations for the year ended April 30, 2005. We also restated our consolidated financial statements for all years presented in Amendment No. 2 to our April 30, 2005 Form 10-K to reflect corrections to our consolidated income tax provisions and recording of minority interest. These errors also resulted in a restatement of our interim financial statements as of and for the six months ended October 31, 2005.

The restated amounts above reflect the adjustments enumerated in Note 2 to the Consolidated Financial Statements in our Form 10-K/A Amendment No. 2 and the following adjustments for years prior to fiscal 2004;

	2002			2001		
	As previously reported	**As Restated**	**Reclassified for Discontinued Operations**	**As previously reported**	**As Restated**	**Reclassified for Discontinued Operations**
Statement of Operations Data:						
(Loss) Income Before Cumulative Effect of Change in Accounting Principle and Discontinued Operations	$ (8,244)	$ (8,415)	$ (7,966)	$ 4,038	$ 3,713	$ 1,882
Net (Loss) Income	(7,853)	(8,024)	(8,024)	1,630	1,304	1,304
Net (Loss) Income per share:						
Basic & Diluted						
Net Loss	(0.52)	(0.53)	(0.53)	0.11	0.09	0.09

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	2003		2002		2001	
	As previously reported	As Restated	As previously reported	As Restated	As previously reported	As Restated
Balance Sheet Data:						
Working Capital	$ (6,709)	$ (6,709)	$ 84,532	$ 84,556	$ 91,750	$ 95,322
Total Assets	147,701	147,088	208,674	205,572	209,309	206,270
Total Shareholders Equity	4,872	5,959	71,054	69,967	68,755	67,839

(5) Our consolidated statements of operations for all periods has been recast to give effect to the sale of the Avure Business and present the results for the Avure Business as discontinued operations.

Pro forma financial information is included in this prospectus to reflect the closing of the PIPE transaction on March 21, 2005. The following pro forma financial information is excerpted from the detailed presentation found on pages 14-17.

(In thousands, except per share amounts)	Year Ended April 30, 2005 (unaudited)
Pro forma Statement of Operations Data:	
Sales	$ 172,966
Income from Continuing Operations	3,874
Basic Income Per Share from Continuing Operations	0.12
Diluted Income Per Share from Continuing Operations	0.11

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RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the risks described below, together with the financial and other information contained in this prospectus, before making a decision to buy our common stock from the Selling Shareholder. If any of the following risks actually occur, our business, financial condition and results of operations could suffer. In these circumstances, the market price of our common stock could decline, and you may lose all or part of your investment in our common stock.

We have incurred losses in recent years and we may be unable to achieve profitability.

While we had income from continuing operations of $1.2 million for the six months ended October 31, 2005, our losses from continuing operations for each of the fiscal years ended April 30, 2005, 2004 and 2003 were $12.2 million, $10.7 million and $44.0 million, respectively. We believe our recently completed restructuring and related cost-cutting initiatives will reduce overall spending. If our restructuring efforts fail to adequately reduce costs, or if our sales are less than we project, we will continue to incur losses in future periods. Economic weakness in our served markets may adversely affect our ability to meet our sales projections.

Economic weakness in our served markets may adversely affect our financial results.

The products we sell are capital goods with individual system prices ranging from $150,000 to several million dollars. Many of our customers depend on long term financing from a financial institution to purchase our equipment. Economic weakness in the capital goods market and or a credit tightening by the banking industry would reduce our sales and accordingly affect our financial results.

If we fail to comply with our financing arrangements, our ability to continue operations would be impaired.

Under the Current Senior Credit Agreement (entered into on July 8, 2005), we are operating under a credit agreement with our senior lenders which expires July 8, 2008 and sets forth specific financial covenants to be attained on a quarterly basis. In addition, our agreement includes subjective acceleration clauses which permit the lenders to demand payment on the determination of a material adverse change in the business. In the event of default, the senior lenders may limit our access to borrow funds as needed. Our ability to continue operating is dependent on the senior lenders willingness to grant access to funds. If we are unable to obtain the necessary funds, our ability to continue operations would be seriously impaired unless we are able to obtain alternative financing from another source. In the event of a default, obtaining alternative financing may be difficult and may be at less favorable terms. We may be unable to achieve our projected operating results and maintain compliance with the loan covenants which would trigger an event of default with our lenders. In an event of default, the lenders would be in the position to exercise default remedies which include applying a default interest rate and acceleration of payment schedules for our outstanding debt. Our lenders may pursue any number of plans to reduce the outstanding debt, including, in certain circumstances, a liquidation of some or all of our assets.

If our Form S-1 registration statement becomes ineffective for more than 40 days, after having gone effective, we may be subject to significant financial penalties.

Under terms of a Registration Rights Agreement entered into on March 20, 2005, as part of a Private Investment in Public Equity transaction (PIPE Transaction), we were required not to have the Form S-1, which registers the shares sold in the PIPE Transaction, become ineffective for more than 40 days (not necessarily consecutive). If this event occurs, then we will be subject to a cash penalty of up to $650,000 per month for each month the registration statement is not effective. Certain factors that could cause the registration statement to become or remain ineffective are not within our control.

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If we are unable to retain the current members of our senior management team and other key personnel, our future success may be negatively impacted.

We may lose key management personnel and encounter difficulties replacing these positions. We may have to incur greater costs to attract replacement personnel.

Our inability to protect our intellectual property rights, or our possible infringement on the proprietary rights of others, and related litigation could be time consuming and costly.

We defend our intellectual property rights because unauthorized copying and sale of our proprietary equipment and consumables represents a loss of revenue to us. From time to time we also receive notices from others claiming we infringe their intellectual property rights. The number of these claims may grow in the future, and responding to these claims may require us to stop selling or to redesign affected products, or to pay damages. On November 18, 2004, Omax Corporation (Omax) filed suit against us alleging that our products infringe on Omax s patents. The suit also seeks to have a specific patent we hold declared invalid. Although the suit seeks damages of over $100 million, we believe Omax s claims are without merit and we intend not only to contest Omax s allegations of infringement but also to vigorously pursue our claims against Omax with regard to our own patent. See Note 15 to our April 30, 2005 and interim October 31, 2005 Consolidated Financial Statements for further discussion of contingencies.

Fluctuations in our quarterly operating results may cause our stock price to decline and limit our shareholders ability to sell our common stock in the public market.

In the past, our operating results have fluctuated significantly from quarter to quarter and we expect them to continue to do so in the future due to a variety of factors, many of which are outside of our control. Our operating results may in some future quarter fall below the expectations of securities analysts and investors. In this event, the trading price of our common stock could decline significantly. In addition to the risks disclosed elsewhere in this prospectus, factors outside of our control that have caused our quarterly operating results to fluctuate in the past and that may affect us in the future include:

- *fluctuations in general economic conditions;*
- *demand for UHP pumps and UHP water management systems generally;*
- *fluctuations in the capital budgets of customers; and*
- *development of superior products and services by our competitors.*

In addition, factors within our control, such as our ability to deliver equipment in a timely fashion, have caused our operating results to fluctuate in the past and may affect us similarly in the future.

The factors listed above may affect both our quarter-to-quarter operating results as well as our long-term success. Given the fluctuations in our operating results, you should not rely on quarter-to-quarter comparisons of our results of operations as an indication of our future performance or to determine any trend in our performance. Fluctuations in our quarterly operating results could cause the market price of and demand for our common stock to fluctuate substantially, which may limit your ability to sell our common stock on the public market.

We do business in industries that are cyclical, which may result in weakness in demand for our products.

Our products are sold in many industries, including machine tool, automotive and aerospace, that are highly cyclical. The machine tool industry, in particular from 1998 through 2003, experienced a significant decline in global demand. Cyclical weaknesses in the industries that we serve could lead to a reduced demand for our products.

We may be affected by rising costs or lack of availability of materials, which could negatively impact our operations.

We have experienced and may continue to experience significant increases in the costs of materials we use in the manufacture of our products, such as steel, and we may not be able to either achieve corresponding

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increases in the prices of our products or reduce manufacturing costs to offset these increases, or if we do increase prices, we may experience lower sales. Any of the foregoing may adversely affect our financial results.

If we cannot develop technological improvements to our products through continued research and engineering, our financial results may be adversely affected.

In order to maintain our position in the market, we need to continue to invest in research and engineering to improve our products and technologies and introduce new products and technologies. If we are unable to make such investment, if our research and development does not lead to new and/or improved products or technologies, or if we experience delays in the development or acceptance of new and/or improved products, our financial results will be adversely affected.

We have received notice of material weaknesses in internal controls. Consequently, there is more than a remote likelihood that a material misstatement of our financial statements will not be prevented or detected in the current or any future period. Additionally we may conclude that our system of internal controls under Section 404 of Sarbanes-Oxley is not effective.

In December 2004, in connection with the restatement of our fiscal 2004, 2003 and 2002 financial statements, and in November 2005 and January 2006, in connection with the restatement of our fiscal 2005, 2004 and 2003 financial statements, our former independent registered public accounting firm reported to management and to the Audit Committee material weaknesses in internal control over financial reporting. A material weakness is a control deficiency, or a combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Management agrees with and has responded to the Audit Committee with our plans to remediate the material weaknesses communicated by our former independent registered public accounting firm. Remediation of these material weaknesses is ongoing.

The material weaknesses in our internal control over financial reporting are as follows:

The Company did not maintain effective controls over the financial reporting process due to an insufficient complement of personnel with an appropriate level of accounting knowledge, experience and training in the application of generally accepted accounting principles commensurate with its financial reporting requirements and the complexity of the Company s operations and transactions. Specifically, the Company incorrectly applied generally accepted accounting principles for (i) the impairment of goodwill, (ii) the classification of deferred tax balances, (iii) the valuation of anti-dilution warrants, (iv) the accrual of costs on contracts and balance sheet presentation of accounts receivable and cash receipts relating to contracts accounted for using the percentage-of-completion method, (v) leases with rent escalation clauses, (vi) the recording of minority interest, and (viii) the computation of the provision for income taxes, affecting receivables, deferred income taxes, prepaid expenses, goodwill, other accrued liabilities, other long-term liabilities and taxes payable, customer deposits, minority interest, capital in excess of par, accumulated deficit, cost of sales, general and administrative expenses, impairment charge, interest expense and other income, net and the provision for income taxes**.** This material weakness contributed to the material weakness discussed below.

The Company did not maintain effective controls to ensure there is adequate (i) analysis, documentation, reconciliation and review of accounting records, and supporting data, and (ii) monitoring and oversight of the work performed by accounting and financial reporting personnel to ensure the accuracy and completeness of the consolidated financial statements in accordance with generally accepted accounting principles. Specifically, the Company did not have effective controls designed and in place over the consolidation of the financial statements of subsidiaries and the computation of minority interest, the reconciliation of inter-company accounts, the valuation of anti-dilution warrants, the accrual of costs on contracts and balance sheet presentation of accounts receivable and cash receipts relating to contracts accounted for using the percentage-of-completion method, the

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classification of technical service expenses, the accounting for performance based equity awards and the computation of income tax provisions, affecting receivables, prepaid expenses, other accrued liabilities, taxes payable, customer deposits, capital in excess of par, minority interest, accumulated deficit, cost of sales, marketing expense, research and engineering, general and administrative expense, interest expense, other income, net, and the provision for income taxes.

A review of the remediation process to date, as well as the steps remaining, can be found on page 21 under the heading Remediation of Material Weakness .

Section 404 of the Sarbanes-Oxley Act of 2002 requires us to assess the design and effectiveness of our internal control systems effective April 30, 2006. Our independent registered public accounting firm is required to render an attestation report on managements assessment and the effectiveness of our system of internal control over financial reporting. We must complete the documentation, evaluation and remediation of our systems of internal control. The costs associated with such compliance are likely to be substantial and will negatively impact our financial results. In addition, there is no assurance that we will be able to conclude that our systems are appropriately designed or effective, which could result in a material misstatement of the financial statements in the future and a decline in the stock price.

We have outstanding options and warrants that have the potential to dilute the return of our existing common shareholders and cause the price of our common stock to decline.

We grant stock options to our employees and other individuals. At January 31, 2006, we had options outstanding to purchase 1,395,884 shares of our common stock, at exercise prices ranging from $2.00 to $12.25 per share. In addition, we currently have outstanding 2,269,618 warrants, for which we are registering the resale of the underlying shares hereby. The exercise price of the warrants range from $.008 to $4.07 per share.

As a result of accounting regulations, which become applicable to us on May 1, 2006, requiring companies to expense stock options, our expenses will increase and our stock price may decline.

A number of publicly traded companies have recently announced that they will begin expensing stock option grants to employees. In addition, the Financial Accounting Standards Board (FASB) has adopted rule changes with an effective date as of the beginning of fiscal years beginning after June 15, 2005 requiring expensing of stock options. Currently we include such expenses on a pro forma basis in the notes to our financial statements in accordance with accounting principles generally accepted in the United States, but do not include stock option expense for employee options in our reported financial statements. This change in accounting standards will require us to expense stock options, and as a result our reported expenses may increase significantly.

Washington law and our charter documents may make an acquisition of us more difficult.

Provisions in Washington law and in our articles of incorporation, bylaws, and rights plan could make it more difficult for a third-party to acquire us, even if doing so would benefit our shareholders. These provisions:

Establish a classified board of directors so that not all members of our board are elected at one time;

Authorize the issuance of blank check preferred stock that could be issued by our board of directors (without shareholder approval) to increase the number of outstanding shares (including shares with special voting rights), each of which could hinder a takeover attempt;

Provide for a Preferred Share Rights Purchase Plan or poison pill;

Impose restrictions on certain transactions between a corporation and certain significant shareholders.

Provide that directors may be removed only at a special meeting of shareholders and provide that only directors may call a special meeting;

Require the affirmative approval of a merger, share exchange or sale of substantially all of the Corporation s assets by 2/3 of the Corporation s shares entitled to vote; and

Provide for 60 day advance notification for shareholder proposals and nominations at shareholder meetings.

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Market risk exists in our operations from potential adverse changes in foreign exchange rates relative to the U.S. dollar in our foreign operations.

A significant portion of our sales take place outside of the United States, and we transact business in various foreign currencies, primarily the Canadian dollar, the Eurodollar, the Japanese yen, the New Taiwan dollar, and the Swedish Krona. In addition, our foreign divisions may have customer receivables and vendor obligations in currencies other than their local currency which exposes us to near-term and longer term currency fluctuation risks. The assets and liabilities of our foreign operations, with functional currencies other than the U.S. dollar, are translated into U.S. dollars at exchange rates in effect at the balance sheet date. Income and expense items are translated at the average exchange rates prevailing during the period. Based on our results for the quarter ended October 31, 2005 for our foreign subsidiaries, and based on the net position of foreign assets less liabilities, a near-term 10% appreciation or depreciation of the U.S. dollar in all currencies we operate could impact operating income on an annualized basis by $1.4 million and other income (expense) by $740,000. Our financial position and cash flows could be similarly impacted.

Current year foreign sales have benefited from a weak U.S. dollar. If the dollar were to strengthen against certain foreign currencies, such as the euro and yen, our margins may be negatively affected.

A significant portion of our products sold outside the United States are manufactured domestically. The weaker U.S. dollar, relative to the local currency of many of the countries we sell into, has made our products less expensive, on a relative basis, when compared to locally manufactured products and products manufactured in certain other countries. As the U.S. dollar gains in value relative to these foreign currencies, our products will increase in cost to the customer relative to locally produced product and products manufactured in certain other countries, which could negatively impact sales.

Sales of registered stock could exert downward pressure on the market price of our stock and could encourage short selling that could exert further downward pressure.

To the extent that shareholders who have acquired or may acquire shares of our common stock (either directly or through the exercise of warrants, which are exercisable at $0.01 per share or less) in the PIPE Transaction or in connection with certain loans (the Selling Shareholders) acquired their shares at prices less than the then current trading price of our common stock, they may have an incentive to immediately resell material amounts of such shares in the market which may, in turn, cause the trading price of our common stock to decline. Significant downward pressure on our stock price caused by the sale of stock registered in an offering could encourage short sales by the Selling Shareholders (and in particular short sales by warrant holders in anticipation of exercising their warrants) or third parties that would place further downward pressure on our stock price. In an ordinary or uncovered short sale, a seller causes his or her executing broker to borrow the shares to be delivered at the completion of the sale from another broker, subject to an agreement to return them upon request, thereby avoiding the need to deliver any shares actually owned by the seller stockholder on the settlement date for the sale. Since the seller does not own the shares that are sold, the seller must subsequently purchase an equivalent number of shares in the market to complete or cover the transaction. The seller stockholder will realize a profit if the market price of the shares declines after the time of the short sale, but will incur a loss if the market price rises and he or she is forced to buy the replacement shares at a higher price. Accordingly, a declining trend in the market price of our common stock may stimulate short sales.

Under the terms of certain outstanding warrants, we could be required to make antidilution adjustments.

Certain of the Selling Shareholders (as defined above) hold warrants to purchase our common stock at a price of $.01 per share. Such warrants were originally issued to our lenders (Lender Warrants). While such Lender Warrants are outstanding customary anti-dilution adjustments will be made in the Lender Warrants, if we issue common stock (other than pursuant to the exercise of warrants or other rights or convertible securities) at a price less than then current market price, or we issue warrants or other rights or convertible securities to purchase or acquire common stock exercisable or convertible, at a price less than then current market price when the warrants, rights or convertible securities are issued. The customary anti-dilution adjustments will be made in the purchase price of the common stock under the Lender Warrants (multiplying the exercise price before the issuance by a fraction in which the numerator is the number of shares outstanding prior to the issuance and the denominator is the number of shares outstanding after the issuance) and the number of shares of common stock issuable in exercise of the Lender Warrants (multiplying the current number of shares subject to the warrants by a fraction in which the numerator is the purchase price before the issuance and the denominator is the purchase price after the issuance). The exercise of any currently outstanding warrants will not trigger any adjustments in the Lender Warrants because adjustments made to the extent required on the issuance of such warrants. We have no plans to issue any common stock, or warrants to purchase common stock exercisable, at a price below the then current market price, except to the extent we may be required to issue Common Stock under currently outstanding warrants.

Current Events

Avure Disposition. On October 31, 2005, consistent with our strategy to divest operations that are not part of our core UHP water pump business, we sold our General Press operations and the non UHP portion of our Food reportable segment (the Avure Disposition). Included in the Avure Disposition were our Avure Technologies, Incorporated, Flow International FPS AB, Avure Technologies AB subsidiaries, and our 51% interest in Flow Autoclave Systems (together, the Avure Business). The Avure Business became a discontinued operation in accordance with FAS 144 *Accounting for the Impairment or Statements of operations in the Disposal of Long-Lived Assets* at the time it was sold and has been presented as a discontinued operation in the Statements of Operations in the financial statements. In connection with the sale we agreed to continue to supply UHP pumps to the Avure Business.

Current Senior Credit Agreement. Until April 28, 2005, our long-term financing consisted of a senior credit agreement (originally entered into on July 28, 2004) whose maturity date was August 1, 2005 (Senior Credit Agreement) and a subordinated debt agreement (Subordinated Debt Agreement). On April 28, 2005, we entered into a new senior debt agreement (April Senior Credit Agreement) for the purpose of being able to pay off the Subordinated Debt Agreement, which was done. The April Senior Credit Agreement also had a maturity date of August 1, 2005. On July 8, 2005, we entered into a new senior credit agreement, with a maturity date of July 8, 2008 (Current Senior Credit Agreement). At certain places in this report, we refer to Senior Credit Arrangements referring to one or more of the senior credit agreements when identification of a particular agreement is not important. The Current Senior Credit Agreement is a $30 million, three year agreement with Bank of America N.A. and U.S. Bank N.A. It bears interest at Bank of America s prime rate (5.75% at April 30, 2005) or is linked to LIBOR plus a percentage depending on our leverage ratios, at our option. The agreement sets forth specific financial covenants to be attained on a quarterly basis, which we believe, based on our financial forecasts, are achievable. The financial covenants in the Current Senior Credit Agreement are less restrictive than in the earlier Senior Credit Arrangements.

Restructuring. In fiscal 2005, we completed a plan intended to return us to profitability through reductions in headcount, consolidation of facilities and operations, and closure or divestiture of selected operations. We evaluated the workforce and skill levels necessary to satisfy the expected future requirements of the business. As a result, we implemented plans to eliminate redundant positions and realign and modify certain roles based on skill assessments. We recorded restructuring charges of $2.5 million (excluding discontinued operations) for the year ended April 30, 2004 which are shown in the table below (in thousands):

	Year Ended April 30, 2004
Severance benefits	$ 217
Facility exit costs	867
Inventory write-down	1,384

	$ 2,468

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These charges included employee severance related costs for approximately 35 individuals. The fiscal 2004 reductions in the global workforce were made across manufacturing, engineering and general and administrative functions. We have also recorded facility exit costs for the year ended April 30, 2004 primarily as a result of consolidating our two Kent facilities into one facility and vacating the manufacturing warehouse portion of our Flow Europe facility. In addition, we scrapped some obsolete parts, returned surplus parts to vendors and sold parts to third parties, in conjunction with the shutdown of our manufacturing operation in Europe and standardization of our product line. See restructuring accrual information in Note 17 to Consolidated Financial Statements.

The Avure Business incurred restructuring charges of $239,000 and $788,000 for the years ended April 30, 2005 and 2004, respectively, which included employee severance costs for 15 individuals. In addition, the Avure Business reduced the space utilized in its Swedish manufacturing facility and closed the Memphis sales office for the food portion of the business.

During the year ended April 30, 2005 and 2004, we incurred $.6 million and $1.5 million, respectively, of professional fees associated with the restructuring of our debt in July 2004 and July 2003, respectively. These costs were evaluated under EITF 98-14, Debtor s Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements , and as they were either expenses related to potential Senior Credit Arrangement with lenders that did not occur, or they related to expenses associated with our subordinated debt and did not result in an increase in the facility and accordingly they were expensed.

Robotics Division. In an effort to control costs and to focus on our core UHP waterjet systems, on June 2, 2005, we announced that we had expanded our strategic relationship with Motoman Inc., to deliver standard, pre-engineered robotic waterjet cutting solutions to the automotive industry. The relationship means that Motoman, Inc. will be the primary sales contact with the end user for standard systems and we will sell UHP pumps and parts to Motoman, Inc. to be integrated into the pre-engineered robotic cutting system. At the same time we announced that, in order to re-align our resources with this new strategic direction, our custom robotic waterjet cutting system manufacturing would be relocated from Wixom, Michigan to Burlington, Ontario. The Company terminated 25 employees and recorded associated severance benefits of $175,000 which were paid in the six month period ended October 31, 2005. The Company also wrote off $24,000 of inventory with no future value. In October 2005, once the facility was vacated, the Company recorded restructuring charges related to lease termination costs of $278,000, net of expected sublease income, and wrote-off leasehold improvements of $108,000 related to this leased space.

We have also retained a broker to assist us in evaluating various opportunities for the Applications Group, our Other segment.

