

BLACK BOX CORP  
Form 10-Q  
July 23, 2007

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549  
FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the quarterly period ended December 30, 2006**  
**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
**For the transition period from \_\_\_\_\_ to \_\_\_\_\_**  
**Commission File Number: 0-18706**  
**Black Box Corporation**  
(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other jurisdiction of incorporation or organization)

**95-3086563**  
(I.R.S. Employer Identification No.)

**1000 Park Drive, Lawrence, Pennsylvania**  
(Address of principal executive offices)

**15055**  
(Zip Code)

Registrant's telephone number, including area code: **724-746-5500**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.  Yes  No

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

Large accelerated filer  Accelerated filer  Non-accelerated filer

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

As of July 16, 2007, there were 17,527,227 shares of common stock, par value \$.001 (the common stock), outstanding.

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**EXPLANATORY NOTE**

In this Quarterly Report on Form 10-Q for the three (3) and nine (9) month period ended December 30, 2006 ( Form 10-Q ), Black Box Corporation ( Black Box or the Company ) is restating its Consolidated Balance Sheets as of March 31, 2006, Consolidated Statements of Income and Consolidated Statements of Cash Flows for the three (3) and nine (9) month periods ended December 31, 2005 and the related Notes to the Consolidated Financial Statements. This Form 10-Q also includes the amendment of Management s Discussion and Analysis of Financial Condition and Results of Operations presented in the Company s Quarterly Report on Form 10-Q for the quarter ended December 31, 2005 as it relates to the three (3) and nine (9) month periods ended December 31, 2005. All restated information identified above is collectively referred to as the Restatement. References herein to Fiscal Year or Fiscal mean the Company Fiscal Year ended March 31 for the year referenced.

The Restatement reflects adjustments arising from the determinations of the Audit Committee ( the Audit Committee ) of the Company s Board of Directors (the Board ), with the assistance of outside legal counsel, and the Company s management to record additional non-cash charges for stock-based compensation expense and the related income tax effects, relating to certain stock option grants during the period from 1992 through September, 2006. Additionally, the Company has recorded an adjustment to its financial statements for the quarter ended September 30, 2006 to reflect the proper accounting treatment for an interest rate swap.

Following the filing of this Form 10-Q, the Company will file its Annual Report on Form 10-K for the period ended March 31, 2007 (the FY07 Form 10-K ). In the FY07 Form 10-K, the Company will restate its Consolidated Balance Sheet at March 31, 2006, its Consolidated Statements of Income for the years ended March 31, 2006 and 2005, its Consolidated Statements of Changes in Stockholders Equity for the years ended March 31, 2006, 2005 and as of April 1, 2004, its Consolidated Statements of Cash Flows for the years ended March 31, 2006 and 2005, its quarterly financial data as of and for the quarters ended in the fiscal year ended March 31, 2006 and its Selected Financial Data as of and for the years ended March 31, 2006, 2005, 2004 and 2003.