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CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

SAFE HARBOR STATEMENT:

Statements made in this prospectus that are not historical facts are forward-looking statements that involve risks and uncertainties. Forward-looking statements typically are identified by the use of such terms as may, will, expect, believe, anticipate, estimate, plan and similar words, although some forward-looking statements are expressed differently. You should be aware that our actual results could differ materially from those contained in any forward-looking statement due to a number of factors, which include, but are not limited to the following: the special risk factors and uncertainties set forth in this document; our striving to continue to improve our customer s profitability through investment in the development of innovative products and services; our ability to absorb cyclical downturns through the flexibility of our UHP technology and market diversity; our confidence that we can continue to gain market share; our conclusion that waterjet technology is in the early adoption phase of its product life cycle; our ability to retain a technical lead over our competitors through non-patented proprietary trade secrets and know-how in UHP applications; the ability of our patents to act as a barrier to entry for competitors in the UHP technology field; increased market acceptance of waterjet cutting systems by the aerospace, automotive, and machine (Job shop) industries will encourage other manufacturers, including those in other industries, to adopt waterjet solutions; our intent to contest Omax s allegations; our belief that the estimated cost of probable legal claims resolutions will not have an adverse effect on our consolidated financial position; our belief that the appropriate actions to remedy our material weakness are to implement new control policies and procedures and to hire additional accounting staff with appropriate levels of experience in order to improve the reconciliation process; our belief that our restructuring activities and related cost-cutting initiatives will reduce overall spending; our belief that the benefits of our restructuring activities will continue into fiscal 2006; spare parts sales will continue to increase as more systems are put into operation; expected severance and relocation costs; our belief that our existing cash and credit facilities at October 31, 2005 are adequate to fund our operations through April 30, 2006; our belief that compliance with covenants in the current senior credit agreement is achievable; our expectation that the funds necessary for capital expenditures will be generated internally and through available credit facilities; the strengthening of global economies; and global economic conditions and additional threatened terrorist attacks and responses thereto, including war. Additional information on these and other factors that could affect our financial results is set forth below. Finally, there may be other factors not mentioned above or included in our SEC filings that may cause our actual results to differ materially from those in any forward-looking statement. You should not place undue reliance on these forward-looking statements. We assume no obligation to update any forward-looking statements as a result of new information, future events or developments, except as required by federal securities laws.

All references to fiscal years are references to our fiscal year end of April 30.

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USE OF PROCEEDS

The proceeds from the sale of the shares covered by this prospectus will be received by the Selling Shareholders. We will not receive any of the proceeds from the sales by the Selling Shareholders of the shares covered by this prospectus.

We originally received gross proceeds of $65 million and net proceeds of $59.3 million on March 21, 2005 when we sold 17,473,116 equity units at $3.72 per unit in the PIPE Transaction. A unit consists of one share of our common stock and one warrant to buy 1/10th of a share of our common stock. Ten warrants give the holder the right to purchase one share of common stock for $4.07. We will receive an aggregate of up to $7.1 million if the selling shareholders who participated in the PIPE Transaction, exercise all of their warrants to purchase common stock.

We used the gross proceeds to pay the entire balance of our subordinated debt and accrued interest totaling $42.3 million in April 2005. The remaining proceeds were used to repay borrowings on our senior credit facility.

562,608 shares are issuable on the exercise of warrants issued to lenders, including approximately 217,000 warrants issued for anti-dilution. The exercise price of the shares issuable on the exercise of warrants issued to lenders is $0.01 per share and the exercise price of the anti-dilution warrants is $0.008 per share.

We would expect to use any such proceeds for general corporate purposes.

DIVIDEND POLICY

We have not paid dividends to common shareholders in the past. Our Board of Directors intends to retain future earnings, if any, to finance development and expansion of our business and reduce debt and does not expect to declare dividends to common shareholders in the near future. Our previous credit agreements contained restrictions on our ability to pay dividends to our shareholders. However, the Current Senior Credit Agreement does permit us to pay dividends.

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PRO FORMA INFORMATION

The unaudited pro forma consolidated statement of operations for the fiscal year ended April 30, 2005 gives effect to the PIPE Transaction. The PIPE Transaction, as described on page 2, was completed in March 2005, and the transaction was reported in the Company s financial statements for the year ended April 30, 2005. In the PIPE Transaction, as described on page 2, we sold 17,473,116 shares of common stock and warrants to purchase 1,747,310 shares of common stock. The PIPE Transaction gross proceeds of $65 million, less investment banking fees of $5.1 million and other costs of $626,000 resulted in net cash proceeds of $59.3 million. The pro forma presentation reflects application of all of the net proceeds to pay down debt as if the transaction occurred on May 1, 2004. In this presentation, we have assumed that our subordinated debt and related accrued interest was paid off in its entirety and the remaining net proceeds were used to pay down our Senior debt. We issued 304,000 anti-dilution warrants to our senior and subordinated lenders in connection with the PIPE transaction. The fair value of these warrants was $1.7 million. The pro forma presentation includes the amortization of these debt issue costs as if the transaction occurred on May 1, 2004.

These unaudited pro forma financial statements should be read in conjunction with the accompanying notes to unaudited pro forma financial statements, our historical financial statements and related notes, the sections of this prospectus entitled Selected Financial Data and Management s Discussion and Analysis of Financial Condition and Results of Operations , and the consolidated financial statements and related notes appearing elsewhere in this prospectus.

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Unaudited Pro Forma Consolidated Statements of Operations for the Year Ended April 30, 2005

(In thousands, except share amounts)

	Restated Consolidated(1)	PIPE Transaction	Pro Forma Consolidated
Sales	$ 172,966		$ 172,966
Cost of Sales	106,943		106,943
Gross Margin	66,023		66,023
Operating Expenses:			
Marketing	28,371		28,371
Research and Engineering	5,889		5,889
General and Administrative	22,849		22,849
Financial Consulting Charges	623		623
	57,732		57,732
Operating Income	8,291		8,291
Interest Expense	(20,342)	16,048(a)	(4,294)
Interest Income	106		106
Other Income, net	1,705		1,705
(Loss) Income from Continuing Operations Before Income Taxes	(10,240)	16,048	5,808
Provision for Income Taxes	(1,934)	(b)	(1,934)
(Loss) Income from Continuing Operations	$ (12,174)	$ 16,048	$ 3,874
(Loss) Income Per Share from Continuing Operations			
Basic	$ (0.69)		$ 0.12
Diluted	$ (0.69)		$ 0.11
Weighted Average Shares Used in Computing (Loss) Income per Share from Continuing Operations			
Basic	17,748		33,402 (c)
Diluted	17,748		35,427 (c)

(1) As described in Note 2 to the Consolidated Financial Statements, we restated our consolidated financial statements for the year ended April 30, 2005.

Notes to Unaudited Pro Forma Consolidated Statements of Operations

(a) To record the interest expenses reduced due to the PIPE Transaction.

The subordinated debt and accrued interest at May 1, 2004 (the beginning of fiscal 2005) was $42.3 million. The pro forma interest expense, net income and earnings per share information assumes the proceeds of the PIPE Transaction were used first to pay off the balance of the subordinated debt and accrued interest and the remaining net proceeds were used to pay-down Senior Credit Facility borrowings. The reduction between the Actual and Pro Forma amounts of interest expense is attributable to the reduced levels of senior and subordinated borrowings. Because the interest expense on the subordinated borrowings was all accrued and did not require cash payments, the pro forma proceeds applied to reduce senior borrowings are the full difference between net proceeds of $59.3 million and $42.3 million of subordinated borrowing and accrued interest or $17.0 million. In addition, the pro-forma amounts exclude the amortization of the Debt Discount on the Subordinated debt of approximately $1.1 million per year. No pro forma impact was ascribed to the antidilution warrants issued in conjunction with the PIPE Transaction as such impact is not determinable. The pro-forma interest expense includes the following adjustments:

In Thousands	Year Ended April 30, 2005
Reduced interest expense on subordinated debt	$ 7,724
Reduced interest expense on senior debt	1,509
Exclude write-off of capitalized fees and debt discount	5,281
Exclude charges for the antidilution warrants	1,534
Total pro forma adjustment to interest expense	$ 16,048

The pro forma presentation also excludes the write off of unamortized debt discount, write-off of any capitalized fees. These fees were expensed in the fourth quarter of fiscal 2005 when the underlying debt was retired. They amounted to $5.3 million in additional charges. Charges taken in the fourth quarter of fiscal 2005 for the portion of the warrants ($1,534,000) issued to our subordinated lender and those senior lenders who did not participate in an ongoing senior credit agreement are excluded from the pro forma results.

(b) Because we have provided for full valuation allowances for our deferred tax assets in the United States, the reductions to our interest expense would not effect our income tax provision. Therefore we have not adjusted the impact of these pro forma items to reflect any tax effect.

(c) The pro forma weighted average number of shares outstanding includes the following adjustments:

	Year Ended April 30, 2005	
In Thousands	Basic	Diluted
Common shares issued in PIPE Transaction	15,654	15,654
Dilutive potential common shares from warrants and options		2,025

Total additional shares included in weighted average shares outstanding	15,654	17,679

The weighted average shares are adjusted for the additional shares issued in the PIPE Transaction, as if they were issued May 1, 2004. Diluted income (loss) per share takes into consideration the warrants issued to purchasers of stock in the PIPE Transaction, as well as the anti-dilution warrants issued to then current warrant holders prior to the PIPE Transaction where their inclusion would be dilutive.

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The Company s potential common stock equivalents were:

	April 30, 2005
	Actual
In Thousands	
Common stock options	2,035
Warrants	3,219
Total	5,254

1,982,046 options are excluded from dilutive potential common shares in the pro forma presentation because they are out-of-the-money.

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Controls and Procedures

In December 2004, in connection with the restatement of our fiscal 2004, 2003 and 2002 financial statements, in November 2005 and January 2006, in connection with our restatement of our fiscal 2005, 2004 and 2003 financial statements, our former independent registered public accounting firm reported to management and to the Audit Committee material weaknesses in internal control over financial reporting. A material weakness is a control deficiency, or a combination of control deficiencies, that results in more than a remote likelihood that a material misstatement of the annual or interim financial statements will not be prevented or detected. Management agrees with and has responded to the Audit Committee with our plans to remediate the material weaknesses communicated by our former independent registered public accounting firm. Remediation of these material weaknesses is ongoing.

The material weaknesses in our internal control over financial reporting are as follows:

> The Company did not maintain effective controls over the financial reporting process due to an insufficient complement of personnel with an appropriate level of accounting knowledge, experience and training in the application of generally accepted accounting principles commensurate with its financial reporting requirements and the complexity of the Company s operations and transactions. Specifically, the Company incorrectly applied generally accepted accounting principles for (i) the impairment of goodwill, (ii) the classification of deferred tax balances, (iii) the valuation of anti-dilution warrants, (iv) the accrual of costs on contracts and balance sheet presentation of accounts receivable and cash receipts relating to contracts accounted for using the percentage-of-completion method, (v) leases with rent escalation clauses, (vi) the recording of minority interest, and (viii) the computation of the provision for income taxes, affecting receivables, deferred income taxes, prepaid expenses, goodwill, other accrued liabilities, other long-term liabilities and taxes payable, customer deposits, minority interest, capital in excess of par, accumulated deficit, cost of sales, general and administrative expenses, impairment charge, interest expense and other income, net and the provision for income taxes**.** This material weakness contributed to the material weakness discussed below.

> The Company did not maintain effective controls to ensure there is adequate (i) analysis, documentation, reconciliation and review of accounting records, and supporting data, and (ii) monitoring and oversight of the work performed by accounting and financial reporting personnel to ensure the accuracy and completeness of the consolidated financial statements in accordance with generally accepted accounting principles. Specifically, the Company did not have effective controls designed and in place over the consolidation of the financial statements of subsidiaries and the computation of minority interest, the reconciliation of inter-company accounts, the valuation of anti-dilution warrants, the accrual of costs on contracts and balance sheet presentation of accounts receivable and cash receipts relating to contracts accounted for using the percentage-of-completion method, the classification of technical service expenses, the accounting for performance based equity awards and the computation of income tax provisions, affecting receivables, prepaid expenses, other accrued liabilities, taxes payable, customer deposits, capital in excess of par, minority interest, accumulated deficit, cost of sales, marketing expense, research and engineering, general and administrative expense, interest expense, other income, net, and the provision for income taxes.

These control deficiencies resulted in the restatement of the Company s consolidated financial statements for the years ended April 30, 2005, 2004 and 2003, and certain quarters in these years and in the restatement of the condensed consolidated financial statements for the first and second quarters of fiscal 2006. Additionally, each of these control deficiencies could result in a material misstatement of the aforementioned account balances or disclosures that would result in a material misstatement to the annual or interim financial statements that would not be prevented or detected. Accordingly, management has determined that each of the above control deficiencies represents a material weakness.

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Remediation of Material Weakness

Our management and Audit Committee have dedicated significant resources to assessing the underlying internal control deficiencies giving rise to the restatements and to ensure that proper steps have been and are being taken to improve our internal control over financial reporting. We have assigned the highest priority to the correction of these deficiencies and have taken and will continue to take action to fully correct them. Management is committed to instilling strong control policies and procedures and ensuring that the tone at the top is committed to accuracy and completeness in all financial reporting. The remedial measures include the following:

Insufficient compliment of personnel with an appropriate level of accounting knowledge, experience and training in the application of generally accepted accounting principles.

We have filled several positions in the corporate accounting and finance department with newly hired staff, including a financial planner, assistant controller and senior accountant. We have not completed the hiring process at corporate as we continue to assess our staffing needs. During August 2005, we hired a technical accounting manager to ensure compliance with all current and future accounting rules. Prior to that date the existing staff was addressing our application of technical accounting literature. We will continue to assess staffing needs at both corporate and our subsidiaries, and have identified the need for additional staff in the areas of accounting supervision and financial analysis. We have applied additional resources and time to improve the appropriateness and documentation of our conclusions on technical accounting issues. This will be enhanced with the addition of our technical accounting manager and other planned additions.

Lack of effective controls to ensure adequate analysis, documentation, reconciliation and review of accounting records. Lack of effective controls to ensure adequate monitoring and oversight of work performed by accounting and financial reporting personnel.

We engaged a financial consulting firm to assist in both detail reconciliation work, as well as reviewing current processes and controls and assistance in the development of prospective processes and controls over the inter-company reconciliation process. We created a standardized template used in the reconciliation of all our inter-company accounts. These reconciliations are reviewed for accuracy and completeness by our Chief Financial Officer. Additionally, we have created a new template for use in generation of our Statement of Cash Flows. We have modified our monthly divisional close checklist to ensure all required reconciliations are completed, as well as help ensure adherence to corporate policies and procedures. We have begun to improve the documentation of our accounting policies and procedures to ensure that all transactions are recorded consistently and with the appropriate level of documentation. As is described in the above paragraph, we still need to hire additional experienced staff to provide enhanced review, analysis and documentation of accounting transactions and of the consolidated financial statements.

The implementation of the initiatives described above, are among our highest priorities. Our Audit Committee will continually assess the progress and sufficiency of these initiatives and make adjustments as and when necessary. As of the date of this report, management believes that the plan outlined above, when completed, will eliminate the material weaknesses in internal control over financial reporting as described above.

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SELECTED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and related notes, which are included elsewhere in this prospectus. The selected consolidated statement of operations data for each of the fiscal years ended April 30, 2005, 2004 and 2003 and the selected consolidated balance sheet data as of April 30, 2005 and 2004 are derived from our audited consolidated financial statements, which are included elsewhere in this prospectus. The selected consolidated statement of operations data of each of the fiscal years ended April 30, 2002 and 2001 and the balance sheet as of April 30, 2003, 2002 and 2001 are derived from our unaudited financial statements that are not included in this prospectus. The selected consolidated statement of operations data for the six months ended October 31, 2005 and the selected consolidated balance sheet data as of October 31, 2005 are derived from our unaudited condensed consolidated financial statements which are included in this prospectus. Our unaudited financial statements have been prepared on the same basis as our audited consolidated financial statements included elsewhere in this prospectus and, in the opinion of our management, reflect all adjustments, which include only normal recurring adjustments, necessary to state fairly our financial position and results of operations as of and for those periods.

(In thousands, except per share amounts)	Six Months Ended October 31, 2005 (restated)(4)(5) (unaudited)	Year Ended April 30, 2005 (restated)(4)(5)	2004(5) (restated)(4)	2003(3)(5) (restated)(4)	2002(2)(5) (restated)(4) (unaudited)	2001(1)(5) (restated)(4) (unaudited)
Statement of Operations Data:						
Sales	$ 92,671	$ 172,966	$ 132,861	$ 121,833	$ 116,386	$ 132,797
Income (Loss) Before Cumulative Effect of Change in Accounting Principles and Discontinued Operations	1,221	(12,174)	(10,668)	(43,965)	(7,966)	1,882
Net Income (Loss)	1,040	(21,197)	(11,274)	(67,813)	(8,024)	1,304
Basic Income (Loss) Per Share Before Cumulative Effect of Change in Accounting Principles and Discontinued Operations	0.04	(0.69)	(0.69)	(2.86)	(0.52)	0.13
Basic Earnings (Loss) Per Share	0.03	(1.19)	(0.73)	(4.42)	(0.53)	0.09
Diluted Income (Loss) Per Share Before Cumulative Effect of Change in Accounting Principles and Discontinued Operations	0.03	(0.69)	(0.69)	(2.86)	(0.52)	0.12
Diluted Income (Loss) Per Share	0.03	(1.19)	(0.73)	(4.42)	(0.53)	0.09

(In thousands)	October 31, 2005 (restated)(4) (unaudited)	April 30, 2005 (restated)(4)	2004 (restated)(4)	2003 (restated)(4) (unaudited)	2002 (restated)(4) (unaudited)	2001 (restated)(4) (unaudited)
Balance Sheet Data:						
Working Capital	$ 35,343	$ 6,154	$ (8,757)	$ (6,709)	$ 84,556	$ 95,322
Total Assets	108,862	118,467	129,272	147,088	205,572	206,270
Short-Term Debt	1,437	13,443	48,727	61,056	5,237	8,464
Long-Term Obligations, net	23,538	5,704	38,081	29,023	83,453	85,652
Shareholders Equity (Deficit)	28,499	29,464	(8,217)	5,959	69,967	67,839

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(1) The Statement of Operations for fiscal 2001 includes the adoption of SEC Staff Accounting Bulletin No. 101, Revenue Recognition in Financial Statements , as amended by SAB101A and 101B. We reflected this change in policy as a Cumulative Effect of Change in Accounting Principle.

(2) The Statement of Operations for fiscal 2002 includes the adoption of Statement of Financial Accounting Standards No. 142, Goodwill and Other Intangible Assets (FAS 142). See Note 1 to the Consolidated Financial Statements for the year ended April 30, 2005 for further discussion of the impact of this adoption.

(3) The Statement of Operations for fiscal 2003 includes the impact of management s launch of its restructuring program and resulting focus on cash generation. See the Fiscal 2003 Comprehensive Financial Review at the end of the Fiscal 2004 Compared to Fiscal 2003 financial analysis in the Management s Discussion and Analysis section for further discussion of the impact on our financial results.

(4) As described in Note 2 to the April 30, 2005 Consolidated Financial Statements included elsewhere in this prospectus, we have restated our consolidated financial statements for the year ended April 30, 2005 to reflect additional charges in the Consolidated Statement of Operations associated with 1) the impairment of goodwill, 2) the revised valuation of anti-dilution warrants issued to our senior and subordinated lenders, 3) the revision of estimated losses on long-term contracts, 4) the correction of compensation expense for performance based equity awards and stock awards for services and 5) straight-line rent expense for leases with escalating rents. We have identified errors in the Consolidated Financial Statements related to the presentation of percentage-of-completion related balances on the Consolidated Balance Sheet. Specifically, we noted inconsistencies between our divisions in the balance sheet presentation of accounts receivable and cash receipts relating to contracts accounted for using the percentage-of-completion method. We have, therefore, adjusted the financial statements to reflect a consistent presentation and comply with the provisions of SOP 81-1, Accounting for Performance of Construction-Type and Certain Production-Type Contracts for all years presented. In addition, we restated certain balances for incorrect classification on our Consolidated Balance Sheet as of April 30, 2005 and 2004 and Consolidated Statement of Operations for the year ended April 30, 2005. We also restated our consolidated financial statements in Amendment No. 2 to our April 30, 2005 Form 10-K to reflect corrections to our consolidated income tax provisions and recording of minority interest for all years presented. These errors also resulted in a restatement of our interim financial statements as of and for the six months ended October 31, 2005.

The restated amounts above reflect the adjustments enumerated in Note 2 to the Consolidated Financial Statements in our Form 10-K/A Amendment No. 2 and the following adjustments for years prior to fiscal 2004;

	2002			2001		
	As previously reported	**As Restated**	**Reclassified for Discontinued Operations**	**As previously reported**	**As Restated**	**Reclassified for Discontinued Operations**
Statement of Operations Data:						
(Loss) Income Before Cumulative Effect of Change in Accounting Principle and Discontinued Operations	$ (8,244)	$ (8,415)	$ (7,966)	$ 4,038	$ 3,713	$ 1,882
Net (Loss) Income	(7,853)	(8,024)	(8,024)	1,630	1,304	1,304
Net (Loss) Income per share:						
Basic & Diluted						
Net Loss	(0.52)	(0.53)	(0.53)	0.11	0.09	0.09

	2003		2002		2001	
	As previously reported	**As Restated**	**As previously reported**	**As Restated**	**As previously reported**	**As Restated**

Balance Sheet Data:						
Working Capital	$ (6,709)	$ (6,709)	$ 84,532	$ 84,556	$ 91,750	$ 95,322
Total Assets	147,701	147,088	208,674	205,572	209,309	206,270
Total Shareholders Equity	4,872	5,959	71,054	69,967	68,755	67,839

(5) Our consolidated statement of operations for all periods has been recast to give effect to the sale of the Avure Business and present the results for the Avure Business as discontinued operations.

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MANAGEMENT S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS

Current Events

Avure Disposition

On October 31, 2005, consistent with our strategy to divest operations that are not part of our core UHP water pump business, we sold our General Press operations and the non UHP portion of our Food reportable segment (the Avure Disposition). Included in the Avure Disposition were our Avure Technologies, Incorporated, Flow International FPS AB, Avure Technologies AB subsidiaries, and our 51% interest in Flow Autoclave Systems (together, the Avure Business). The Avure Business became a discontinued operation in accordance with FAS 144 *Accounting for the Impairment or Disposal of Long-Lived Assets* at the time it was sold and has been presented as a discontinued operation in the Statements of Operations in the financial statements.

Barton

On August 26, 2005, we received $2.5 million for giving the exclusive right to Barton Mines Company to sell abrasive to our customers. Under a Purchase Agreement, we are also entitled to future annual payments of up to $250,000 for the next three years based on achievement of system sales targets and royalty payments for systems sold over the next 10 years.

Current Senior Credit Agreement

Until April 28, 2005, our long-term financing consisted of a senior credit agreement (originally entered into on July 28, 2004) whose maturity date was August 1, 2005 (Senior Credit Agreement) and a subordinated debt agreement (Subordinated Debt Agreement). On April 28, 2005, we entered into a new senior debt agreement (April Senior Credit Agreement) for the purpose of being able to pay off the Subordinated Debt Agreement, which was done. The April Senior Credit Agreement also had a maturity date of August 1, 2005. On July 8, 2005, we entered into a new senior credit agreement, with a maturity date of July 8, 2008 (Current Senior Credit Agreement). At certain places in this report, we refer to Senior Credit Arrangements referring to one or more of the senior credit agreements when identification of a particular agreement is not important. The Current Senior Credit Agreement is a $30 million, three year agreement with Bank of America N.A. and U.S. Bank N.A. It bears interest at Bank of America s prime rate (5.75% at April 30, 2005) or is linked to LIBOR plus a percentage depending on our leverage ratios, at our option. The agreement sets forth specific financial covenants to be attained on a quarterly basis, which we believe, based on our financial forecasts, are achievable. The financial covenants in the Current Senior Credit Agreement are less restrictive than in the earlier Senior Credit Arrangements.

Restructuring

In fiscal 2005, we completed a plan intended to return us to profitability through reductions in headcount, consolidation of facilities and operations, and closure or divestiture of selected operations. We evaluated the workforce and skill levels necessary to satisfy the expected future requirements of the business. As a result, we implemented plans to eliminate redundant positions and realign and modify certain roles based on skill assessments. We recorded restructuring charges of $2.5 million for the year ended April 30, 2004 which are shown in the table below (in thousands):

	Year Ended April 30, 2004
Severance benefits	$ 217
Facility exit costs	867
Inventory write-down	1,384
	$ 2,468

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These charges included employee severance related costs for approximately 35 individuals. The fiscal 2004 reductions in the global workforce were made across manufacturing, engineering and general and administrative functions. We have also recorded facility exit costs for the year ended April 30, 2004 primarily as a result of consolidating our two Kent facilities into one facility and vacating the manufacturing warehouse portion of our Flow Europe facility. In addition, we scrapped some obsolete parts, returned surplus parts to vendors and sold parts to third parties, in conjunction with the shutdown of our manufacturing operation in Europe and standardization of our product line. See restructuring accrual information in Note 17 to Consolidated Financial Statements.

The Avure Business incurred restructuring charges of $239,000 and $788,000 for the years ended April 30, 2005 and 2004, respectively, which included employee severance costs for 15 individuals. In addition, the Avure Business reduced the space utilized in its Swedish manufacturing facility and closed the Memphis sales office for the food portion of the business.

During the year ended April 30, 2005 and 2004, we incurred $.6 million and $1.5 million, respectively, of professional fees associated with the restructuring of our debt in July 2004 and July 2003, respectively. These costs were evaluated under EITF 98-14, Debtor s Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements , and as they were either expenses related to potential Senior Credit Arrangement with lenders that did not occur, or they related to expenses associated with our subordinated debt and did not result in an increase in the facility and accordingly they were expensed.

Robotics Division

In an effort to control costs and to focus on our core UHP waterjet systems, on June 2, 2005, we announced that we had expanded our strategic relationship with Motoman Inc., to deliver standard, pre-engineered robotic waterjet cutting solutions to the automotive industry. The relationship means that Motoman, Inc. will be the primary sales contact with the end user for standard systems and we will sell UHP pumps and parts to Motoman, Inc. to be integrated into the pre-engineered robotic cutting system. At the same time we announced that, in order to re-align our resources with this new strategic direction, our custom robotic waterjet cutting system manufacturing would be relocated from Wixom, Michigan to Burlington, Ontario. This closure was completed by the second quarter of fiscal 2006 with restructuring expenses of approximately $600,000. These expenses include severance payments for employees, exit expenses for the facility as well as logistical expenses for moving and disposing of equipment and assets.

Other

We have also retained a broker to assist us in evaluating various opportunities for the Applications Group, our Other segment.

Three and Six Months Ended October 31, 2005 Compared to Three and Six Months Ended October 31, 2004

Changes in Financial Condition

We generated $9.2 million of cash from operating activities during the six months ended October 31, 2005 compared to $6.7 million of cash generated for the six months ended October 31, 2004. The current period s operating cash flow includes $2.5 million of cash received related to the Purchase Agreement with Barton referred to earlier. Customer deposits increased $4.7 million further contributing to the cash flow from operations. These deposits provide the funding for the manufacturing of our systems and primarily relate to large aerospace contracts that we have been awarded. The revenue associated with these deposits is expected to be recognized in the next twelve months. Offsetting these inflow is a $1.2 million increase in Receivables, net from progress made on percentage-of-completion projects during the six months ended October 31, 2005. Trade receivables accounted for cash generation of $1.8 million in the year ago comparable period. Additionally, increases in inventory of $4.1 million during the six months ended October 31, 2005 offset the cash generated by the Barton transaction and customer deposits. These increases were the result of additional inventory purchases in our core business to meet upcoming demand in the third quarter of fiscal 2006 as well as inventory changes in the Avure business prior to the disposition.

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Net receivables are comprised of trade accounts and unbilled revenues. At October 31, 2005, the net receivables balance decreased $10.2 million or 27% from April 30, 2005. The decrease in net receivables stemmed from the reduction in trade receivables of $8.9 million or 24% from $37.2 million at April 30, 2005 to $28.3 million at October 31, 2005 on sale of the Avure Business which reduced trade receivables by $7.5 million and on collection of standard waterjet system sales for the six months ended October 31, 2005. Receivables days sales outstanding (including unbilled revenues and excluding the Avure business for the comparative periods) increased to 55 days at October 31, 2005 from 49 as of April 30, 2005. This decrease in Trade Receivables was compounded by a reduction in unbilled revenues from $5.0 million at April 30, 2005 to $3.4 million at October 31, 2005, a $1.6 million or 32% decrease. The Avure Business accounted for $4.6 million of the decrease which was offset by an increase in the percentage complete on our aerospace contracts as well as a higher number of automation contracts being worked on. Our unbilled receivables relate to equipment and systems sales accounted for on a percentage of completion basis. Unbilled revenues fluctuate due to the scheduling of production and achievement of certain billing milestones. In general, receivables can be negatively affected by the traditionally longer payment cycle outside the United States and the timing of billings and payments on large special system orders. We do not believe these timing issues will present a material adverse impact on our short-term liquidity requirements. Because of the lead-time to build and deliver such equipment, ultimate collection of such accounts can be subject to changing customer business and economic conditions.

Inventories, net at October 31, 2005 decreased $4.8 million or 20% from April 30, 2005 driven by the sale of the Avure Business which accounted for $6.2 million. This was offset by an increase in Waterjet inventory of $1.3 million primarily related to some equipment for our aerospace contracts which we anticipate shipping in our fourth fiscal quarter of 2006.

Customer deposits were $7.6 million at October 31, 2005, versus the $10.6 million balance at April 30, 2005. The disposition of the Avure Business accounted for a decrease of $3.1 million which was offset by the receipt of milestone advances due under the significant aerospace contracts which we were awarded in fiscal 2005.

Liquidity and Capital Resources

Approximately $20.3 million of our cash and restricted cash is held by divisions outside the United States. The repatriation of offshore cash balances from certain divisions will trigger tax liabilities. In fiscal 2004, we recorded a $1.9 million liability for withholding taxes on future repatriation of historical foreign earnings. In fiscal 2005, we repatriated $4.8 million from certain foreign subsidiaries. During the six months ended October 31, 2005, we repatriated $1.4 million from a foreign subsidiary and we plan to continue repatriating additional funds in the future.

On March 21, 2005, in a Private Investment in Public Equity Transaction (PIPE Transaction), we sold 17,473,116 equity units at $3.72 per unit for gross proceeds of $65 million, and net proceeds of more than $59 million. A unit consists of one share of our common stock and one warrant to buy 1/10th of a share of our common stock. Ten warrants give the holder the right to purchase one share of common stock for $4.07. If all the warrant holders opted to exercise their warrants, we would receive $7.1 million in cash proceeds.

Because the market price of the common stock was greater than $3.70, we issued approximately 304,000 anti-dilution warrants to current warrant holders prior to the PIPE Transaction which have a Black-Scholes value of approximately $1.7 million. Approximately $1.5 million of this amount relates to warrants issued under subordinated debt agreements and $0.2 million relates to warrants issued under senior debt agreements. Proceeds of the PIPE were used to pay down existing debt, including all of the subordinated debt.

Under terms of the PIPE Transaction, we were required to file an initial Form S-1 registration of the shares issued and issuable in the PIPE Transaction on or before May 20, 2005 and were required to cause the Form S-1 to become effective on or before September 17, 2005. We subsequently amended the Registration Rights

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Agreement to grant us an extension until March 10, 2006 for the effective date of the registration of the shares and warrants issued in the PIPE Transaction. We are subject to liquidated damages of $650,000 per month, if we fail to meet the March 10, 2006 deadline.

Our domestic senior credit agreement (Credit Agreement) is our primary source of external funding. Effective July 8, 2005, we executed a new $30 million, three year senior credit agreement with Bank of America N.A. and U.S. Bank N.A. This credit agreement expires July 8, 2008 and bears interest at the bank s prime rate (6.75% at October 31, 2005) or is linked to LIBOR plus a percentage depending on our leverage ratios, at our option. The agreement sets forth specific financial covenants to be attained on a quarterly basis, which we believe, based on our financial forecasts, are achievable. At October 31, 2005, the balance outstanding on the Credit Agreement was $18.5 million against a maximum borrowing of $30 million. Our available credit at October 31, 2005, net of $2.3 million in outstanding letters of credit, was $9.2 million.

We believe that our existing cash, cash from operations, and credit facilities at October 31, 2005 are adequate to fund our operations through April 30, 2006. If we fail to achieve our planned revenues, costs and working capital objectives, management believes it has the ability to curtail capital expenditures and reduce costs to levels that will be sufficient to enable us to meet our cash requirements and debt covenants through April 30, 2006.

On August 26, 2005, we received $2.5 million for giving the exclusive right to Barton Mines Company to sell abrasive to our customers. Under a Purchase Agreement, we are also entitled to future annual payments of up to $250,000 for the next three years based on achievement of system sales targets and royalty payments for systems sold over the next 10 years.

Since fiscal 2004, we had been investigating, with approval from our Board, alternatives for our non-core operations. On October 31, 2005, we completed the sale of our Avure Business with Gores Technology for estimated net proceeds of $14.4 million, comprised of cash and notes. The Avure Business was comprised of the International and North America Press reporting segments as well as the non ultrahigh-pressure portion of our Food reportable segment. The ultrahigh-pressure portion of our Food segment will be reported under North America Waterjet on a go-forward basis. The results of operations are shown as discontinued operations in our financial statements.

Off-Balance Sheet Arrangements

We do not have any special purpose entities or off-balance sheet financing arrangements.

Contractual Obligations

During the quarter ended October 31, 2005, there were no material changes outside the ordinary course of business in our contractual obligations and minimum commercial commitments as reported in Amendment No. 2 to our Annual Report on Form 10-K for the year ended April 30, 2005.

Critical Accounting Policies and Judgments and New Accounting Pronouncements

There are no material changes in our critical accounting policies as disclosed in Amendment No. 2 to our Annual Report on Form 10-K for the year ended April 30, 2005. New accounting pronouncements are disclosed in Note 16 to the Condensed Consolidated Financial Statements.

Results of Operations

Our ultrahigh-pressure (UHP) business which we call Waterjet is comprised of the following segments: North America Waterjet, Asia Waterjet, Other International Waterjet and Other.

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Sales Summary:

Dollars in thousands

	Three months ended October 31,			Six months ended October 31,		
	2005	2004	% Change	2005	2004	% Change
Operational breakdown:						
Waterjet:						
Systems	$ 36,950	$ 31,274	18 %	$ 65,671	$ 57,174	15 %
Consumable parts and services	13,735	12,813	7 %	27,000	25,212	7 %
	$ 50,685	$ 44,087	15 %	$ 92,671	$ 82,386	13 %
Geographic breakdown:						
United States	$ 28,992	$ 25,308	15%	$ 53,492	$ 45,826	17%
Rest of Americas	6,828	4,710	45%	11,009	9,605	15%
Europe	7,397	7,616	(3)%	14,934	14,151	6%
Asia	7,468	6,453	16%	13,236	12,804	3%
	$ 50,685	$ 44,087	15 %	$ 92,671	$ 82,386	13 %

Three and Six Months Ended October 31, 2005 Compared to Three and Six Months Ended October 31, 2004

(Tabular amounts in thousands)

Sales.

Our sales by segment for the periods noted below is summarized as follows:

	Three Months Ended October 31,				Six Months Ended October 31,			
	2005	2004	Difference	%	2005	2004	Difference	%
Sales								
Waterjet:								
North America	28,644	20,663	7,981	39%	51,571	36,563	15,008	41%
Asia	7,468	6,453	1,015	16%	13,236	12,804	432	3%

Other International	8,789	8,396	393	5%	17,242	15,532	1,710	11%
Other	5,784	8,575	(2,791)	(33)%	10,622	17,487	(6,865)	(39)%
Waterjet Total	50,685	44,087	6,598	15%	92,671	82,386	10,285	12%

Our Waterjet business includes cutting and cleaning operations, which are focused on providing total solutions for the aerospace, automotive, job shop, surface preparation (cleaning) and paper industries. It is comprised of four reporting segments: North America Waterjet, Asia Waterjet, Other International Waterjet and Other. The North America, Asia and Other International Waterjet segments primarily represent sales of our standard cutting and cleaning systems throughout the world, as well as sales of our custom designed systems into the Aerospace industry. The Other segment represents sales of our automation and robotic waterjet cutting sells which are sold primarily into the North American automotive industry.

For the three months ended October 31, 2005, total Waterjet sales of $50.6 million increased $6.6 million or 15% as compared to the prior year same period. For the six months ended October 31, 2005, total Waterjet sales of $92.7 million increased $10.3 million or 12% as compared to the prior year same period of which $15.0 million was recognized in our North America Waterjet segment. Last year we believed the market awareness of waterjet technology was low and addressed this through an increase in marketing and tradeshow activity, including attendance at the bi-annual International Manufacturing Technology Show in early September 2004, as well as increasing the number of domestic waterjet cutting direct sales staff from 10 to 15, adding of two

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machine tool distributors and increasing domestic technical services staff from 12 to 24 persons. The growth in revenue in North America is a result of an increase in unit sales stemming from our increased sales and marketing activity as well as increased revenue recognition on large percentage-of-completion aerospace contracts. There were no significant price increases year over year; however, a price increase of 4% on selected systems was instituted on February 1, 2005. Aerospace sales, which are also included in the North America segment, were $7.5 million and $9.6 million for the three and six months ended October 31, 2005, respectively, up $6.7 million and $8.4 million from the prior year same respective periods from work completed on aerospace contracts awarded in fiscal 2005.

For the three and six months ended October 31, 2005, Asia Waterjet segment revenue increased $1.0 million and $0.4 million, or 16% and 3% for the prior year same respective periods. This increase was fueled by expansion of waterjet systems into the electronics industry in Taiwan. Growth in the Other International Waterjet segment represents primarily sales into Europe and South America. Revenues from our European operations have declined $219,000 to $7.4 million during the three months ended October 31, 2005 on a strengthening dollar while improving by $783,000 for the six months ended October 31, 2005 to $14.9 million. Sales into South America of $1.4 million and $2.3 million for the three and six months ended October 31, 2005 improved $612,000 and $927,000 over the respective prior year same periods on higher standard shapecutting system sales as the Company focused its efforts in this area. We typically sell our products at higher prices outside the U.S. due to the costs of servicing these markets.

The growth in our North America, Asia Waterjet, and Other International Waterjet segments were offset by declines in the Other segments. The Other segment recorded a $2.8 million and a $6.9 million decline for the three and six months ended October 31, 2005 from the prior year same periods from a softness in the domestic automotive industry as well as from the closing and relocation of our Wixom, Michigan facility to our Burlington, Ontario facility. This shutdown was completed to combine like businesses and reduce operating costs.

We also analyze our Waterjet revenues by looking at system sales and consumable sales. Systems sales were $37.0 million, up $5.7 million or 18%, for the three months ended October 31, 2005 and up $8.5 million or 15%, for the six months ended October 31, 2005 due to strong domestic shapecutting sales as well as increased aerospace revenue. Consumables revenues recorded an increase of $922,000 or 7.2% to $13.7 million for the three months ended October 31, and $1.8 million or 7.1% to $27 million for the six months ended October 31, 2005, respectively. The majority of the increase in spares sales for the three and six months ended October 31, 2005 was recorded in Europe and South America. The increasing number of systems in service, our proprietary productivity enhancing kits and improved parts availability as well as the use of Flowparts.com, our easy-to-use internet order entry system, offset domestic spare parts declines resulting from the elimination of garnet revenue pursuant to the Barton transaction. We believe that spare parts sales should continue to increase as more systems are put into service.

Cost of Sales and Gross Margins. Our gross margin by segment for the periods noted below is summarized as follows:

	Three Months Ended October 31,				Six Months Ended October 31,			
	2005 (restated)	2004 (restated)	Difference	%	2005 (restated)	2004 (restated)	Difference	%
Gross Margin								
Waterjet:								
North America	13,878	9,616	4,262	44%	24,865	17,586	7,279	41%
Asia	3,549	2,871	678	24%	6,359	5,726	633	11%
Other International	3,281	2,671	610	23%	6,542	5,051	1,491	30%
Other	1,626	233	1,393	598%	2,501	1,200	1,301	108%
Waterjet Total	22,334	15,391	6,943	45%	40,267	29,563	10,704	36%

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Our gross margin as a percent of sales by segment for the periods noted below is summarized as follows:

	Three Months Ended October 31,		Six Months Ended October 31,	
	2005 (restated)	2004 (restated)	2005 (restated)	2004 (restated)
Gross Margin Percentage				
Waterjet:				
North America	48%	47%	48%	48%
Asia	48%	44%	48%	45%
Other International	37%	32%	38%	33%
Other	28%	3%	24%	7%
Waterjet Total	44%	35%	43%	36%

Gross margin for the three and six months ended October 31, 2005 amounted to $22.3 million or 44% of sales and $40.3 million or 43%, respectively, as compared to gross margin of $15.4 million or 35% of sales and $29.6 million or 36% in the prior year same periods. Domestically, the gross margin improvements are attributable to cost reductions from global supply chain initiatives as well as improved cost absorption from higher sales volumes in standard shapecutting as well aerospace system sales. Asia Waterjet margins rose on strong product pricing and its improved product mix. The Other segment saw improved margins as the prior three and six month results included significant costs accrued on loss contracts at our Wixom, Michigan division which depressed margins to (18)% and (10)%, respectively. Current period margins in the Other segment are in line with margin expectations for this line of business. Generally, comparison of gross margin rates will vary period over period depending on the mix of sales, which includes special system, standard system and consumables sales. Gross margin rates on our systems sales are typically less than 45% as opposed to consumables sales which are in excess of 50%. In addition, gross margin as a percent of sales will vary amongst segments due to inter-company sales and the related inter-company transfer pricing.

Marketing Expenses. Our marketing expenses by segment for the periods noted below are summarized as follows:

	Three Months Ended October 31,				Six Months Ended October 31,			
	2005 (restated)	2004 (restated)	Difference	%	2005 (restated)	2004 (restated)	Difference	%
Marketing:								
Waterjet:								
North America	4,329	3,822	507	13%	8,355	6,828	1,527	22%
Asia	1,069	892	177	20%	2,030	1,733	297	17%
Other International	2,241	1,869	372	20%	4,505	3,841	664	17%
Other	234	473	(239)	(51)%	559	890	(331)	(37)%
Waterjet Total	7,873	7,056	817	12%	15,449	13,292	2,157	16%

Marketing expenses increased $817,000 or 12% and $2.2 million or 16% for the three and six months ended October 31, 2005, respectively, as compared to the prior year same periods. All segments experienced increases in their Marketing expenses for both periods with the exception of the Other segment. The increases are due to increased expenses such as commissions on higher sales, as well as increased marketing and advertising costs directed at increasing waterjet technology awareness. The Other segment decreased its expenses as the Wixom division was closed in Q2 and all marketing activity was handled through our Burlington facility. Expressed as a percentage of revenue, consolidated marketing expenses were 16% and 17% for the three and six months ended October 31, 2005 and 16% for the three and six months ended October 31, 2004.

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Research and Engineering Expenses. Our research and engineering expenses by segment for the periods noted below are summarized as follows:

	Three Months Ended October 31,				Six Months Ended October 31,			
	2005 (restated)	2004 (restated)	Difference	%	2005 (restated)	2004 (restated)	Difference	%
Research and Engineering Waterjet:								
North America	1,429	971	458	47%	3,043	2,289	754	33%
Asia	129	80	49	61%	235	158	77	49%
Other International	103	179	(76)	(42)%	242	349	(107)	(31)%
Other	31	25	6	24%	50	81	(31)	(38)%
Waterjet Total	1,692	1,255	437	35%	3,570	2,877	693	24%

Research and engineering expenses increased $437,000 or 35% and $693,000 or 24% for the three and six months ended October 31, 2005, as compared to the prior year same periods. Increases of $458,000 and $754,000 were recorded in the North America Waterjet segment for the three and six months ended October 31, 2005. This is attributable to the addition of key engineering personnel related to our core UHP technology. Expressed as a percentage of revenue, research and engineering expenses were 3% and 4% for the three and six months ended October 31, 2005 compared to 3% for the prior year same periods.

General and Administrative Expenses. Our general and administrative expenses by segment for the periods noted below are summarized as follows:

	Three Months Ended October 31,				Six Months Ended October 31,			
	2005 (restated)	2004 (restated)	Difference	%	2005 (restated)	2004 (restated)	Difference	%
General and Administrative Waterjet:								
North America	5,861	3,457	2,404	70%	10,741	6,815	3,926	58%
Asia	335	320	15	5%	733	592	141	24%
Other International	593	624	(31)	(5)%	1,168	1,259	(91)	(7)%
Other	346	437	(91)	(21)%	708	830	(122)	(15)%
Waterjet Total	7,135	4,838	2,297	47%	13,350	9,496	3,854	41%

General and administrative expenses increased $2.3 million or 47% and $3.9 million or 41% for the three and six months ended October 31, 2005, as compared to the prior year same periods. The increase was experienced primarily in the North America Waterjet segment which includes all of our corporate overhead costs. These costs were driven higher by legal costs of $936,000 and $1.8 million for the three and six months ended October 31, 2005 and public company-related costs such as Sarbanes-Oxley consulting fees of $838,000 and $1.4 million for the same respective periods. Expressed as a percentage of revenue, consolidated general and administrative expenses were 14% for the three and six months ended October 31, 2005, as compared to 11% and 12% for the prior year same periods.

Restructuring Expenses. During the three and six months ended October 31, 2005, we incurred $487,000 and $585,000 of severance benefits and other costs in the Other segment related to the closing and relocation of our Wixom, Michigan facility. No restructuring costs were incurred during the three and six months ended October 31, 2004.

Financial Consulting Expenses. No financial consulting costs were incurred in the six months ended October 31, 2005 compared with $623,000 in the prior year period associated with our efforts to refinance our subordinated debt. Because no new financing was obtained, these costs were charged to expense.

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Operating Income (Loss). Our operating income (loss) by segment for the periods noted below are summarized as follows:

	Three Months Ended October 31,				Six Months Ended October 31,			
	2005 (restated)	2004 (restated)	Difference	%	2005 (restated)	2004 (restated)	Difference	%
Operating Income (Loss)								
Waterjet:								
North America	2,259	1,366	893	65%	2,726	1,031	1,695	NM
Asia	2,016	1,579	437	28 %	3,361	3,243	118	4%
Other International	344	(1)	345	NM	627	(398)	1,025	NM
Other	528	(702)	1,230	NM	599	(601)	1,200	NM
Waterjet Total	5,147	2,242	2,905	130%	7,313	3,275	4,038	123%

NM = Not Meaningful

Our operating income for the three months ended October 31, 2005 was $5.3 million versus a $2.2 million in the prior year period. For the six months ended October 31, 2005, the operating income was $7.4 million versus $3.3 million in the prior year period. The reasons for the changes in operating profit or loss by segment have been described in the paragraphs above addressing changes in sales, gross margin and operating expenses.

Interest and Other (Expense) Income, net. Current interest expense, net decreased to $437,000 and $1,363,000 for the three and six months ended October 31, 2005. This net amount includes $19,000 and $55,000 of interest income for the three and six months ended October 31, 2005. This decrease results lower interest rates charged coupled with lower average debt on our balance owing with the paydown of the subordinated debt in April 2005 as well as lower amortization of debt issue costs. During the three and six months ended October 31, 2005, we recorded Other (Expense) Income, net of $(1,129,000) and ($2,914,000) compared to Other (Expense) Income, net of $2,655,000 and $2,561,000 in the prior year three and six month period. These changes are the result of changes in realized and unrealized foreign exchange gains and losses as described in the table below, offset by the $4,157,000 expense associated with the warrants used in the previously described PIPE transaction. The terms of these warrants require them to be marked-to-market at each reporting period with corresponding gains and losses reported on the Consolidated Statement of Operations. We also entered into a Purchase Agreement (the Purchase Agreement) with Barton Mines Company (Barton) to give Barton exclusive rights to sell abrasive to the Company s customers for $2.5 million in cash which was recorded as Other Income for the three and six months ended October 31, 2005.

	Three Months Ended October 31,		Six Months Ended October 31,	
	2005	2004	2005	2004
Realized Foreign Exchange (Losses) Gains, Net	$ (237)	$ 726	$ (220)	$ 1,339
Unrealized Foreign Exchange Gains (Losses), Net	631	1,927	(458)	1,251
Fair Value Adjustment on Warrants Issued	(4,157)		(4,835)	
Gain on Barton Sale	2,500		2,500	
Other	134	2	99	(29)

	$ (1,129)	$ 2,655	$ (2,914)	$ 2,561

Income Taxes. For the three and six months ended October 31, 2005 and 2004, the tax provision consists of current expense related to operations in foreign jurisdictions which are profitable primarily in Taiwan and Japan. In addition, operations in certain jurisdictions (principally Germany and US) reported net operating losses for which no tax benefit was recognized as it is more likely than not that such benefit will not be realized. During the fourth quarter of fiscal 2004, as a result of foreign asset collateral requirements and our amended credit agreements, we were no longer able to permanently defer foreign earnings and recorded a $1.7 million liability or

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withholding taxes payable on future repatriation of foreign earnings. We also recorded a U.S. tax liability of $6.7 million on foreign earnings which we have decided to no longer permanently defer. The total $6.7 million tax liability was offset by a reduction of the valuation allowance. In addition, we continue to assess our ability to realize our net deferred tax assets. Recognizing the cumulative losses generated during the quarter ended October 31, 2005 and in prior periods, we have determined it appropriate to continue to maintain a valuation allowance on our domestic net operating losses, certain foreign net operating losses and certain other deferred tax assets based on the expected reversal of both deferred tax assets and liabilities. The domestic net operating losses can be carried forward 20 years to offset domestic profits in future periods and expire from fiscal 2022 through fiscal 2024 if not used. Our foreign net operating losses currently do not have an expiration date. We provided a full valuation allowance against the deferred tax assets associated with the losses recorded during the quarter ended October 31, 2005.

Discontinued Operations, Net of Tax. In October 2005, we sold our Avure Business and have reacast our financial statements to reflect the Avure Business as discontinued operations for all historical periods presented. For the three months ended October 31, 2005 and 2004, loss from operations of discontinued operations was $184,000 and $1,004,000, respectively, primarily due to a significantly lower foreign exchange loss in the current quarter than the same quarter in the prior year. For the six months ended October 31, 2005, income from operations of discontinued operations was $966,000 compared to a loss of $673,000 in the same period in the prior year primarily due to a higher foreign exchange gain in the first quarter and a lower foreign exchange loss in the second quarter.

Net Income (Loss). Our consolidated net income in the three months ended October 31, 2005 amounted to $1.0 million, or $.03 basic and diluted income per share as compared to a net loss of $338,000, or $.02 basic and diluted loss per share in the prior year same periods. For the year-to-date period, our consolidated net income was $1.0 million or $.03 basic and diluted per share as compared to a net loss of $2.7 million, or $.17 basic and diluted loss per share in the prior year same period.

Operational and Financial Data Fiscal 2005, 2004 and 2003

All operational and financial data in the following pages has been recast to give effect to the sale of the Avure Business and reflects the results of the Avure Business as discontinued operations for all periods presented.

Operational Data as a Percentage of Sales

	Year Ended April 30,		
	2005 (restated)	2004 (restated)	2003 (restated)
Sales	100%	100%	100%
Cost of Sales	62%	62%	72%
Gross Margin	38%	38%	28%
Expenses:			
Marketing	16%	17%	24%
Research & Engineering	3%	5%	6%

General & Administrative	13%	14%	15%
Restructuring Charges	%	2%	%
Financial Consulting Charges	1%	1%	%
Impairment Charges	%	%	6%
	33%	39%	51%

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	Year Ended April 30,		
	2005 (restated)	2004 (restated)	2003 (restated)
Operating Income (Loss)	5%	(1)%	(23)%
Interest Expense	(12)%	(10)%	(9)%
Interest Income	%	%	%
Other Income (Expense), net	1%	6%	5%
Loss Before Provision for Income Taxes	(6)%	(5)%	(27)%
Provision for Income Taxes	(1)%	(3)%	(9)%
Loss Before Discontinued Operations	(7)%	(8)%	(36)%
Discontinued Operations, Net of Tax	(5)%	%	(20)%
Net Loss	(12)%	(8)%	(56)%

Sales Summary:

	Year ended April 30,			Year ended April 30,		
Dollars in thousands	2005	2004	% Change	2004	2003	% Change
Operational breakdown:						
Waterjet:						
Systems	$ 122,129	$ 85,015	44%	$ 85,015	$ 76,346	11%
Consumable parts and services	50,837	47,846	6%	47,846	45,487	5%
Total	$ 172,966	$ 132,861	30%	$ 132,861	$ 121,833	9%
Geographic breakdown:						
United States	$ 97,286	$ 70,058	39%	$ 70,058	$ 66,931	5%
Rest of Americas	19,468	17,751	10%	17,751	15,673	13%
Europe	30,707	24,550	25%	24,550	21,563	14%
Asia	25,505	20,502	24%	20,502	17,666	16%
	$ 172,966	$ 132,861	30%	$ 132,861	$ 121,833	9%

Results of Operations Fiscal 2005, 2004 and 2003

Our UHP business which we call Waterjet, is comprised of the following segments: North America Waterjet, Asia Waterjet, Other International Waterjet and Other.

Fiscal 2005 Compared to Fiscal 2004

(Tabular amount in thousands)

Sales.

Our sales by segment for the periods noted below is summarized as follows:

	2005	2004	Difference	%
Sales				
Waterjet:				
North America	$ 82,381	$ 59,044	$ 23,337	40%
Asia	25,505	20,502	5,003	24%
Other International	34,530	28,160	6,370	23%
Other	30,550	25,155	5,395	21%
Waterjet Total	$ 172,966	$ 132,861	$ 40,105	30%

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Waterjet. The Waterjet operation includes cutting and cleaning operations, which are focused on providing total solutions for the aerospace, automotive, job shop, surface preparation (cleaning) and paper industries. It is comprised of four reporting segments: North America Waterjet, Asia Waterjet, Other International Waterjet and Other. The North America, Asia and Other International Waterjet segments primarily represent sales of our standard cutting and cleaning systems throughout the world, as well as sales of our custom designed systems into the aerospace industry. The Other segment represents sales of our automation and robotic waterjet cutting cells, as well as non-waterjet systems, which are sold primarily into the North American automotive industry. For the fiscal year ended April 30, 2005, we reported a $40.1 million, or 30%, increase in revenue to $173.0 million versus the prior year comparative period. All four segments reported an increase in revenue; however $23.3 million of the $40.1 million increase was recognized in our North America Waterjet segment. At the end of fiscal 2004, we believed the market awareness of waterjet technology was low and addressed this through an increase in marketing and tradeshow activity, including attendance at the bi-annual International Manufacturing Technology Show in early September 2004, as well as increasing the number of domestic waterjet cutting direct sales staff from 10 to 15, adding two machine tool distributors, acting as agents, and increasing domestic technical services staff from 12 to 24 persons. The growth in revenue in North America is a result of an increase in unit sales stemming from our increased sales and marketing activity. There were no significant price increases year over year, however a price increase of 4% on selected systems was implemented on February 1, 2005. Aerospace sales, which are also included in the North America segment, were $5.5 million, up $1.4 million (33%) from the prior year. The growth in our Other segment results from improved non-waterjet automated robotic system demand in the domestic automotive industry. We have not increased our marketing and sales staff in this segment year over year. Our waterjets are experiencing growing acceptance in the marketplace because of their flexibility and superior machine performance.

Outside the U.S., Waterjet revenue growth was positively influenced by growth in Asia Waterjet sales which were $25.5 million, up $5.0 million or 24% for the year ended April 30, 2005. This increase was driven largely by sales in China where we experienced strong demand for shapecutting and cutting cell systems from a strengthening automotive industry.

Our Other International Waterjet segment represents primarily sales in Europe and South America. Revenues from our European operations have improved by $6.2 million (25%) for the year ended April 30, 2005 to $30.7 million. Market specific pricing including some price reductions, standardization of system offerings, improved delivery and a recovering European marketplace have helped to increase our European sales. Sales in South America of $3.8 million for the year ended April 30, 2005 were comparable to the respective prior year period. The economic conditions in the South America region make it difficult to increase sales. We are typically able to sell our products at higher prices outside the U.S. due to the costs of servicing these markets. As much of our product is manufactured in the U.S., the weakness of the U.S. dollar also has helped strengthen our foreign revenues.

We also analyze our Waterjet revenues by looking at system sales and consumable sales. Systems revenues for the year ended April 30, 2005 were $122.1 million, an increase of $37.1 million or 44%, compared to the prior year same period due to both strong domestic and global sales from recovering economic conditions. The majority, $21.4 million, of the increase was generated domestically. Consumables revenues recorded an increase of $3.0 million or 6% to $50.8 million for the year ended April 30, 2005. The majority of the increase in spares sales is domestic and is the result of the increasing number of operating systems, increasing sales of our proprietary productivity enhancing kits, improved parts availability, as well as increased customer acceptance of Flowparts.com, our easy-to-use internet order entry system. We believe that spare parts sales should continue to increase as more systems are put into operation.

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Cost of Sales and Gross Margins. Our gross margin by segment for the periods noted below is summarized as follows:

	2005 (restated)	2004	Difference	%
Gross Margin				
Waterjet:				
North America	$ 38,768	$ 25,985	$ 12,783	49%
Asia	11,682	9,762	1,920	20%
Other International	12,034	9,876	2,158	22%
Other	3,539	4,435	(896)	(20)%
Waterjet Total	$ 66,023	$ 50,058	$ 15,965	32%

Our gross margin as a percent of sales by segment for the periods noted below is summarized as follows:

	2005 (restated)	2004
Gross Margin Percentage		
Waterjet:		
North America	47%	44%
Asia	46%	48%
Other International	35%	35%
Other	12%	18%
Waterjet Total	38%	38%

Gross margin for the year ended April 30, 2005 amounted to $66.0 million or 38% of sales as compared to gross margin of $50.1 million or 38% of sales in the prior year period. Generally, gross margin rates will vary period over period depending on the mix of sales, which includes special system, standard system and consumables sales. Gross margin rates on our systems sales are typically less than 45% as opposed to consumables sales which are in excess of 50%. On average, standard systems which are included in the North America, Asia and Other International Waterjet segments carry higher margins than the custom engineered systems, which are represented by the Other, segment. In addition, gross margin as a percent of sales will vary amongst segments due to inter-company sales and the related inter-company transfer pricing.

The increase in North American waterjet margins were offset in part by the decrease of five percentage points in the Other segment in fiscal 2005. This weakness stems from a number of very low margin contracts built in fiscal 2005, including several loss contracts which totaled $1.2 million in losses. All loss contracts were non-waterjet related systems. We have consolidated the management of this division within the Other segment and current contracts appear to be in line with historical gross margins in the automotive industry, between 15% and 25%.

Marketing Expenses. Our marketing expenses by segment for the periods noted below are summarized as follows:

	2005 (restated)	2004	Difference	%
Marketing				
Waterjet:				
North America	$ 14,717	$ 10,159	$ 4,558	45%
Asia	3,704	3,022	682	23%
Other International	8,161	7,840	321	4%
Other	1,789	1,822	(33)	(2)%
Waterjet Total	$ 28,371	$ 22,843	$ 5,528	24%

Marketing expenses increased $5.5 million or 24% to $28.4 million for the year ended April 30, 2005 as compared to the prior year period. The Waterjet increase in North America was the result of improved sales and the market awareness programs. Fiscal 2005 also includes over $.5 million in costs associated with the bi-annual International Manufacturing Technology Show held during the second quarter ended October 31, 2004. Asia and Other International Waterjet recorded cost increases in line with changes in sales and the Other segment held marketing costs constant. Expressed as a percentage of sales, consolidated marketing expenses were 16% for fiscal 2005, compared to 17% of sales for fiscal 2004.

Research and Engineering Expenses. Our research and engineering expenses by segment for the periods noted below are summarized as follows:

	2005 (restated)	2004	Difference	%
Research and Engineering				
Waterjet:				
North America	$ 4,605	$ 4,504	$ 101	2%
Asia	348	295	53	18%
Other International	712	737	(25)	(3)%
Other	224	337	(113)	(34)%
Waterjet Total	$ 5,889	$ 5,873	$ 16	%

Research and engineering expenses increased $16,000 for fiscal 2005 as compared to fiscal 2004. Waterjet expenses were up slightly associated with our aerospace programs. The overall changes were related to the timing of research and development work, the use of engineers on revenue generating projects and continued cost cutting across most segments. Expressed as a percentage of revenue, research and engineering expenses were 3% in fiscal 2005, as compared to 5% in fiscal 2004.

General and Administrative Expenses. Our general and administrative expenses by segment for the periods noted below are summarized as follows:

	2005	2004	Difference	%
General and Administrative				
Waterjet:				
North America	$ 16,949	$ 13,096	$ 3,853	29%
Asia	1,381	1,146	235	21%
Other International	2,653	2,947	(294)	(10)%
Other	1,866	1,842	24	1%
Waterjet Total	$ 22,849	$ 19,031	$ 3,818	20%

General and administrative expenses increased $3.8 million or 20% for the year ended April 30, 2005, as compared to the prior year. The North America Waterjet segment increased $3.9 million. This includes increased professional fees of $900,000 associated with patent litigation, $600,000 for increased audit fees and Sarbanes Oxley consulting fees, increased incentive compensation of $1.5 million and increased labor and miscellaneous other costs associated with strengthening key corporate functions of $900,000. As a percent of sales, however, North America Waterjet general and administrative expenses decreased from 22% to 21% in fiscal 2005. Expressed as a percentage of revenue, consolidated general and administrative expenses were 13% in fiscal 2004 as compared to 14% for the prior year period.

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Restructuring Charges. During fiscal 2004, we incurred $2.5 million of restructuring charges in loss from continuing operations, including severance, lease termination and inventory related charges, primarily in the U.S. and Germany. The most significant parts of this total being incurred in the North America Waterjet segment, $1.0 million and Other International Waterjet, $1.4 million. The Avure Business incurred restructuring charges of $239,000 and $788,000 for the years ended April 30, 2005 and 2004, respectively.

The following table summarizes accrued restructuring activity for fiscal 2004 and 2005 (in thousands):

	North America Waterjet		Other International Waterjet			Other Waterjet	Discontinued Operations			Consolidated			
	Facility Exit Costs	Other	Severance Benefits	Facility Exit Costs	Other	Severance Benefits	Severance Benefits	Facility Exit Costs	Other	Severance Benefits	Facility Exit Costs	Other	Total
Q1 restructuring charge	$	$	$ 248	$	$	$	$	$	$	$ 248	$	$	$ 248
Q1 cash payments			(128)							(128)			(128)
Balance, July 31, 2003			120							120			120
Q2 restructuring charge		113	(120)	105	302		201	191	65	81	296	480	857
Q2 cash payments		(113)			(47)				(65)			(225)	(225)
Q2 charge-offs					(255)							(255)	(255)
Balance, October 31, 2003				105			201	191		201	296		497
Q3 restructuring charge	407	109		85	484	89			61	89	492	654	1,235
Q3 cash payments	(270)	(99)		(14)			(121)		(61)	(121)	(284)	(160)	(565)
Q3 charge-offs		(10)		(85)	(484)						(85)	(494)	(579)
Balance, January 31, 2004	137			91		89	80	191		169	419		588
Q4 restructuring charge	15	376		255			234		36	234	270	412	916
Q4 cash payments	(13)	(90)		(13)		(89)	(70)		(36)	(159)	(26)	(126)	(311)
Q4 charge-offs		(286)										(286)	(286)
Balance, April 30, 2004	139			333			244	191		244	663		907
Q1 restructuring charge													
Q1 cash payments	(9)			(4)			(68)	(3)		(68)	(16)		(84)
Balance, July 31, 2004	130			329			176	188		176	647		823
Q2 restructuring charge													
Q2 cash payments	(9)			(4)			(64)	(3)		(64)	(16)		(80)
Balance, October 31, 2004	121			325			112	185		112	631		743
Q3 restructuring charge							120	119		120	119		239
Q3 cash payments	(9)			(10)			(56)	(42)		(56)	(61)		(117)
Balance, January 31, 2005	112			315			176	262		176	689		865
Q4 restructuring charge													
Q4 cash payments	(9)			(31)			(89)	(20)		(89)	(60)		(149)
Balance, April 30 2005	$ 103	$	$	$ 284	$	$	$ 87	$ 242	$	$ 87	$ 629	$	$ 716

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Financial Consulting Charges. During the years ended April 30, 2005 and 2004, we incurred $.6 million and $1.5 million, respectively, of professional fees associated with the restructuring of our debt in July 2004 and July 2003, respectively. These costs were either expenses related to potential Senior Credit Arrangements with lenders that did not occur, or they related to expenses associated with our subordinated debt and did not result in an increase in the facility, accordingly, they were expensed.

Operating Income (Loss).

Our operating income (loss) by segment for the periods noted below are summarized as follows:

	2005 (restated)	2004	Difference	%
Operating Income (Loss)				
Waterjet:				
North America	$ 1,874	$ (4,403)	$ 6,277	NM
Asia	6,249	5,299	950	18%
Other International	508	(2,908)	3,416	NM
Other	(340)	335	(675)	NM
Waterjet Total	$ 8,291	$ (1,677)	$ 9,968	NM

NM = Not Meaningful

Our operating income for the year ended April 30, 2005 was $8.3 million as compared to an operating loss of $1.7 million for the year ended April 30, 2004. The reasons for the changes in operating profit or loss by segment have been described in the paragraphs above addressing changes in sales, gross margin and operating expenses.

Interest and Other Income (Expense), net. Interest expense increased to $20.3 million for the year ended April 30, 2005, a $7.6 million increase as compared to the prior year. This increase includes the write-off of debt discount of $4.3 million associated with the pay-off of our subordinated debt, $1.6 million in write off of capitalized loan costs under EITF 98-14 Debtor s Accounting for Changes in Line-of Credit or Revolving-Debt Arrangements (EITF 98-14) and $1.6 million related to the expensing of anti-dilution warrants provided to lenders whose underlying debt was retired in April 2005 under EITF 98-14. During fiscal 2005, we recorded Other Income, net of $1.7 million as outlined below. This compares to Other Income, net of $8.1 million in the prior year period. Other income, net in fiscal 2004 includes a $2.6 million gain on the sale of investment securities we held and net foreign exchange gains and losses.

The following table shows the detail of Other Income (Expense), net, in the accompanying Consolidated Statements of Operations:

	2005	2004

Net realized foreign exchange gains	$ 2,826	$ 915
Net unrealized foreign exchange (losses) gains	(772)	3,960
Realized gain on sale of equity securities		2,618
Other	(349)	628
Total	$ 1,705	$ 8,121

Income Taxes. The fiscal 2005 and 2004 tax provision consists of current expense related to operations in foreign jurisdictions which are profitable, primarily in Taiwan and Japan. In addition, operations in certain jurisdictions (principally Germany and the United States) reported net operating losses for which no tax benefit was recognized as it is more likely than not that such benefit will not be realized. During the fourth quarter of fiscal 2004, as a result of foreign asset collateral requirements and our amended credit agreements, we were no longer able to permanently defer foreign earnings and recorded a $1.7 million liability for withholding taxes payable on future repatriation of foreign earnings. We also recorded a U.S. tax liability of $6.7 million on foreign earnings. The total $6.7 million tax liability was offset by a reduction of the valuation allowance. In addition, we continue to assess our ability to realize our net deferred tax assets. Recognizing the continued losses generated during fiscal 2005 and in prior periods, we have determined it appropriate to continue to maintain a valuation allowance on our domestic net operating losses, certain foreign net operating losses and certain other deferred tax assets based on the expected reversal of both deferred tax assets and liabilities. The domestic net operating losses can be carried forward 20 years to offset domestic profits in future periods and expire between fiscal 2022 and fiscal 2024 if not used. Our foreign net operating losses currently do not have an expiration date. We provided a full valuation allowance against the deferred tax assets associated with the losses recorded during fiscal 2005.

Discontinued Operations, Net of Tax. In October 2005, we sold our Avure Business and have recast our financial statements to reflect the Avure Business as discontinued operations for all historical periods presented. For the year ended April 30, 2005, loss from discontinued operations was $8.9 million compared to a loss of $733,000 for the year ended April 30, 2004 which includes a gain on the disposition of our HCS subsidiary of $650,000. Fiscal 2005 results included a $9.1 million goodwill impairment charge which caused the increase in the loss compared to fiscal 2004.

Net Loss. For the year ended April 30, 2005, our consolidated net loss was $21.2 million or $1.19 per basic and diluted loss per share as compared to a net loss of $11.3 million, or $.73 basic and diluted loss per share in the prior year period.

The weighted average number of shares outstanding used for the calculation of basic and diluted loss per share is 17,748,000 for fiscal 2005 and 15,415,000 for fiscal 2004. There were 2,034,546 and 2,089,412 of potentially dilutive common shares from employee stock options and 3,219,245 and 860,000 of potentially dilutive shares from warrants which have been excluded from the diluted weighted average share denominator for fiscal 2005 and 2004, respectively, as their effect would be anti-dilutive.

Fiscal 2004 Compared to Fiscal 2003. (Tabular amounts in thousands)

Sales.

Our sales by segment for 2004 and 2003 is summarized as follows:

	Year Ended April 30,		Dollar	Percent
	2004	2003	Change	Change
Sales				
Waterjet:				
North America	$ 59,044	$ 53,995	$ 5,049	9%
Asia	20,502	17,667	2,835	16%
Other International	28,160	23,279	4,881	21%
Other	25,155	26,892	(1,737)	(6)%

Waterjet Total	$ 132,861	$ 121,833	$ 11,028	9%

Waterjet. For the year ended April 30, 2004, total Waterjet revenue increased $11.0 million or 9% to $132.9 million from $121.8 million in the prior year. All of this growth was recorded in the North America, Asia and Other International Waterjet segments, driven by market demand for our dynamic waterjet cutting head and improved global market conditions in the primary industries we serve. This growth was all volume related as we did not increase prices during fiscal 2004.

Included in the $5.0 million increase in fiscal 2004 in North American waterjet sales is a $3.3 million or 6% revenue increase over the prior year period for sales of our domestic standard waterjet cutting systems. Our

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waterjets are experiencing continued acceptance in the marketplace from their flexibility and superior machine performance. The remainder of the North America Waterjet increase relates to an increase in our aerospace business, which totaled $4.1 million in fiscal 2004 driven by the manufacture of the Airbus A380. North American automotive and automation (our Other segment) sales decreased 6% or $1.7 million in fiscal 2004 as compared to fiscal 2003 due to the cyclical nature of the automotive industry.

Outside the U.S., Waterjet revenue growth was positively influenced by growth in Asian revenues which were up $2.8 million or 16% for the year ended April 30, 2004 to $20.5 million, compared to $17.7 million in the prior year. These increases were driven largely by sales in Japan where we experienced strong demand for our surface preparation and shapecutting systems, due in part to the refurbishment program for U.S. Navy ships based in Japan.

Our Other International Waterjet segment represents primarily sales into Europe and South America. Revenues from our European operations have improved by $3.0 million or 14% to $24.6 million during fiscal 2004. Market specific pricing and standardization of system offerings and a recovering European marketplace contributed to this improvement. Sales into South America are up $1.9 million due to improvements in sales of surface preparation equipment.

We also analyze our Waterjet revenues by looking at system sales and consumable sales. Systems revenues for the year ended April 30, 2004 were $85.0 million, an increase of $8.7 million or 11%, compared to the prior fiscal year due to strong global sales from recovering economic conditions driven by a weaker U.S. dollar. Consumables revenues also recorded an improvement of 5% or $2.3 million to $47.8 million for the year ended April 30, 2004, compared to the prior year consumable revenue of $45.5 million. This is due to increased machine utilization by our customers in North and South America and Asia, all of which led to higher parts consumption. Consumables revenue continues to be positively impacted by our proprietary productivity enhancing kits and improved parts availability as well as the introduction of Flowparts.com, our easy-to-use internet order entry system.

Cost of Sales and Gross Margins. Our gross margin by segment for 2004 and 2003 is summarized as follows:

	Year Ended April 30,		Dollar	Percent
	2004	2003	Change	Change
Gross Margin				
Waterjet:				
North America	$ 25,985	$ 22,570	$ 3,415	15%
Asia	9,762	7,702	2,060	27%
Other International	9,876	1,782	8,094	NM
Other	4,435	2,321	2,114	91%
Waterjet Total	$ 50,058	$ 34,375	$ 15,683	46%

NM=Not meaningful

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Our gross margin percentage by segment for 2004 and 2003 is summarized as follows:

	Year Ended April 30,	
	2004	2003
Gross Margin Percent		
Waterjet:		
North America	44%	42%
Asia	48%	44%
Other International	35%	8%
Other	18%	9%
Waterjet Total	38%	28%

Gross margin for the year ended April 30, 2004 amounted to $50.1 million or 38% of revenues, as compared to gross margin of $34.4 million or 28% of revenues in the prior year. Fiscal 2003 gross margin was negatively impacted by a number of adjustments posted during the third quarter of that year which totaled $6.9 million. We experienced improvement in the gross margin as a percent of revenues in each of the four segments that comprise the Waterjet operations. This gross margin improvement of 10 percentage points, 38% of revenues in fiscal 2004 compared to 28% of revenues in the prior year, was a result of better overhead absorption in light of higher sales volumes of $11 million in the year and on fiscal 2003 inventory valuation charges of $4.4 million which did not recur in 2004.

Marketing Expenses. Our marketing expense by segment for 2004 and 2003 is summarized as follows:

	Year Ended April 30,		Dollar	Percent
	2004	2003	Change	Change
Marketing				
Waterjet:				
North America	$ 10,159	$ 12,763	$ (2,604)	(20)%
Asia	3,022	3,008	14	%
Other International	7,840	10,881	(3,041)	(28)%
Other	1,822	2,780	(958)	(34)%
Waterjet Total	$ 22,843	$ 29,432	$ (6,589)	(22)%

Marketing expenses decreased $6.6 million or 22% to $22.8 million for the year ended April 30, 2004, as compared to the prior year marketing expenses of $29.4 million.

Fiscal 2003 included a $4.1 million charge, in the Waterjet operations, to the allowance for doubtful accounts based on our assessment of the financial conditions of our individual customers and general marketplace conditions. The predominance of this increase in the allowance was recorded in the Other International Waterjet segment. The remainder of the reduction in Waterjet marketing expenses over the prior year results from the implementation of cost cutting measures during fiscal 2004 aimed at providing return on invested marketing dollars, as well as the fact that the fiscal 2003 North America Waterjet segment includes the costs of participation at the 2003 bi-annual IMTS tradeshow of approximately $500,000.

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Research and Engineering Expenses. Our research and engineering expense by segment for 2004 and 2003 is summarized as follows:

	Year Ended April 30,			
	2004	**2003**	**Dollar Change**	**Percent Change**
Research and Engineering				
Waterjet:				
North America	$ 4,504	$ 4,754	$ (250)	(5)%
Asia	295	278	17	6%
Other International	737	951	(214)	(23)%
Other	337	688	(351)	(51)%
Waterjet Total	$ 5,873	$ 6,671	$ (798)	(12)%

Research and engineering expenses decreased $798,000 or 12% to $5.9 million for the year ended April 30, 2004, as compared to the prior year s research and engineering expenses of $6.7 million. The decrease in Waterjet is spread evenly throughout all segments within Waterjet except Asia, which was flat with the prior year. The reductions in all segments, relate to the timing of research and development work and the increased use of engineers on revenue generating projects, where costs are charged to Cost of Sales. Expressed as a percentage of revenue, research and engineering expenses were 5% and 6% for the years ended April 30, 2004 and 2003, respectively.

General and Administrative Expenses. Our general and administrative expense by segment for 2004 and 2003 is summarized as follows:

	Year Ended April 30,			
	2004	**2003**	**Dollar Change**	**Percent Change**
General and Administrative				
Waterjet:				
North America	$ 13,096	$ 11,164	$ 1,932	17%
Asia	1,146	983	163	17%
Other International	2,947	4,313	(1,366)	(32)%
Other	1,842	2,324	(482)	(21)%
Waterjet Total	$ 19,031	$ 18,784	$ 247	1%

General and administrative expenses increased $247,000 or 1% to $19.0 million for the year ended April 30, 2004, as compared to the prior year s general and administrative expenses of $18.8 million. All segments experienced a decrease in general and administrative expense, except for the North America Waterjet segment, up $1.9 million (17%) and the Asia Waterjet segment, up $.2 million (17%). The decreases represent cost cutting measures put in place by management. The increase in North America Waterjet is attributable to higher costs of doing business as a public company following the enactment by Congress of the Sarbanes-Oxley Act of 2002 and include increased directors and officers liability insurance of $.9 million as well as higher consulting costs for internal control work and other special projects of $.2 million. In addition, we resumed the compensation of our Board members in fiscal 2004 and implemented a performance-based bonus plan for management which together amounted to an increase of $2.9 million. These increases in the North America Waterjet segment were offset in part to general across the board cost reductions. The increase in Asia Waterjet is the addition of staff. Expressed as a percentage of revenue, general and administrative expenses were 14% and 15% for the years ended April 30, 2004 and 2003, respectively.

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Restructuring and Impairment Charges. Our restructuring and impairment charges by segment for 2004 and 2003 is summarized as follows:

	Year Ending April 30, 2004 Restructuring	Year Ending April 30, 2003 Impairment
Waterjet:		
North America	$ 1,020	$
Asia		
Other International	1,359	2,113
Other	89	5,032
Waterjet Total	$ 2,468	$ 7,145

	North America Waterjet		Other International Waterjet			Other Waterjet	Discontinued Operations			Consolidated			
	Facility Exit Costs	Other	Severance Benefits	Facility Exit Costs	Other	Severance Benefits	Severance Benefits	Facility Exit Costs	Other	Severance Benefits	Facility Exit Costs	Other	Total
Q1 restructuring charge	$	$	$ 248	$	$	$	$	$	$	$ 248	$	$	$ 248
Q1 cash payments			(128)							(128)			(128)
Balance, July 31, 2003			120							120			120
Q2 restructuring charge		113	(120)	105	302		201	191	65	81	296	480	857
Q2 cash payments		(113)			(47)				(65)			(225)	(225)
Q2 charge-offs					(255)							(255)	(255)
Balance, October 31, 2003				105			201	191		201	296		497
Q3 restructuring charge	407	109		85	484	89			61	89	492	654	1,235
Q3 cash payments	(270)	(99)		(14)			(121)		(61)	(121)	(284)	(160)	(565)
Q3 charge-offs		(10)		(85)	(484)						(85)	(494)	(579)
Balance, January 31, 2004	137			91		89	80	191		169	419		588
Q4 restructuring charge	15	376		255			234		36	234	270	412	916
Q4 cash payments	(13)	(90)		(13)		(89)	(70)		(36)	(159)	(26)	(126)	(311)
Q4 charge-offs		(286)										(286)	(286)
Balance, April 30, 2004	$ 139	$	$	$ 333	$	$	$ 244	$ 191	$	$ 244	$ 663	$	$ 907

Restructuring Charges. There were no restructuring charges in fiscal 2003. During the year ended April 30, 2004, we incurred $2.5 million of restructuring-related costs, including severance, lease termination and inventory related charges , primarily in the U.S. and Germany. The most significant of this total being incurred in the North America Waterjet segment, $1.0 million and Other International Waterjet, $1.4 million.

Financial Consulting Charges. During the year ended April 30, 2004, we incurred $1.5 million of professional fees associated with the restructuring of our debt in July 2003. These costs were evaluated under EITF 98-14, Debtor s Accounting for Changes in Line-of-Credit or Revolving-Debt Arrangements , and as they

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were either expenses related to potential Senior Credit Arrangements with lenders that did not occur, or they related to expenses associated with our subordinated debt and did not result in increase in the facility and accordingly they were expensed. No such costs were incurred for the year ended April 30, 2003.

Impairment Charges. There were no impairment charges in fiscal 2004. During fiscal 2003, we conducted a review of the carrying value of our goodwill. Statement of Financial Accounting Standard No. 142 (FAS 142), Goodwill and Other Intangible Assets, requires a company to perform impairment testing when certain triggering events affecting a business unit have taken place. The triggering events were the expectation of a sale or full or partial disposal of certain of our divisions and the continuing deterioration of the economic climate. Our review resulted in impairment charges of $7.1 million during the quarter ended January 31, 2003, $5 million was recorded in the Other segment and $2.1 million was recorded in the Other International Waterjet segment. The impairment resulted primarily from continued weakness in the automotive industry, as well as weakness in our European operations. We also prepared an analysis of the fair value of the Company s reporting units for our required FAS 142 annual assessment. This assessment, performed as of April 30, 2003, revealed no further impairment. At April 30, 2003, we also conducted an impairment review of our long-lived assets in accordance with Statement of Financial Accounting Standard No. 144 (FAS 144), Accounting for the Impairment or Disposal of Long-Lived Assets. This review led to no impairment charges.

Operating Income (Loss). Our operating income (loss) by segment for 2004 and 2003 is summarized as follows:

	Year Ended April 30,			
	2004	**2003**	**Dollar Change**	**Percent Change**
Operating income (loss)				
Waterjet:				
North America	$ (4,403)	$ (6,111)	$ 1,708	28%
Asia	5,299	3,433	1,866	54%
Other International	(2,908)	(16,476)	13,568	82%
Other	335	(8,503)	8,838	NM
Waterjet Total	$ (1,677)	$ (27,657)	$ 25,980	94%

We recorded an operating loss of $1.7 million for the year ended April 30, 2004, as compared to a loss of $27.7 million in the prior year. All segments of our business recorded either increases in operating profit or a decrease in the operating loss as compared to fiscal 2003. The reasons for the changes in operating-profit or loss have been described in the paragraphs above addressing changes in sales, gross margin and operating expenses.

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Interest and Other Income (Expense), net. Fiscal 2004 interest expense increased $1.4 million or 12% to $12.8 million compared to the prior year of $11.4 million due to increased amounts of amortization of fees from our credit facilities and a higher weighted average cost of capital from interest charged on the deferred and capitalized semi-annual interest payments to our subordinated lender. Included in Other Income, net is a $2.6 million gain from the sale of our investment in WGI Heavy Minerals. In addition, the weaker dollar has positively impacted our foreign transactions and we have thus realized net currency gains of $915,000, as well as unrealized currency gains of $4.0 million in fiscal 2004. As the U.S. dollar remains weak, this has also caused other changes in our balance sheet, including an increase in our goodwill and intangible assets due to the translation from foreign currencies. Included in Other Income, net for the year ended April 30, 2003, are $624,000 of net realized foreign exchange transaction losses offset by $6.8 million of unrealized currency gains. Below is the detail of Other Income (Expense), net.

	Year Ended April 30,	
	2004	2003
Net realized foreign exchange gains (losses)	$ 915	$ (624)
Net unrealized foreign exchange gains (losses)	3,960	6,837
Realized gain on sale of equity securities	2,618	
Write-off of investment and other assets		(35)
Other	628	(231)
Total	$ 8,121	$ 5,947

Income Taxes. We are providing for income taxes in jurisdictions where we have generated taxable income. During fiscal 2004, as a result of foreign asset collateral requirements and the amended credit agreements discussed in Note 9 to Consolidated Financial Statements, we were no longer able to permanently defer foreign earnings and recorded a $1.7 million liability for withholding taxes payable on future repatriation of foreign earnings. We also recorded a U.S. tax liability of $6.7 million on foreign earnings which we have decided to no longer permanently defer. The total $6.7 million tax liability is offset by a release of the valuation allowance. In addition, we continue to assess our ability to realize our net deferred tax assets. Recognizing the continued losses generated during the quarter and in prior periods, we have determined it appropriate to continue to maintain a valuation allowance on our domestic net operating losses, certain foreign net operating losses and certain other deferred tax assets based on the expected reversal of both deferred tax assets and liabilities. As of April 30, 2004, we had approximately $42.9 million of domestic net operating loss carryforwards to offset certain earnings for federal income tax purposes. All of these net operating loss carryforwards expire between fiscal 2022 and 2023. Net operating loss carryforwards in foreign jurisdictions amount to $35.6 million and do not expire. See Note 10 to Consolidated Financial Statements for discussion of tax components.

Discontinued Operations, Net of Tax. As of April 30, 2003, we held one of our service subsidiaries for sale and consequently showed its results of operations as discontinued operations for all periods presented. The sale of this subsidiary was consummated May 16, 2003 and resulted in cash proceeds of $1.8 million and a gain of approximately $650,000. In addition, in October 2005, we sold our Avure Business and have recast our financial statements to reflect the Avure Business as discontinued operations for all historical periods presented. Results from discontinued operations amounted to a loss of $1.4 million for the year ended April 30, 2004 as compared to a loss of $23.8 million for the year ended April 30, 2003. Fiscal 2003 included a number of charges related to our comprehensive financial review which caused this loss to be so large.

Net Loss. Our consolidated net loss for fiscal 2004 amounted to $11.3 million, or $.73 basic and diluted loss per share as compared to a net loss of $67.8 million, or $4.42 basic and diluted loss per share in the prior year.

The weighted average number of shares outstanding used for the calculation of basic and diluted loss per share is 15,415,000 for fiscal 2004 and 15,348,000 for fiscal 2003.

Fiscal 2003 Comprehensive Financial Review. During fiscal 2003, we revised our approach to receivable collection, inventory reduction and investigated other cash-generating initiatives in response to the continued

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decline in the economy and our highly leveraged position. We reviewed the carrying values of those assets that we expected to convert to cash in the short-term, as well as long-lived tangible and intangible assets and adjusted the carrying value of such assets to reflect their estimated current net realizable value. In addition, we conducted a review of potential liabilities. The total adjustments for the year ended April 30, 2003 are included in the Consolidated Statement of Operations. These adjustments, which are summarized below, were highly influenced by the economic environment our customers and we are facing.

We increased our allowance for doubtful accounts by $4.1 million. This increase was based on extensive collection efforts and the results of a worldwide receivable-by-receivable review, including evaluation of the impact of current economic conditions, which had restricted customers ability to pay their account balances.

We evaluated our ability to convert inventories, including evaluation and demonstration units, into cash in the short term by their sale or disposition. This evaluation led to a total adjustment of $5.4 million to arrive at the estimated net realizable value of our inventories. Of this amount, $1.8 million related to our Discontinued Operations.

We conducted a detailed review of the carrying value of our goodwill in accordance with FAS 142. The triggering events were the expectation of sale or full or partial disposal of certain of our divisions, the continuing deterioration of the economic climate, and our operating losses. Our review resulted in impairment charges of $7.1 million during the third quarter of fiscal 2003. The impairment resulted primarily from continued weakness in the automotive industry, as well poor performance at our European operations. Our required annual FAS 142 review as of April 30, 2003 led to no further impairment charges.

We determined that no significant future services would be required of our former CEO. Therefore we accrued and charged to operations all remaining contractual fees and related benefits aggregating approximately $1.1 million.

During fiscal 2003, we sold $9.7 million of long-term notes receivable for $8.6 million. This discount of $1.1 million plus an additional accrual of $0.1 million on potential future notes available for sale were recorded in Discontinued Operations.

We accrued an additional $1.5 million for potential losses related to several recourse/repurchase obligations on European sales. We have from time to time entered into recourse obligations with third party leasing companies. In response to continued concerns about the financial health of several customers, we revised our estimate of potential future exposure. Included in the $1.5 million accrual was $760,000 for the estimated loss on the repurchase and subsequent sale of a flex form press system from our Discontinued Operations, where we had a recourse obligation for a bankrupt customer. We sold this unit to an unrelated party in fiscal 2004.

We had deferred $0.8 million in professional fees associated with previous ongoing strategic transactions, consisting of a planned equity offering and spin-off of Avure. We abandoned these plans and accordingly expensed all of these fees.

We reversed percentage of completion revenue previously recognized on three food systems (one customer) based on the customer s failure to fulfill its obligations under the contract terms. The total revenue reversed in the third quarter of fiscal 2003 was $4.3 million with an associated gross margin of $2.3 million. This reversal is shown in Discontinued Operations. We received new orders for which we plan to deliver already-completed systems from inventory. Accordingly, these specific contracts did not qualify for percentage of completion accounting and the corresponding revenue was recognized upon delivery and acceptance in fiscal 2004.

We assessed our ability to realize our net deferred tax assets. Recognizing the magnitude of the losses generated during the fiscal year, we determined it appropriate to establish a valuation allowance for our net deferred tax assets, with the exception of our Swedish operations, amounting to $12.7 million as well discontinuing, in the near term, any future recognition of deferred tax assets resulting from losses.

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Based upon our proposed strategy to downsize and streamline our operations and convert non-core or excess assets to cash, we adjusted various other asset values and reserves to appropriately reflect their net realizable value on a prospective basis, in accordance with FAS 144. These adjustments totaled $9.1 million for the year. Of this amount, $3.7 million related to our Discontinued Operations.

Liquidity and Capital Resources

At April 30, 2005, approximately $12.3 million of our cash and restricted cash was held by divisions outside the United States. The repatriation of offshore cash balances from certain divisions will trigger tax liabilities. In fiscal 2004, we recorded a $1.9 million liability for withholding taxes on future repatriation of historical foreign earnings. In February 2005 and June 2004, we repatriated $1.3 million and $3.5 million, respectively, from certain foreign subsidiaries and we plan to continue repatriating additional funds in the future.

By April 30, 2005, we completed the execution of our restructuring plan, which resulted in total cash outlays of $9 million (including amounts accrued as restructuring charges in accordance with generally accepted accounting principles). We have funded the restructuring plan from our cash from operations and foreign debt. The $9 million outlay included completing the construction of our new $5.2 million Taiwanese facility, to which we had committed in July 2000. The facility construction was financed via three unsecured lines of credit with Taiwanese banks. We then obtained a collateralized long-term credit facility and borrowed $4.1 million on this facility in June 2004. We have used the proceeds to repay and reduce the senior credit facility by $3.5 million. The benefits from our restructuring activities are beginning to be reflected in our operating results for the year ended April 30, 2005 and, we believe, should continue into fiscal 2006.

On March 21, 2005, in a Private Investment in Public Equity Transaction (PIPE Transaction), we sold 17,473,116 equity units at $3.72 per unit for gross proceeds of $65 million, and net proceeds of more than $59 million. A unit consists of one share of our common stock and one warrant to buy 1/10th of a share of our common stock. Ten warrants give the holder the right to purchase one share of common stock for $4.07. If the warrant holders opt to exercise their warrants, we would receive $7.1 million in additional cash.

Under terms of PIPE Transaction, we were required to file an initial Form S-1 registration of the shares issued and issuable in the PIPE Transaction on or before May 20, 2005 (which we did) and are required to cause the Form S-1 to become effective on or before September 17, 2005. We are subject to liquidated damages of $650,000 per month, if we fail to meet the September 17, 2005 date requirement. We have subsequently amended the Registration Rights Agreement to grant an extension until March 10, 2006 for the effective date of the registration of the shares and warrants issued in the PIPE transaction. Because the issuance price of the common stock of the PIPE Transaction was less than market value, we issued approximately 304,000 anti-dilution $0.01 warrants to our lenders. These warrants have a Black-Scholes value of approximately $1.7 million. Approximately $1.5 million of this amount relates to warrants issued under subordinated debt agreements and $222,000 relates to warrants issued under senior debt agreements. Proceeds of the PIPE were used to pay down existing debt, including all of the subordinated debt. Upon payoff of the subordinated debt, (on April 28, 2005) we also were required to charge to Interest Expense in the Consolidated Statement of Operations all remaining unamortized debt discount, which amounted to $4.3 million, plus $1.5 million related to the anti-dilution warrants issued to subordinated debt warrant holders prior to the PIPE. In addition, capitalized fees related to the Senior Agreement and anti-dilutional warrants provided to our senior lenders were amortized to interest expense through July 8, 2008.

Our domestic senior credit agreement (Credit Agreement) is our primary source of external funding. At April 30, 2005, the balance outstanding on the Credit Agreement was $9.7 million against a maximum borrowing of $30 million. Our available credit at April 30, 2005, net of $7.6 million in outstanding letters of credit, was $12.7 million.

On July 28, 2004, we signed an amendment to the then current credit agreement (the Amendment). The Amendment provided for a revolving line of credit of up to $42.7 million and an extension of the credit

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agreement through August 1, 2005. The commitment reduced to $41.0 million at April 30, 2005. Interest rates under the Senior Credit Agreement were at Bank of America s prime rate in effect from time to time plus 4% and increased by one percentage point each quarter beginning November 1, 2004. The Amendment also required the issuance of 150,000 detachable $.01 warrants to the senior lender as a fee and a quarterly commitment fee of $^1/2$ of 1% (50 basis points) of the total commitment.

We also amended our Subordinated Debt Agreement effective July 28, 2004. The subordinated lenders agreed to defer the semi-annual interest remittances due on October 31, 2004 and April 30, 2005, which total $5.3 million. This deferred interest balance accrues additional interest at the rate of 15% per annum. The subordinated lenders also received 150,000 detachable $.01 warrants to purchase common stock as an amendment fee.

On April 28, 2005 we entered into a new senior debt agreement (The April 28, 2005 Credit Agreement) with Bank of America N.A. and U.S. Bank N.A. The agreement provided a $30 million commitment which was to expire August 1, 2005. This expiration date was consistent with our previous agreement. The April 28, 2005 Credit Agreement, however, gave us the ability to pay off our subordinated debt in its entirety, which we did on April 28, 2005. The April 28, 2005 Credit Agreement, including covenants, was very similar to the previous senior debt agreement except for the following provisions:

Required the complete pay-off of subordinated debt

The interest rate was reduced from prime + 6% to LIBOR + 2.5%

The annualized cost of Letters of Credit were reduced from 5% to 2.5% of the face amount

The total commitment increased to $30 million, up from the prior debt agreement commitment level of $25.1 million.

The April 28, 2005 Credit Agreement was collateralized by general liens on all of our assets. We were required to comply with certain covenants in the credit agreement, including restrictions on dividends and transactions with affiliates, limitations on additional indebtedness, capital expenditures, research and engineering expenses, and maintenance of EBITDA ratios and collateral values. We were in compliance with all covenants in the April 28, 2005 Credit Agreement as of April 30, 2005. In addition, the New Credit Agreement, similar to prior agreements, included a subjective acceleration clauses which permit the lenders to demand payment in the event of a material adverse change.

Effective July 8, 2005, we executed a new $30 million, three year senior credit agreement with Bank of America N.A. and U.S. Bank N.A. This credit agreement expires July 8, 2008 and bears interest at the bank s prime rate (5.75% at April 30, 2005) or is linked to LIBOR plus a percentage depending on our leverage ratios, at our option. The agreement sets forth specific financial covenants to be attained on a quarterly basis, which we believe, based on our financial forecasts, are achievable.

We believe that our existing cash, cash from operations, and credit facilities at April 30, 2005 are adequate to fund our operations through April 30, 2006. If we fail to achieve our planned revenues, costs and working capital objectives, management believes it has the ability to curtail capital expenditures and reduce costs to levels that will be sufficient to enable us to meet our cash requirements and debt covenants through April 30, 2006.

With authorization from the Board of Directors in September 2004, we engaged the services of Danske Markets, Inc., which is working in Europe in cooperation with Close Associates to assist us in the sale of our General Press operations. These businesses are comprised of the North America Press and International Press segments. As these segments do not utilize ultrahigh-pressure water pumps, they are not considered core to our business, and it is our intent to divest ourselves of these operations. These segments did not meet the accounting criteria to be considered assets held for sale as of April 30, 2005 and accordingly the results of operations are shown as continuing operations and the related assets have not been reported as held for sale in our financial statements. On October 31, 2005, we completed the sale of the North America Press and International Press reportable segments, as well as the non ultrahigh-pressure portion of the Food reportable segment with the Gores Technology Group, LLC (Gores) for consideration of $14.4 million, comprised of cash and notes. At closing, we also entered into a Supply Agreement with Gores whereby we have agreed to supply certain high pressure pump products on an exclusive basis to Gores.

Presented below is a summary of contractual obligations and other minimum commercial commitments at April 30, 2005, by due date. See Notes 5, 10 and 15 to April 30, 2005 Consolidated Financial Statements for additional information regarding foreign currency contracts, long-term debt, and lease obligations, respectively.

	Maturity by Fiscal Year						
	2006	2007	2008	2009	2010	Thereafter	Total
	(in thousands)						
Foreign currency contracts(1)	$ 12,639	$	$	$	$	$	$ 12,639
Inventory purchases(2)	1,542						1,542
Operating leases(3)	3,716	3,464	2,814	1,851	1,773	4,096	17,714
Other(4)	778	293	40	40	40		1,191
Long-term debt and notes payable(5)	3,649	1,978	10,505	832	855	1,328	19,147
Interest on long-term debt and notes payable(6)	668	705	657	170	54	37	2,291
Total	$ 22,992	$ 6,440	$ 14,016	$ 2,893	$ 2,722	$ 5,461	$ 54,524

(1) As these obligations were entered into as hedges, the majority of these obligations will be offset by losses/gains on the related assets, liabilities and transactions being hedged. As of April 30, 2005, the fair value of the transactions and related hedges amounts to a net loss of $50,000 which is included in Accumulated Other Comprehensive Loss on the Consolidated Balance Sheet. These amounts relate entirely to our Discontinued Operations.

(2) We have included inventory purchase commitments, which are legally binding and specify minimum purchase quantities. These purchase commitments do not exceed our projected requirements and are in the normal course of business. These commitments exclude open purchase orders.

(3) Amounts include commitments of $1,483,000, $1,115,000, $877,000, $146,000 and $71,000 for fiscal 2006, 2007, 2008, 2009 and 2010, respectively, related to our discontinued operations.

(4) These obligations include non-inventory vendor commitments, such as professional retainers and trade show commitments. Amounts include commitments of $158,000, $90,000, $40,000, $40,000 and $40,000 for fiscal 2006, 2007, 2008, 2009 and 2010, respectively, related to our discontinued operations.

(5) This table is reporting the contractual due dates of the long-term debt and notes payable balances. Fiscal 2006 includes a $2.5 million note balance payable by our discontinued operations.

(6) Interest payments are estimated based on the outstanding debt balances as of April 30, 2005 using the then interest rate in effect through the contractual maturity of the debt instrument. These estimates may change over time as we opt to refinance our debt instruments. See note above. Fiscal 2006 amount includes $56,000 of interest related to a debt instrument from our discontinued operations.

Long-term debt, notes payable and lease commitments are expected to be met from working capital provided by operations and, as necessary, by other borrowings.

Our capital spending plans currently provide for outlays of approximately $3 million in fiscal 2006, primarily related to information technology spending. It is expected that funds necessary for these expenditures will be generated internally and through available credit facilities. In fiscal 2005 and 2004, our investments in capital equipment were minimal as we were trying to conserve cash and were restricted by our debt agreements on the amount of capital spending we were allowed. Excluding spending on our Taiwan facility in 2004, our capital spending for fiscal 2005 and 2004 amounted to $1.8 million and $1.7 million, respectively. We are required to test our internal controls under Sarbanes-Oxley 404 for the year end April 2006. The external costs to achieve Sarbanes-Oxley compliance will exceed $1.5 million.

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Related Party Transactions

Arlen I. Prentice, a director, is Chief Executive Officer of Kibble & Prentice, Inc., a company that, together with its wholly owned subsidiary, provides insurance brokerage and employee benefits, administrative and consulting services to the Company. Payments by the Company to Kibble & Prentice, Inc. and such subsidiary for such services have totaled $1.0 million, $2.4 million and $2.1 million for the fiscal years ended April 2005, 2004 and 2003, respectively. Such payments were for various categories of insurance and included both the brokerage commissions and the premiums that Kibble & Prentice, Inc. passes on to the underwriter. Mr. Prentice abstains from participating in the approval of matters where he may have a conflict of interest.

Critical Accounting Estimates

The discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of our financial statements. Actual results may differ from these estimates under different assumptions or conditions.

Critical accounting estimates are defined as those that are reflective of significant judgments and uncertainties, and potentially result in materially different results under different assumptions and conditions. We believe that our critical accounting estimates are limited to those described below. For a detailed discussion on the application of these estimates and our accounting policies, refer to Note 1 of the Consolidated Financial Statements.

Revenue Recognition

For standard systems and consumable and services sales, we recognize revenue in accordance with SEC Staff Accounting Bulletin No. 104 (SAB 104), Revenue Recognition in Financial Statements. SAB 104 requires that revenue can only be recognized when it is realized or realizable and earned. Revenue generally is realized or realizable and earned when all four of the following criteria have been met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services rendered; (3) the price is fixed and determinable; and (4) collectibility is reasonably assured. Determination of criterion (4) is based on our judgments regarding the collectibility of those amounts. Should changes in conditions cause us to determine this criterion is not met for certain future transactions, revenue recognized for any reporting period could be adversely affected.

During the second quarter of fiscal 2004, we adopted EITF Issue No. 00-21 (EITF 00-21), Revenue Arrangements with Multiple Deliverables on a prospective basis. EITF 00-21 provides guidance on how to account for arrangements that involve the delivery or performance of single or multiple products, services and/or rights to use assets. For standard systems, our multiple deliverables are: (1) the standard system and (2) the installation thereof. We recognize revenue upon shipment of the standard system at the fair value of that system. Installation revenue is recorded upon completion of the service. In some cases, systems are delivered with payment terms contingent on acceptance of installation. We will recognize revenue for those systems on installation acceptance.

For non-standard and long lead time systems, including the Avure operation, we recognize revenues using the percentage of completion method in accordance with Statement of Position 81-1 (SOP 81-1), Accounting for Performance of Construction-Type and Certain Production-Type Contracts. We use the cost to cost method, measuring the costs incurred on a project at a specified date, as compared to the estimated total cost of the project. Percentage of completion requires management to estimate costs to complete. Accordingly, modifications to estimates will impact percentage of completion revenues and associated gross margins. If, however, the time from order to install is less than three months, revenue is recognized under SAB 104. Shipping revenues and expenses are recorded in revenue and costs of goods sold, respectively.

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Product Warranty Reserve

Our products are generally covered by a warranty up to 12 months. We accrue a reserve for estimated warranty costs at the time revenue is recognized. Our estimate of costs to service our warranty obligations is based on historical experience and expectation of future conditions. To the extent we experience increased warranty claim activity or increased costs associated with servicing those claims, our warranty accrual will increase resulting in decreased gross profit.

Valuation of Accounts Receivable

We use estimates in determining our allowance for bad debts that are based on our historical collection experience, current trends, credit policy and a percentage of our accounts receivable by aging category. In determining these percentages, we review historical write-offs in our receivables. In determining the appropriate reserve percentages, we also review current trends in the credit quality of our customers, as well as changes in our internal credit policies. If our estimate of our allowance is understated, operating income would be reduced.

Valuation of Obsolete/Excess Inventory

We currently record a reserve for obsolete or excess inventory for parts and equipment that are no longer used due to design changes to our products or lack of customer demand. We regularly monitor our inventory levels and, if we identify an excess condition based on our usage and our financial policies, we record a corresponding reserve. If our estimate for obsolete or excess inventory is understated, gross margins would be reduced.

Valuation of Deferred Tax Assets

We review our deferred tax assets regularly to determine their realizability. When evidence exists that it is more likely than not that we will be unable to realize a deferred tax asset, we set up a valuation allowance against the asset based on our estimate of the amount which will likely not be realizable. Future utilization of deferred tax assets could result in recording of income tax benefits.

Impairment of Property and Equipment, Patents, Other Intangibles and Goodwill

We evaluate property and equipment, patents and other intangibles for potential impairment indicators when certain triggering events occur. Our judgments regarding the existence of impairment indicators are based on expected operational performance, market conditions, legal factors and future plans. If we conclude that a triggering event has occurred, we will compare the carrying values of the asset with the undiscounted cash flows expected to be derived from usage of the asset. If there is a shortfall and the fair value of the asset is less than its carrying value, we will record an impairment charge for the excess of carrying value over fair value. We estimate fair value by using a discounted cash flow model. Any resulting impairment charge could have a material adverse impact on our financial condition and results of operations. Many factors will ultimately influence the accuracy of these estimates.

We evaluate goodwill for potential impairment indicators as of our fiscal year-end and when certain triggering events occur. Our judgments regarding the existence of impairment indicators are based on expected operational performance, market conditions, legal factors, and future plans. Future events could cause us to conclude that impairment indicators exist and that goodwill should be evaluated for impairment prior to our fiscal year-end. Our impairment evaluation is based on comparing the fair value of the operating division with its associated carrying value and any shortfalls would require us to record an impairment charge for the difference between the carrying value and implied value of goodwill. We determine fair value by using a discounted cash flow model. Any resulting impairment charge could have a material adverse impact on our financial condition and results of operations. Expected future operational performance is based on estimates and management s judgment. Many factors will ultimately influence the accuracy of these estimates.

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Legal Contingencies

At any time, we may be involved in certain legal proceedings. As of April 30, 2005, we have accrued our estimate of the probable costs for the resolution of these claims. This estimate has been developed in consultation with outside legal counsel and is based upon an analysis of potential outcomes, assuming a combination of litigation and settlement strategies. We do not believe these proceedings will have a material adverse effect on our consolidated financial position. However, it is possible that future results of operations or cash flows for any particular quarterly or annual period could be materially affected by changes in our assumptions, or the effectiveness of our strategies, related to these proceedings. See Legal Proceedings.

Recent Accounting Pronouncements

See Note 19 to the April 30, 2005 Consolidated Financial Statements included in our Form 10-K/A Amendment No. 2 for recently issued accounting pronouncements.

Change in Auditors

The Company dismissed PricewaterhouseCoopers LLP effective January 12, 2006 and engaged Deloitte and Touche, LLP as the Company s new independent registered public accounting firm, effective January 17, 2006 for the fiscal year ending April 30, 2006.

Quantitative and Qualitative Disclosures About Market Risk:

Market risk exists in our financial instruments related to an increase in interest rates, adverse changes in foreign exchange rates relative to the U.S. dollar, as well as financial risk management and derivatives. These exposures are related to our daily operations.

Interest Rate Exposure At April 30, 2005, we had $19.1 million in interest bearing debt. Of this amount, $5.7 million was fixed rate debt with an interest rate of less than 2.8% per annum. The remaining debt of $13.4 million was at a variable interest rate, $9.7 million at a rate of prime or 5.75% and the remainder at an interest rate of Swedish prime + 0.75% or less. See Note 9 to the Consolidated Financial Statements for additional contractual information on our debt obligations. Market risk is estimated as the potential for interest rates to increase 10% on the variable rate debt. A 10% increase in interest rates would result in an approximate additional annual charge to our pre-tax profits and cash flow of $66,000. At April 30, 2005, we had no derivative instruments to offset the risk of interest rate changes. We may choose to use derivative instruments, such as interest rate swaps, to manage the risk associated with interest rate changes.

Foreign Currency Exchange Rate Risk We transact business in various foreign currencies, primarily the Canadian dollar, the Eurodollar, the Japanese yen, the New Taiwan dollar, and the Swedish Krona. As all of our foreign operations have functional currencies in other than the U.S. dollar, we translate the assets and liabilities of these operations into U.S. dollars at exchange rates in effect at the balance sheet date. Income and expense items are translated at the average exchange rates during the period. Aggregate net foreign exchange gains included in the determination of net loss amounted to $2.1 million for the year ended April 30, 2005. Based on the net position of foreign assets less liabilities, a near-term

10% appreciation or depreciation of the U.S. dollar in all currencies we operate could impact operating income by $0.8 million and other income (expense) by $2.8 million. Our financial position and cash flows could be similarly impacted. We have in the past, and may continue to use derivative instruments in the future, such as forward exchange rate contracts, to manage the risk associated with foreign currency exchange rate changes.

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BUSINESS

Overview

We design, develop, manufacture, market, install and service ultrahigh-pressure, or UHP, water pumps and UHP water management systems. Our core competency is our UHP water pumps. Our UHP water pumps pressurize water from 40,000 to over 100,000 pounds per square inch (psi) and are integrated with water delivery systems so that water can be used to cut or clean material or pressurize food. Our products include both standard and specialized waterjet cutting and cleaning systems. In addition to UHP water pumps and related systems, we provide non-UHP automation and articulation systems, primarily to the automotive industry.

Our mission is to provide the highest value product in the UHP water pump market. This requires our products to be of the highest reliability and provide our customers with a system which maximizes productivity and profitability. We are a developer of productivity technologies and we continually focus on customer support. Our brand promise is to provide reliability, superior value, service and technology through products based on UHP water pump technology. We will strive to continue to improve our customers profitability through investment in the development of innovative products and services that expand our customers markets and increase their productivity.

Our UHP technology has three broad applications: cutting, cleaning and food processing. In cutting and cleaning applications the ultrahigh-pressure created by our pumps is released through a small orifice to create a jet of water. In food processing we supply UHP pumps to Avure Technologies, Inc., a company we recently sold, to kill spoilage bacteria and pathogens in food products placed inside a pressure vessel.

The primary application of our UHP water pumps is cutting. In cutting applications, pressures from 50,000 to 87,000 psi create a thin stream of water traveling at three or more times the speed of sound which can cut both metallic and nonmetallic materials for many industries, including aerospace, automotive, disposable products, food, glass, job shop, sign, metal cutting, marble, tile and other stone cutting, and paper slitting and trimming. Waterjet cutting is recognized as a more flexible alternative to traditional cutting methods such as lasers, saws or plasma. It is often faster, has greater versatility in the types of products it can cut and eliminates the need for secondary processing operations. We also manufacture a product line used in waterjet cleaning, where pressures in the range of 40,000 to 55,000 psi, are used in industrial cleaning, surface preparation, construction, and petro-chemical and oil field applications.

Products and Services

We provide UHP systems and related products and services to our target markets: aerospace, automotive, food, job shops, pulp and paper and surface preparation. We had, prior to the sale of Avure, divided our business into its two UHP operations: Waterjet and Avure, representing the applications of released pressure and contained pressure, respectively.

Waterjet:

The Waterjet operation is comprised of the following segments: North America Waterjet, Asia Waterjet, Other International Waterjet and Other. The Other segment includes the sales of systems for automotive and articulation for non UHP applications.

Systems

We offer a variety of UHP products, including both waterjet cutting and cleaning systems, as well as accessories and related robotic articulation equipment. UHP water pumps, as well as the related water management systems, are the core components of our technology. We utilize two different technologies to create the water pressure: intensifier and direct drive. In cutting applications a UHP pump pressurizes water up to

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87,000 psi and forces it through a small orifice, generating a high-velocity stream of water traveling in excess of 3,000 feet per second. In order to cut metallic and other hard materials, an abrasive substance, usually garnet, is added to the waterjet stream creating an abrasivejet. Abrasivejets cut without heat, cause no metallurgical changes, and leave a high-quality edge that usually requires no secondary operation. In addition to our intensifier pumps which pressurize water up to 87,000 psi, we offer our unique and patented direct drive pressure-compensated pumps which pressurize water up to 55,000 psi utilizing triplex piston technology.

A UHP system consists of a UHP intensifier or direct drive pump and one or more waterjet cutting or cleaning heads with the necessary robotics, motion control and automation systems. We have sold UHP waterjet cutting and cleaning systems worldwide. Our cutting systems may also combine waterjet with other applications such as conventional machining, pick and place handling, inspection, assembly, and other automated processes. Our waterjet systems are also used in industrial cleaning applications such as paint removal, surface preparation, factory and industrial cleaning, ship hull preparation, and heat exchanger cleaning.

Our sales are affected by worldwide economic changes. However, we believe that the productivity enhancing nature of our UHP technology and the diversity of our markets enable us to absorb cyclical downturns with less impact than conventional machine tool manufacturers, and we are confident that we can continue to gain market share in the machine cutting tool market. Waterjet systems represented 71% of waterjet revenues in fiscal 2005.

Consumable Parts and Services

Consumables represent parts used by the pump and cutting head during operation, such as seals, orifices and garnet. Every pump we sell will require consumables to operate, and the sale of consumables is a significant part of our revenues. Many of these consumable or spare parts are proprietary in nature and are patent protected. We also sell various tools and accessories which incorporate UHP technology, as well as aftermarket consumable parts and service for our products. Consumable parts and services represented 29% of waterjet revenues in fiscal 2005.

Marketing and Sales

We market and sell our products worldwide through our headquarters in Kent, Washington (a suburb of Seattle) and through subsidiaries, divisions and joint ventures located in Wixom, Michigan; Jeffersonville, Indiana; Birmingham, England; Bretten, Germany; Burlington and Windsor, Canada; Hsinchu, Taiwan; Shanghai and Beijing, China; Incheon, Korea; Sao Paulo, Brazil; Buenos Aires, Argentina; Lyon, France; Milan, Italy; Madrid, Spain; Yokohama, Nagoya and Tokyo, Japan. We sell directly to customers in North and South America, Europe, and Asia, and have distributors or agents covering most other countries. No single customer accounted for 10% or more of our revenues during any of the three years ended April 30, 2005.

In late fiscal 2004, we conducted an internal study of our installed waterjet cutting systems and the potential sale opportunities of the market. Based on the significant market potential relative to the installed base, we concluded that waterjet technology is in the early adoption phase of its product life cycle. To increase waterjet awareness, we have focused our marketing efforts on specific target industries, applications and markets. Marketing efforts include increased presence at regional tradeshows, increased advertising in print media and other product placement and demonstration/educational events as well as an increase in domestic sales representation, including distributors. To enhance the effectiveness of sales efforts, our marketing staff and sales force gather detailed information on the applications and requirements in targeted market segments. We also utilize telemarketing and the internet to generate sales leads in addition to lead generation through tradeshows and print media,. This information is used to develop standardized and customized solutions using UHP and robotics technologies. We provide turnkey systems, including system design, specification, hardware and software integration, equipment testing and simulation, installation, start-up services, technical training and service.

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We offer our spare parts and consumables through the internet at our Flowparts.com website and strive to ensure that we are able to ship a large number of parts within 24 hours to our customers.

Patents

We hold a large number of UHP technology and related systems patents. While we believe the patents we hold protect our intellectual property, we do not consider our business dependent on patent protection. In addition, we have over the years developed non-patented proprietary trade secrets and know-how in UHP applications, and in the manufacture of these systems, which we believe allows us to retain a technical lead over our competitors.

We believe the patents we hold and have in process, along with the proprietary application and manufacturing know-how, act as a barrier to entry for other competitors who may seek to provide UHP technology.

See Legal Proceedings below for a discussion of certain pending patent litigation.

Backlog

At April 30, 2005, our Waterjet backlog was $43.3 million compared to the April 30, 2004 backlog of $25.5 million. Generally our products, exclusive of the aerospace product line, which account for $21.2 million of the backlog, can be shipped within a four to 16 week period. The aerospace systems typically have lead times of six to 18 months. Our North American standard waterjet backlog increased $6.2 million over the prior year to $13.9 million. The changes in our backlog are not necessarily indicative of comparable variations in sales or earnings. The April 30, 2005 backlog represented 25% of our trailing twelve months sales. The unit sales price for most of our products and services is relatively high (typically ranging from tens of thousands to millions of dollars) and individual orders can involve the delivery of several hundred thousand dollars of products or services at one time. Furthermore, some items in backlog can be shipped more quickly than others, some have higher profit margins than others, and some may be cancelled by customers.

Competition Waterjet

Waterjet technology has been developed to provide manufacturers with an alternative to traditional cutting or cleaning methods, which utilize lasers, saws, knives, shears, plasma, routers, drills and abrasive blasting techniques. Many of the companies that provide these competing methods are larger and better funded than Flow. Within the manufacturing setting, several firms, including Flow, have developed tools for cleaning and cutting based on waterjet technology.

Waterjet cutting systems offer manufacturers many advantages over traditional cutting machines including an ability to cut in any direction, faster throughput times, minimal impact on the material being cut and a continuously expanding range of applications. These factors, in addition to the elimination of secondary processing in most circumstances, enhance the manufacturing productivity of our systems.

We believe increased market acceptance of waterjet cutting systems by the aerospace, automotive, and machining (job shop) industries will encourage other manufacturers, including those in other industries, to adopt waterjet solutions. We estimate the worldwide waterjet cutting systems market size at $350 million and the waterjet cleaning systems market at $335 million. The recent slowdown in many of the major world economies created a difficult operating environment for waterjet systems manufacturers, as new investments in infrastructure projects were curtailed and customers reduced capital expenditures. Low demand, coupled with price-based competition among waterjet manufacturers, caused many firms in the industry to restructure operations, lay off employees, and close plants.

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We believe we are the leader in the global waterjet cutting systems market with a market share estimated at more than 40%. In North America, together with another supplier, we have a combined market share of approximately 75%. The remaining 25% of the market is divided among 10 firms. The European market is also highly concentrated, with the top three companies controlling 50% of the market. We compete in the high-end and mid-tier segments of the waterjet cutting market.

In addition, we sell spare parts and consumables. While we believe our on-time delivery and internet parts ordering web site combine for the best all around value for our customers, we do face competition from numerous other companies who sell replacement parts for our machines. While they generally offer a lower price, we believe the quality of our parts, coupled with our service, makes us the value leader in spares and consumables.

Waterjet cleaning offers many advantages over other cleaning methods, such as the ability to remove difficult coatings or deposits from a surface without damaging such surface or adding potentially hazardous chemicals to the cleaning process. A UHP waterjet system is an environmentally-friendly answer to many difficult cleaning applications and can often be justified solely on the basis of hazardous material containment or reduction of secondary operations in the cleaning process.

We believe we are a major competitor in the ultrahigh-pressure (equal to or greater than 40,000 psi) segment of the waterjet cleaning systems market with an estimated global market share of 27%. We have a significant share of the market in North and South America and Asia. We also have an opportunity to build share and grow our business in Europe where waterjet cleaning had not previously been a market priority for us.

The automobile and aerospace industry and other industries that rely heavily on assembly-based manufacturing processes are primary consumers of robotics systems equipment and services. Using waterjet and other suitable technologies such as laser, robotics systems manufacturers provide custom engineered robotic systems designed for material separation and removal. The market for robotic systems is concentrated among a few companies in the U.S. and Europe.

Research and Engineering

We have devoted between 3% and 6% of revenues to research and engineering during each of the three years ended April 30, 2005. Research and engineering expenses were $5.9 million, $5.9 million, and $6.7 million, in fiscal 2005, 2004 and 2003, respectively. While we will continue a robust research and engineering program to maintain our technological leadership position through development of new products and applications, as well as enhancement of our current product lines, a more focused effort has allowed us to decrease our research and engineering expenses as a percent of revenue to 4% for the fiscal year ended April 30, 2005.

Employees

As of December 31, 2005, we employed 659 full time and 39 part time personnel. We are not a party to any material collective bargaining agreements.

Legal Proceedings

At any time, we may be involved in certain legal proceedings. As of April 30, 2005, we have accrued our estimate of the probable costs for the resolution of these claims. This estimate has been developed in consultation with outside legal counsel and is based upon an analysis of potential outcomes, assuming a combination of litigation and settlement strategies. We do not believe these proceedings will have a material adverse effect on our consolidated financial position. However, it is possible that future results of operations or cash flows for any particular quarterly or annual period could be materially affected by changes in our assumptions, or the

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effectiveness of our strategies, related to these proceedings. See Notes 1 and 15 of Notes to the April 30, 2005 Consolidated Financial Statements for a description of our product liability claims and litigation.

Omax Corporation (Omax) filed suit against us on November 18, 2004. The case, *Omax Corporation v. Flow International Corporation*, United States District Court, Western Division at Seattle, Case No. CV04-2334, was filed in federal court in Seattle, Washington. The suit alleges that our products infringe Omax s Patent Nos. 5,508,596 entitled Motion Control with Precomputation and 5,892,345 entitled Motion Control for Quality in Jet Cutting. The suit also seeks to have our Patent No. 6,766,216 entitled Method and System for Automated Software Control of Waterjet Orientation Parameters declared invalid, unenforceable and not infringed. Omax manufactures waterjet equipment that competes with our equipment. Both the Omax and our patents are directed at the software that controls operation of the waterjet equipment. Although the suit seeks damages of over $100 million, we believe Omax s claims are without merit and we intend not only to contest Omax s allegations of infringement but also to vigorously pursue our claims against Omax with regard to our own patent.

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INFORMATION CONCERNING DIRECTORS AND EXECUTIVE OFFICERS

Our Directors and Executive Officers

The following table sets forth certain information about our directors and executive officers as of January 31, 2006.

Name	Age	Position
Stephen R. Light	59	President, Chief Executive Officer and Director
Douglas P. Fletcher	51	Chief Financial Officer
Thomas C. Johnson	53	Senior Vice President of Operations
Richard A. LeBlanc	50	Executive Vice President of Sales
John S. Leness	46	General Counsel and Corporate Secretary
Rick L. Nicholson	57	Vice President Human Resources
Felix M. Sciulli	54	Senior Vice President of Global Engineering and Research and Development
Ronald D. Barbaro	74	Director
Richard P. Fox	58	Director
Kathryn L. Munro	57	Chairman of the Board and Director
Arlen I. Prentice	68	Director
J. Michael Ribaudo	63	Director
Kenneth M. Roberts	59	Director
Jan K. Ver Hagen	68	Director

Stephen R. Light (age 59) became President and Chief Executive Officer of the Company in January 2003. He was appointed to the Board in January of 2003 and his current term expires in 2006. Prior to joining the Company, from 2000 to 2002, Mr. Light was President and Chief Executive Officer of Omniquip Textron Group, Inc., a manufacturer of material handling equipment, aerial work platforms and hydraulic systems. From 1998 to 1999 he was President and Chief Executive Officer of Bucyrus International, Inc. From 1997 to 1998 he was Vice President and General Manager of Operations at P&H Mining Equipment Co., a subsidiary of Harnischfeger Industries; from 1986 to 1996 he served in various positions at Emerson Electric Company; from 1985 to 1986, he served as General Manager of North American Philips Mexican consumer electronics manufacturing business; and from 1968 to 1985 at General Electric Company. Mr. Light earned a B.S.M.E. in 1968 from Colorado State University.

Douglas P. Fletcher (age 51) joined the Company on August 16, 2005 as Interim Chief Financial Officer. He and was appointed Chief Financial Officer on October 5, 2005. He served as Chief Financial officer of GiftCertificates.com from August 2001 until July 31, 2005. Prior to joining GiftCertificates.com, he served as the Chief Financial Officer at eCharge Corporation. Mr. Fletcher previously worked for Citigroup/Citibank from 1987 to 2000, where he served in senior management positions in the company s corporate finance, restructuring and equipment finance businesses. Mr. Fletcher has also worked in various financial capacities with International Paper and PricewaterhouseCoopers. Mr. Fletcher holds a bachelor s degree in Accounting and Finance from Ohio University.

Thomas C. Johnson (age 53) joined the Company in August 1996 as Vice President of Manufacturing. Mr. Johnson became Senior Vice President, Manufacturing Technology in October of 1999 and Senior Vice President of Operations in June of 2003. Prior to joining the Company, he was employed by the Kenworth Truck Company Division of PACCAR for sixteen years, serving as Plant Manager and before that as Assistant Plant Manager.

Richard A. LeBlanc (age 50) joined the Company in 1994 as Vice President of Sales. Mr. LeBlanc became Executive Vice President in August 1998. Prior to joining the Company, he was employed by the ASI Robotic Systems Division of Cargill Detroit Corporation for ten years, serving as Manager of Sales and Marketing and before that in direct sales.

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John S. Leness (age 46) joined the Company in June 1990 as its Corporate Counsel, became General Counsel in December 1990, and was appointed Assistant Secretary in January 1991 and Secretary in February 1991. From 1986 until joining the Company, Mr. Leness had been associated with the Perkins Coie law firm.

Rick L. Nicholson (age 57) joined the Company in 2005 as Vice President, Human Resources. From 2003 until he joined the Company, Mr. Nicholson had been a private consultant. From 2001 to 2003 he was the Chief Human Resources Executive at Milgard Manufacturing, Inc., a manufacturer of windows and patio doors, and from 1998 to 2001 he was Vice President of Human Resources at U.S. Marine Corporation a builder of boats. Prior to 1998 Mr. Nicholson was employed by Weyerhaeuser Company and Tektronix.

Felix M. Sciulli (age 54) joined the Company in October 1995 as Vice President of Engineering. Mr. Sciulli became Senior Vice President, Engineering and Research and Development in June 2000. Prior to joining the Company, he was with Equimeter, Inc., a division of BTR plc (acquired from Rockwell International Corporation), for six years as Director of Engineering and Research and Development. Mr. Sciulli also spent thirteen years with Rockwell in various engineering and research roles, and three years with Westinghouse Electric Corporation.

Ronald D. Barbaro (age 74) was the Chair and Chief Executive Officer, Ontario Lottery and Gaming Corporation from 1998-2003. Prior to this, he was President of The Prudential Insurance Company of America; responsible for worldwide operations (retired 1993). He was responsible for Prudential s Canadian operation from 1985 to 1990. Mr. Barbaro was elected to the Company s Board of Directors in 1995 and his current term expires in 2007. Mr. Barbaro currently chairs the Premier of Ontario s Economic Recovery Council and Chairman, Board of Trustees for The Brick Group Income Fund. He also serves on the boards of The Thomson Corporation International Group of Companies and TransGlobal Life Insurance Company (Alberta).

Richard P. Fox (age 58) has served as consultant and outside board member since 2001 to entrepreneurs and the financial services industry. Mr. Fox was appointed to the Company s Board of Directors in 2002 and his current term expires with the 2006 Annual Meeting. He was President and Chief Operating Officer of CyberSafe Corporation, responsible for the overall financial services and operations of the company. Prior to joining CyberSafe, Mr. Fox was Chief Financial Officer and a member of the Board of Directors of Wall Data where he was responsible for the company s finances, operations, and human resources activities. Mr. Fox spent 28 years at Ernst & Young, last serving as Managing Partner of the Seattle Office. He serves on the Board of Directors of Premera, a Blue Cross managed-care provider, aQuantive (NASDAQ AQNT), an on line marketing company, as well as Shurgard Storage Centers, Inc. (NYSE SHU), a real estate investment trust. In addition, he serves as Treasurer and is on the Board of Trustees of the Seattle Foundation and is on the Board of Visitors of the Fuqua School of Business, Duke University. Mr. Fox received a B.A. degree in Business Administration from Ohio University and an M.B.A. from Fuqua School of Business, Duke University. He is a Certified Public Accountant in Washington State.

Kathryn L. Munro (age 57) is the current Chairperson of the Board of Directors and is Principal of Bridge West, a technology investment company. She previously held a variety of senior management positions in both the commercial and retail areas of Seafirst Bank and Bank of America, most recently as Chief Executive for Bank of America s Southwest Banking Group. Ms. Munro began her banking career in 1980. She was elected to the Company s Board of Directors in 1996 and her current term expires in 2008. Ms. Munro currently serves on the corporate boards of Pinnacle West (NYSE PNW) and Capitol Bancorp (NYSE CBC). She also serves on the board of The Bank Administration Institute in Chicago and numerous community boards in Phoenix, including Valley of the Sun United Way and the national board of advisors for University of Arizona School of Business. Ms. Munro holds a B.S. degree from Auburn University and an M.B.A. from the University of Washington.

Arlen I. Prentice (age 68) is Chairman and Chief Executive Officer of Kibble & Prentice, which provides insurance and financial consulting services. He has served as a director of the Company since 1993 and his

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current term expires in 2007. He founded Kibble & Prentice 32 years ago. Mr. Prentice serves as a director of Northland Telecommunications Corporation and is a past director of the Starbucks Coffee Corporation, a position he held for 19 years.

J. Michael Ribaudo (age 63) is Chairman and Chief Executive Officer of Surgical Synergies, Inc., a national company that develops, acquires and operates ambulatory surgery centers. Dr. Ribaudo was elected to the Company s Board of Directors in 1995, and his current term expires in 2007. Dr. Ribaudo graduated from Louisiana State University in 1963 and Louisiana State Medical School in 1967 with graduate medical school training at Emory University, Washington University and New York University. He received postgraduate training at Harvard Law School, Kellogg Business School and Stanford Graduate School of Business.

Kenneth M. Roberts (age 59) is President and Chief Investment Officer of Ken Roberts Investment Management, Inc., an investment advisory firm. Mr. Roberts is also President and Chief Executive Officer of Ken Roberts Financial Services, Inc. Mr. Roberts was appointed to the Company s Board of Directors in 1991 and his current term expires with the 2006 Annual Meeting. Mr. Roberts was, until November 1994, President and Chief Investment Officer of Ken Roberts Advisory Group, an investment advisory firm and subsidiary of the Spokane, Washington, office of Smith Barney Shearson, Inc. From 1981 to 1991, he was Vice President of Shearson Asset Management and Foster & Marshall Management, investment advisors, and President of Shearson Lehman Fundamental Value Fund, a registered investment company. From 1987 to 1991, Mr. Roberts was also a director of Shearson Lehman Fundamental Value Fund. Mr. Roberts currently serves on the Finance Advisory Board of Washington State University. He is also past President and Treasurer of the Spokane Chapter of the Seattle Society of Chartered Financial Analysts. Mr. Roberts received a B.A. from Whitworth College in 1968 and an M.B.A. from the Harvard Graduate School of Business in 1971.

Jan K. Ver Hagen (age 68) is the retired Chairman of the Board (non-executive) of Wolverine Tubing Corporation, a copper tubing manufacturer and processor of specialty heat transfer products, and continues to serve as Director and Chair of the Audit Committee of Wolverine. Mr. Ver Hagen was elected to the Company s Board of Directors in 2003, and his current term expires in 2008. He worked for Emerson Electric Co. from 1977 to 1994 including serving as Vice-Chairman and Director from 1987 to 1994. From 1994 to 1999 he was a director of United Dominion Industries, a multinational manufacturing group, and was President and Chief Operating Officer from 1994 to 1998. He returned to Emerson to serve as Senior Vice President from 1999 to 2002. He also serves as trustee of the Wisconsin Alumni Research Foundation. He received a B.S.M.E. in 1961 from the University of Wisconsin Madison.

The Board of Directors consists of a majority of independent directors as such term is defined under Rule 4200(a)(15) of the NASDAQ Stock Market Inc. s Marketplace Rules. The Board of Directors has determined that Messrs. Barbaro, Fox, Munro, Roberts, Ribaudo, and Ver Hagen are independent directors.

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BOARD STRUCTURE, COMMITTEES AND COMPENSATION AND COMPOSITION

Currently, 9 individuals are serving as our directors. Our board of directors is divided into three classes of directors as provided in our articles of incorporation and bylaws and as set forth below.

Class	Expiration of Term	Directors
I	2006	Richard P. Fox, Stephen R. Light, Kenneth M. Roberts
II	2007	Ronald D. Barbaro, Arlen I. Prentice, J. Michael Ribaudo
III	2008	Kathryn L. Munro, Jan K. Ver Hagen

Directors for each class will be elected at the annual meeting of shareholders held in the year in which the term for that class expires and thereafter will serve for a term of three years.

Executive officers are appointed by the board of directors on an annual basis and serve until their successors have been duly elected and qualified. There are no family relationships among any of our directors or executive officers.

Board Committees

The Company has an Audit Committee, a Compensation and Plan Administrator Committee, a Mergers, Acquisitions and Dispositions Committee and a Nominating and Governance Committee. In addition to these standing committees, the Board, from time to time, may form ad hoc committees. During fiscal 2004, the Board appointed a Restructuring Committee which has reviewed matters related to the Company s capital structure. After fiscal 2005, the Board appointed a Strategic Scenario Planning Committee.

Audit Committee. The primary function of the Audit Committee is to assist the Board of Directors in its oversight of the integrity of financial information provided to shareholders and others, its review of the adequacy of the system of internal controls established by the Company and its monitoring of the audit process. In performing these functions, the Audit Committee reviews the Company s financial reporting process and internal controls, reviews and appraises the audit efforts of the Company s independent registered public accounting firm and internal auditor. The Audit Committee also provides open lines of communication between the directors, the independent registered public accounting firm, the internal auditors and the financial and senior management of the Company. The Audit Committee has adopted a charter (a copy of which is available at the Company s website at www.flowcorp.com), hereinafter Charter, requiring, among other things, that members of the Committee be independent of Management, free of any relationship that would interfere with their independent judgment and have a minimum level of financial competency. The members of the Audit Committee are Richard P. Fox (Chair), Kathryn L. Munro, Kenneth M. Roberts, and Jan K. Ver Hagen, each of whom are all independent directors as defined under the NASDAQ s Marketplace Rules and each of whom are also experienced in financial matters. The members of the Audit Committee, in addition to the foregoing criteria, meet the additional criteria of SEC Rule 10A-3 that they neither (1) accept any direct compensation from the Company other than director and committee fees and pension or other deferred compensation for prior service, nor (2) are an affiliated person of the Company. The Board of Directors has determined that Richard P. Fox is an audit committee financial expert as defined in the rules of the Securities and Exchange Commission. The Audit Committee held eleven meetings in the fiscal year ended April 30, 2005.

Compensation and Plan Administrator Committee. The primary function of the Compensation and Plan Administrator Committee is to assist the Board of Directors to ensure that all officers and key management personnel of the Company and its subsidiaries are effectively compensated in terms of salary, supplemental compensation, and benefits which are internally equitable and externally competitive. The Committee establishes and maintains a competitive, fair, and equitable compensation and benefits policy designed to retain personnel, to stimulate their useful and profitable efforts on behalf of the Company, and to attract necessary additions to the staff with appropriate qualifications. The Committee also acts as Administrator of the Company s stock option plans, determining the terms, amounts and recipients of stock option grants. J. Michael Ribaudo (Chair), Richard P. Fox, Kathryn L. Munro, and Arlen I. Prentice (nonvoting) serve on the Committee. All members of the

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Committee are independent directors as defined under the NASDAQ s Marketplace Rules except Arlen I. Prentice, who is Chief Executive Officer of Kibble & Prentice, Inc., a company that, together with its wholly-owned subsidiary, provides insurance brokerage and employee benefits, administrative and consulting services to the Company. During fiscal 2005 and through January 31, 2006, payments by the company to Kibble & Prentice, Inc. and such subsidiary for such services totaled $2,566,541. Such payments were for various categories of insurance and included both the brokerage, commissions and the premiums that Kibble passes on to the underwriters. Mr. Prentice does not vote on the Committee. There were six meetings of the Compensation and Plan Administrator Committee during the fiscal year ended April 30, 2005.

Mergers, Acquisitions and Dispositions Committee. The primary function of the Mergers, Acquisitions and Dispositions Committee is to assist the Board of Directors to review potential opportunities for acquisitions, mergers, dispositions, divestitures or similar transactions and to assist the Board of Directors in analyzing equity or debt financings or other capital raising opportunities. Kenneth M. Roberts (Chair), Ronald D. Barbaro, Arlen I. Prentice, Jan K. Ver Hagen, J. Michael Ribaudo, and Richard P. Fox serve on the Committee. There were four meetings of the Mergers, Acquisitions and Dispositions Committee during the fiscal year ended April 30, 2005.

Nominating and Governance Committee. The primary function of the Nominating and Governance Committee is to assist the Board of Directors in matters of Board organization and composition and to locate and recommend to the Board individuals to fill vacancies on the Board. Kathryn L. Munro (Chair), Ronald D. Barbaro, and Kenneth M. Roberts serve on the Committee, each of whom is an independent directors as defined under the NASDAQ s Marketplace Rules. The Nominating and Governance Committee met nine times during the fiscal year ended April 30, 2005.

Growth Committee. The Growth Committee was formed after the completion of fiscal 2005 to assist the Chief Executive Officer in the area of business strategy. The members of the Growth Committee are Ronald D. Barbaro (Chair), Stephen R. Light, Arlen I. Prentice, Kathryn L. Munro and Jan K. Ver Hagen.

Compensation Committee Interlocks and Insider Participation

No member of the board of directors or the compensation committee serves as a member of the board of directors or compensation committee of any entity that has one or more executive officers serving as a member of our board of directors or compensation committee.

Code of Business Conduct and Ethics

Our board of directors has adopted a code of business conduct and ethics applicable to our directors, executive officers, including our chief financial officer and other of our senior financial officers performing similar functions, and employees, in accordance with applicable rules and regulations of the SEC and the Nasdaq National Market.

Board Compensation

The Compensation and Plan Administrator Committee is charged with ensuring that the Company will be able to continue to attract and retain directors having the qualifications necessary to serve the interest of the Company s shareholders. To achieve this goal and based on a thorough review of director compensation at a peer group of 16 companies conducted by a nationally recognized independent compensation consulting firm, the Committee has adopted the following compensation program for Directors.

Directors who are not employees of the Company receive an annual retainer of $20,000, payable quarterly, $1,500 per meeting for attendance at Board meetings and $1,000 per meeting for attendance at Committee meetings. The Company also reimburses directors for their travel expenses in connection with their attendance at Board and Committee meetings.

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In addition, Committee Chairs are paid an additional annual retainer of $5,000 with the exception of the Audit Committee Chair who is paid an additional annual retainer of $10,000, and the non-executive Chairperson of the Board who is paid an additional annual retainer of $15,000.

Non-employee Directors will also receive annual grants of shares of common stock that are vested at the time of grant. The annual grants of shares of company stock will have a value equal to $30,000. The grants will be made at each Annual Meeting of Shareholders, and the shares will be valued based on the average closing price over the twenty trading days preceding the Annual Meeting.

For Directors serving prior to 2003, the Company had adopted a post retirement policy providing that Directors may receive, if they agree to provide consultation services to the officers and directors of the Company (and execute a consultation agreement in that regard), annual amounts for a period equal to the director s years of service on the Board, up to a maximum of nine years. The annual amounts to be paid will equal the annual Director retainer in place at the time of his or her retirement. If a Director agrees to provide services, but does not subsequently provide such services, the Director will lose his or her eligibility to receive payments. This policy will not apply to newly-appointed directors.

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EXECUTIVE COMPENSATION

Summary Compensation Table

The following table sets forth information for the years ended April 30, 2005, 2004 and 2003, with respect to the Chief Executive Officer and each of the four other highest paid executive officers of the Company whose aggregate cash compensation in fiscal 2005 exceeded $100,000:

		Annual Compensation			Long-Term Compensation		
Name and Principal Position	**Year**	**Salary**	**Bonus**	**Other Annual Compensation(1)**	**Restricted Stock Awards**	**Number of Stock Options**	**All Other Compensation(2)**
Stephen R. Light(3)	2005	$ 480,008	$ 421,414	$ 184,679	$ 350,053	21,250	$ 0
	2004	450,008	264,061	181,438	181,000(4)	21,250	40,760
President and Chief Executive Officer	2003	200,772	0	0	0	321,250	21,072
D. Patterson Adams, Jr.	2005	$ 250,016	$ 124,925	$ 57,575	$ 0	0	$ 104,859(5)
	2004	249,054	119,477	66,148	0	0	104,059(5)
President and Chief Executive Officer, Avure Technologies, Incorporated(5)	2003	250,016	0	0	0	0	111,946(5)
Thomas C. Johnson	2005	$ 190,008	$ 99,785	$ 56,253	$ 0	0	$ 58,629
	2004	190,008	83,620	57,445	39,000(6)	0	32,314
Senior Vice President of Operations	2003	188,469	0	0	0	0	11,506
Richard A. LeBlanc	2005	$ 220,002	$ 128,503	$ 59,596	$ 0	0	$ 58,629
	2004	220,002	96,824	66,527	39,000(6)	0	32,690
Executive Vice President of Sales	2003	215,043	30,856(7)	0	0	0	12,025
Stephen D. Reichenbach	2005	$ 209,997	$ 121,037	$ 58,512	$ 0	0	$ 67,200
	2004	196,154	98,773	57,152	39,000(6)	0	6,600
Chief Financial Officer(8)	2003	180,003	0	0	0	0	11,385

(1) Represents dollar value of shares of Company stock received in lieu of cash bonus.
(2) Includes Company contributions to the Voluntary Pension and Salary Deferral Plan and the Flow International Corporation Executive Deferral Plan and amounts paid in connection with retention agreements.
(3) Mr. Light joined the Company in December 2002 and became President and CEO on January 2, 2003.
(4) Includes 200,000 restricted stock units granted in connection with a retention agreement and vesting December 31, 2006, and 20,000 shares granted pursuant to an employment agreement.
(5) Mr. Adams is employed by Avure, which was sold on October 31, 2005.
(6) Includes reimbursement of moving expenses and interest paid on a relocation loan made to Mr. Adams when he joined the Company in August 2001.
(7) Includes stock granted in connection with a retention agreement and vesting December 31, 2006.
(8) Amounts paid based on sales commissions.
(9) Mr. Reichenbach resigned effective August 8, 2005.

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Stock Option Grants in 2005

Option Grants Table

Fiscal 2005

The following table sets forth certain information regarding options granted to the Company s Chief Executive Officer during the fiscal year ended April 30, 2005. No options were granted to the other four highest paid executives during fiscal 2005.

Individual Grants					Potential Realizable Value at Assumed Annual Rates of Stock Price Appreciation for Option Term (10 Years)	
Name	Number of Options Granted	Percent of Total Options Granted to Employees in Fiscal Year	Exercise Price ($/Share)	Expiration Date	5%	10%
Stephen R. Light	21,250	100%	$ 5.92	04/23/15	$ 29,401	$ 74,507

Aggregated Option Exercises in Fiscal 2005

and Fiscal Year-End Option Values

The following table sets forth certain information regarding options exercised during the year ended April 30, 2005, by the Company s Chief Executive Officer and each of the individuals named in the Summary Compensation Table.

			Total Number of Unexercised Options at Fiscal Year-End		Value of Unexercised in-the-Money Options at Fiscal Year-End(1)	
Name	Shares Acquired on Exercise	Value Realized	Exercisable	Unexercisable	Exercisable	Unexercisable
Stephen R. Light	0	0	140,207	123,543	$ 352,489	$ 233,861
D. Patterson Adams, Jr.	0	0	100,000	0	0	0
Thomas C. Johnson	0	0	55,000	0	0	0
Richard A. LeBlanc	0	0	156,000	0	0	0
Stephen D. Reichenbach	0	0	213,775	0	0	0

(1) Calculated using $5.92, the closing price of the Company s Common Stock as reported by NASDAQ on April 30, 2005.

Stock Based Plans

Equity Compensation Plan Information

The following table presents the number of stock options and warrants that were and were not approved by our shareholders as of April 30, 2005.

Plan category	(a) Number of securities to be issued upon exercise of outstanding options, warrants and rights	(b) Weighted-average exercise price of outstanding options, warrants and rights	(c) Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by shareholders	2,034,546	$ 9.20	1,368,218

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Compensation and Plan Administrator Committee Report

Introduction. The Compensation and Plan Administrator Committee of the Board of Directors (the Compensation Committee) establishes and directs the administration of all programs under which executive compensation is paid or awarded to the Company s executive officers. In addition, the Compensation Committee evaluates executive officer performance and assesses the overall effectiveness of the Company s executive compensation programs.

Total Compensation Philosophy. For fiscal 2006, with the assistance of an outside compensation consultant, the Compensation Committee conducted a comprehensive review of the Company s executive compensation programs. In conducting that review, the Committee adopted the following compensation philosophy, which it used as the basis for its review of the Company s programs:

Flow International will provide compensation and benefit programs that are competitive with relevant markets where we compete for employees, internally equitable, and consistent with our commitment to providing a work environment that promotes teamwork, outstanding performance, and corporate pride.

Base Salary Base salary opportunities should be competitive with relevant organizations with similar complexity, and internally consistent based upon each position s assigned responsibilities. Individual salary determinations will be made considering incumbent qualifications, experience and performance.

Short-Term Incentives Consistent with competitive practices, executive officers and other key management and technical positions should have a portion of targeted total compensation at risk, contingent upon meeting predefined corporate, business unit and individual goals. Flow International believes it is important that those who are directly involved in contributing to the achievement of our goals should have a meaningful portion of their total compensation opportunity tied to shared corporate objectives.

Long-Term Incentives Executive officers and other key management positions should have a meaningful portion of their competitive total compensation opportunity linked to high levels of sustained performance and increasing shareholder value.

Employee Benefits Flow International will assist employees in meeting their retirement income, health care, survivor income, disability income, time-off and other needs through competitive, cost-effective, company-sponsored programs that provide employees with reasonable flexibility in meeting their circumstances.

Decisions regarding total compensation program design, as well as individual pay decisions, will be made in the context of this Total Compensation Philosophy and our ability to pay, as defined by our financial success.

Elements of Executive Compensation. The elements of executive compensation during fiscal 2005 included base salary, an annual incentive program, a retention program, and retirement and other benefits. For fiscal 2006 the Committee adopted, subject to shareholder approval, a long term incentive program While the elements of compensation described in this report are considered separately, the Compensation Committee takes into account the full compensation package afforded by the Company to each executive, including salary, incentive compensation, retirement and other benefits. In reviewing the individual performance of the executives, other than the Chief Executive Officer (CEO), the Compensation Committee takes into account the views of the CEO.

Base Salaries. Base salaries of the executive officers other than for the CEO had were determined by the Compensation Committee using the CEO s recommendations and data provided by the Committee s consultant. No adjustments to executive base salaries had been made for fiscal 2004 or 2005. The Committee made adjustments to individual executives base salaries for fiscal 2006 based on competitive pay data and practices in the industrial and commercial machinery industry sector, proxy analysis of a group of peer companies and individual performance. The CEO s pay is set by contract and discussed below.

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Annual Incentive Plan. The Company s executive officers are eligible for bonuses under the Company s Annual Incentive Plan. The Annual Incentive Plan emphasizes the achievement of the Company s annual financial goals. For fiscal 2005 these goals were based on achievement of goals including revenue, operating profit and working capital as a percentage of revenue and individual and business unit goals, and bonuses were paid half in stock and half in cash. For fiscal 2006 these goals will be based on return on invested assets, revenue, operating profit and individual and business unit goals. Executives target bonus levels have been set at percentages of base salary, ranging from fifteen to sixty percent, and the CEO s target bonus level set by his employment contract is at 60% of base salary; bonuses will range from zero to two times the target bonus, depending on target achievement. Payouts will be made half in stock and half in cash

The Company exceeded its goals for fiscal 2005, and annual incentive payouts were made for the fiscal year at the maximum levels under the plan.

Long Term Incentive Plan. For fiscal 2006, the Company adopted, and the shareholders approved, a Long Term Incentive Plan. The purpose of the Long Term Incentive Plan is to provide stock incentives for executives who assist the Company in meeting the Company s long-term financial goals and to align the interests of executives with the Company s shareholders. The plan is also intended to provide performance based incentives beginning after the last awards are paid under the retention program described below. Under the plan, executives have the opportunity to receive shares of stock based on achievement of goals over a three year period. At the beginning of each three year performance period participating executives are assigned a target award, based on achievement of specific goals. At the end of the three year period the executive receives a number of shares, based on the Company s achievement of these goals. Awards may range from zero to two times the target number of shares. For the first three year period, ending with the end of fiscal 2008, the goals are based on the Company achieving a return on invested assets and a certain cumulative earnings per share over the preceding three year period. Goals for future three year periods, as well as target awards, will be set at the beginning of each three year period.

Retention Award. During fiscal year 2003, the Company began to implement a comprehensive restructuring program intended to return the Company to profitability. The Compensation Committee determined that during this implementation it was critical to ensure key executives remain employed at the Company and focused on the day-to-day operations to successfully turnaround the Company. As a result, the Compensation Committee adopted a retention program to achieve these goals. The program includes six executives including the CEO. The CEO s retention award is discussed below. Each participating executive who remains in the Company s employ is eligible to receive retention awards in both cash and restricted stock units. The cash retention awards began six months after the plan inception and provide for seven equal semi-annual increments. The executive must be employed at the payment date to receive the cash portion of the award. The restricted stock unit awards vest 42 months after plan inception. Each executive must remain a full-time employee for the entire 42-month period to vest in the restricted stock units. The retention program s final awards will be made in fiscal 2007, following which, executives will first become eligible to receive awards under the Long Term Incentive Program.

Chief Executive Officer Compensation. On November 25, 2002, Mr. Light entered into an employment agreement with the Company with a term ending on April 30, 2005 (the Light Agreement). The Light Agreement provides for automatic extensions beginning on May 1, 2003 (unless notice not to extend is given by either party) so that the remaining term shall always be two years. Under the terms of the Light Agreement, Mr. Light s annual base salary is $450,000 and he is eligible for target annual performance bonuses equal to 60% of base salary. One-half of the bonus is payable in shares of common stock. Mr. Light s annual performance bonuses are based on the same factors as the executives bonuses. The Board has established additional goals for the CEO. These include development of succession plans, development of a customer satisfaction survey and successful resolution of the Company s financing.

The Committee and Board of Directors reviewed Mr. Light s performance for fiscal 2005. They compared the Company s performance to the goals set for Mr. Light by the Board, concluding that he had exceeded the goals that had been set for him.

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Policy on Deductibility of Compensation. Section 162(m) of the Internal Revenue Code limits the Company s federal income tax deduction for compensation to its CEO and any of its four other highest paid executive officers to $1 million. Qualified performance-based compensation is not subject to the $1 million limitation, provided certain requirements of Section 162(m) are satisfied. These requirements include shareholder approval and periodic re-approval of the material terms of performance goals in plans such as the Company s 1995 Long-Term Incentive Plan. The Compensation Committee presently anticipates that the Company s executive compensation will either be below such levels or will be structured to qualify as performance-based compensation which is exempt from such limitation.

Conclusion. After its review of the total compensation program for the executives of the Company, the Compensation Committee believes that the executive compensation policies and practices it has adopted will serve the interests of the shareholders and the Company effectively. The Committee also believes that the various compensation programs offered are appropriately balanced to provide increased motivation for executive officers to contribute to the Company s overall future success, thereby increasing the value of the Company for the shareholders benefit. The Compensation Committee will continue to monitor the effectiveness of the Company s total compensation program to meet the ongoing needs of the Company.

This report is submitted by the members of the Compensation Committee.

COMPENSATION AND PLAN

ADMINISTRATOR COMMITTEE

J. Michael Ribaudo Chairman

Richard P. Fox

Sandra Rorem

Kathryn L. Munro

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MARKET INFORMATION

The principal market for our common stock is the over-the-counter market. Our stock is traded on the NASDAQ National Market under the symbol FLOW. The range of high and low sales prices for our common stock for the first, second and third quarter of fiscal 2006 and the four quarters for fiscal 2005 and 2004 is set forth in the following table.

	Fiscal Year 2006		Fiscal Year 2005		Fiscal Year 2004	
	High	Low	High	Low	High	Low
First Quarter	$ 7.74	$ 5.98	$ 3.66	$ 2.15	$ 1.94	$ 1.13
Second Quarter	9.13	7.40	3.55	2.70	3.11	1.36
Third Quarter	10.49	6.89	3.18	2.71	4.11	2.40
Fourth Quarter			6.60	2.85	3.74	2.20

Director and Officer Indemnification

Article XII of the Articles of Incorporation of Flow International Corporation authorizes Flow International Corporation to indemnify any present or former director or officer to the fullest extent not prohibited under the WBCA, public policy or other applicable law. Chapter 23B.08.510 and .570 of the WBCA authorizes a corporation to indemnify its directors, officers, employees, or agents in terms sufficiently broad to permit such indemnification under certain circumstances for liabilities (including provisions permitting advances for expenses incurred) arising under the 1933 Act.

The directors and officers of Flow International Corporation are entitled to limited indemnification from the Selling Shareholders against any losses based upon the failure of the selling shareholder to comply with the prospectus delivery requirements under the federal securities laws or upon any untrue statement or alleged untrue statement or omission or alleged omission made in this Registration Statement and the Prospectus contained therein, as the same shall be amended or supplemented, made in reliance upon or in conformity with written information furnished to Flow International Corporation by such Selling Shareholder.

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STOCK OWNERSHIP OF MANAGEMENT AND PRINCIPAL SHAREHOLDERS

The following tables sets forth information as of January 31, 2006, with respect to each shareholder known by the Company to be the beneficial owner of more than five percent (5%) of any class of voting securities of the Company, each director, those executive officers listed in the Summary Compensation Table below and all directors and executive officers of the Company as a group. Currently, the Company s sole class of voting securities outstanding is Common Stock. Except as noted below, each person has sole voting and investment powers with respect to the shares shown. The address for each of the persons listed below is 23500 64th Avenue South, Kent, Washington 98032.

Except as otherwise indicated by footnote, and subject to applicable community property laws, we believe that the beneficial owners of the common stock listed below have sole voting power and investment power with respect to their shares. Beneficial ownership is determined in accordance with the rules of the SEC. The table below assumes the conversion of all of the outstanding shares of our convertible preferred stock into common stock, which will occur immediately prior to the completion of this offering.

The number of shares of common stock outstanding, on an as converted basis, used in calculating the percentage for each listed person or entity includes common stock underlying options or a warrant held by the person or entity that are exercisable within 60 days of January 31, 2006 or upon completion of this offering, but excludes common stock underlying options or warrants held by any other person or entity. Percentage of beneficial ownership is based as of January 31, 2006 and is on a non-diluted basis.

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STOCK OWNERSHIP OF MANAGEMENT

Name and Position	Number of Shares	Percent of Outstanding Shares
Ronald D. Barbaro, Director	91,421(1)	0.3
Douglas P. Fletcher, Chief Financial Officer	2,100(2)	0.0
Richard P. Fox, Director	31,546	0.1
Thomas C. Johnson, Senior Vice President of Operations	87,784(3)	0.3
Richard A. LeBlanc, Executive Vice President of Sales	188,917(4)	0.5
John S. Leness, General Counsel and Corporate Secretary	186,400(5)	0.5
Stephen R. Light, President and Chief Executive Officer	483,251(6)	1.4
Kathryn L. Munro, Director	91,421(7)	0.3
Rick L. Nicholson, Vice President Human Resources	7,643(8)	0.01
Arlen I. Prentice, Director	231,750(9)	0.6
J. Michael Ribaudo, Director	215,595(10)	0.6
Kenneth M. Roberts, Director	300,516(11)	0.9
Felix M. Sciulli, Senior Vice President of Global Engineering and Research and Development	93,761(12)	0.3
Jan K. VerHagen, Director	39,046	0.1
All directors and officers as a group (16 persons)	2,044,035(13)	6.0

(1) Includes options exercisable and restricted shares vesting within 60 days for 59,875 shares of Company Common Stock.
(2) Includes options exercisable and restricted shares vesting within 60 days for 840 shares of Company Common Stock.
(3) Includes options exercisable and restricted shares vesting within 60 days for 55,000 shares of Company Common Stock.
(4) Includes options exercisable and restricted shares vesting within 60 days for 151,000 shares of Company Common Stock.
(5) Includes options exercisable and restricted shares vesting within 60 days for 151,000 shares of Company Common Stock.
(6) Includes options exercisable and restricted shares vesting within 60 days for 190,207 shares of Company Common Stock.
(7) Includes options exercisable and restricted shares vesting within 60 days for 59,875 shares of Company Common Stock.
(8) Includes options exercisable and restricted shares vesting within 60 days for 1,250 shares of Company Common Stock.
(9) Includes options exercisable and restricted shares vesting within 60 days for 59,875 shares of Company Common Stock.
(10) Includes options exercisable and restricted shares vesting within 60 days for 59,875 shares of Company Common Stock.
(11) Includes options exercisable and restricted shares vesting within 60 days for 59,875 shares of Company Common Stock.
(12) Includes options exercisable and restricted shares vesting within 60 days for 63,000 shares of Company Common Stock
(13) Includes options exercisable and restricted shares vesting within 60 days for 969,457 shares of Company Common Stock

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Stock Ownership of 5% Owners

Name and Address	Number of Shares	Percent of Outstanding Shares
Pinnacle Fund LP(1) 4965 Preston Park Blvd. Suite 240 Plano, Texas 75093	2,314,483(2)	6.7%
Third Point LLC (f/k/a Third Point Management Company L.L.C.) and Daniel S. Loeb(1)(3) 360 Madison Ave. 24th Floor New York, New York 10017.	4,436,300(4)	12.8 %
Third Point Offshore Fund(1)(5) 360 Madison Ave. 24th Floor New York, New York 10017	3,014,220(6)	8.8%
JLF FUNDS 601 W. Main Avenue, Suite 600, Spokane, WA 99201	4,436,300(4)	12.8%
ICM Asset Management, Inc. 601 W. Main Avenue Suite 600 Spokane, Washington 99201	1,647,150	4.8%
Royce & Associates, LLC(1) 1414 Avenue of the Americas New York, NY 10019	1,805,076	5.21%
SunTrust Banks, Inc(1) 303 Peachtree Street Suite 1500	2,052,000	5.9%

Atlanta, CA 30308

1 Based on filings made pursuant to Section 13(g) of the Exchange Act.
2 Includes 200,000 shares issuable upon exercise of warrants.
3 Third Point LLC, a Delaware limited liability company (the Management Company) serves as investment manager or adviser to a variety of hedge funds and managed accounts (such funds and accounts, collectively, the Funds), with respect to shares of Common Stock directly beneficially owned by the Funds. Mr. Daniel S. Loeb is the managing member of the Management Company and controls its business activities, with respect to shares of Common Stock indirectly beneficially owned by Mr. Loeb by virtue of such position.
4 Includes 403,300 shares issuable upon exercise of warrants.
5 Shares are included in the totals for Third Point LLC.
6 Includes 274,020 shares issuable upon exercise of warrants.

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SELLING SHAREHOLDERS

Set forth below is the name of each Selling Shareholder and the amount and percentage of Common Stock owned by each (including shares that can be acquired on the exercise of outstanding warrants) prior to the offering, the shares to be sold in the offering, and the amount and percentage of Common Stock to be owned by each (including shares that can be acquired on the exercise of outstanding warrants) after the offering. The footnotes provide information about persons who have investment voting power for the Selling Shareholders and about material transactions between the Selling Shareholders and the Company.

	Shares Beneficially Owned Prior to the Offering(1)			Shares Beneficially Owned After the Offering(1)	
Selling Shareholders	Number	Percent	Shares to be Sold	Number	Percent
J. Patterson McBaine(2)(3)	55,000	*	55,000	0	*
Gruber & McBaine International(2)(4)	126,500	*	126,500	0	*
Hamilton College(2)(4)	71,500	*	71,500	0	*
Donaghy Sales Inc.(2)(4)	33,000	*	33,000	0	*
Lagunitas Partners(2)(4)	561,000	1.6%	561,000	0	*
The Wallace Foundation(2)(4)	44,000	*	44,000	0	*
Jon D. Gruber and Linda W. Gruber(2)(4)	132,000	*	132,000	0	*
Linsday Gruber Dunham(2)(4)	8,800	*	8,800	0	*
Jon Gruber Trustee J.W. Gruber Trust(2)(4)	8,800	*	8,800	0	*
Potomac Capital Partners(2)(5)	477,400	1.4%	477,400	0	*
Potomac Capital International(2)(5)	263,560	*	263,560	0	*
Pleiades Investment Partners(2)(5)	294,140	*	294,140	0	*
Crestview Capital Master LLC(2)(6)	591,397	1.7%	591,397	0	*
Presidio Partners(2)(7)	215,342	*	215,342	0	*
Brady Retirement Fund(2)(7)	46,868	*	46,868	0	*
Geary Partners(2)(7)	160,028	*	160,028	0	*
SRB Greenway Capital (QP) LP(2)(8)	238,658	*	238,658	0	*
SRB Greenway Capital LP(2)(8)	32,378	*	32,378	0	*
SRB Greenway Offshore Operating Fund(2)(8)	24,661	*	24,661	0	*
Westpark Capital(2)(9)	297,000	*	297,000	0	*
Pacific Asset Partners(2)(10)	147,849	*	147,849	0	*
BTG Investments(2)(11)	82,783	*	82,783	0	*
Third Point Partners Qualified LP(2)(12)	142,560	*	142,560	0	*
Third Point Partners(2)(12)	752,620	2.2%	752,620	0	*
Third Point Offshore Fund(2)(12)	3,014,220	8.7%	3,014,220	0	*
Points West International Investments(2)(12)	526,900	1.5%	526,900	0	*
JLF Offshore Fund(2)(13)	2,642,200	7.7%	2,642,200	0	*
JLF Partners II(2)(13)	129,800	*	129,800	0	*
JLF Partners I(2)(13)	1,664,300	4.8%	1,664,300	0	*
The Pinnacle Fund(2)(14)	2,314,483	6.7%	2,200,000	114,483	*
Trustman c/o Arthur V Davis Foundation(2)(15)	23,980	*	23,980	0	*
Trustman c/o STI Classic Small Cap Growth Fund(2)(15)	2,016,400	5.8%	1,899,700	116,700	*
Trustman c/o TUA Troyal G Brooks(2)(15)	4,840	*	4,840	0	*
Trustman *c/o* TUA Sandra Brooks(2)(15)	1,980	*	1,980	0	*
Zeke, LP(2)(16)	1,183,600	3.4%	1,183,600	0	*
SF Capital Partners(2)(17)	1,100,000	3.2%	1,100,000	0	*
John Hancock Life Insurance Company(2)(18)	384,765	1.1%	384,765	0	*

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Selling Shareholders	Shares Beneficially Owned Prior to the Offering(1) Number	Percent	Shares to be Sold	Shares Beneficially Owned After the Offering(1) Number	Percent
John Hancock Variable Life Insurance Company(2)(18)(19)	27,479	*	27,479	0	*
Hare & Co., as nominee for Signature Four Limited(2)(18)(19)	13,744	*	13,744	0	*
Hare & Co., as nominee for Signature Five Limited(18)(19)	55,093	*	55,093	0	*
Bank of America Securities(20)(21)	225,364	*	225,364	0	*
General Electric Capital Corporation(22)	81,527	*	81,527	0	*
Total number of shares to be offered under this prospectus			19,987,336		

* denotes less than 1%

(1) Includes shares that may be acquired on the exercise of presently exercisable warrants

(2) On March 21, 2005, we sold securities to each such person under a Securities Purchase Agreement and entered into a Registration Rights Agreement. The securities were units consisting of one share of common stock and a warrant to purchase one-tenth of a share at $4.07 per share. Units were sold for $3.72 per unit. Each purchaser under the Securities Purchase Agreement was an accredited investor as that term is defined in Regulation D under the Securities Act. In issuing the units, the Company relied on an exemption from registration under Section 4(2) and Rule 506 thereunder, each purchaser being accredited and provisions relating to limitations on the manner of sale and limitations on resale in Rule 506 being complied with. The sale of units was a private placement. Roth Capital Partners acted as placement agent in connection with the sale of units. The closing price of our stock on Nasdaq National Market on the day before the agreement between the Company and the Selling Shareholders relating to the PIPE Transaction was entered into $3.70 per share. On the day that the agreement was entered into, the closing price was $4.28 per share. The purchase price of the common stock component of a unit was $3.70, representing a 13.6% discount from the closing price on the date the Securities Purchase Agreement was entered into. The exercise price of the warrants, $4.07 per share, represents an 8.5% discount from the closing price on the date the Securities Purchase Agreement was entered into. The exercise price is a negotiated price. The number of shares listed above includes the shares issuable on the exercise of the warrants. Pursuant to the Registrant Rights Agreement, we agreed to file a registration statement on Form S-1 registering the resale of the shares of common stock issued and the shares issuable on exercise of the warrants and to keep the registration statement effective until the earlier of two years and the date that all the common shares may be sold by the investors pursuant to Rule 144 promulgated under the Securities Act of 1933. The Registration Rights Agreement also provides that if the registration statement of which this prospectus is a part is ineffective for more than 40 trading days, we must pay each of the investors a fee equal to 1% of the aggregate purchase price paid by each such investor pursuant to the Securities Purchase Agreement for the shares of common stock then held by each such investor, and for each monthly anniversary after such date that registration statement is ineffective, we must additionally pay each of the investors a fee equal to 1% of the aggregate purchase price paid by each such investor pursuant to the Securities Purchase Agreement for the shares of common stock then held by each such investor. Pursuant to such agreement, we filed the registration statement of which this pr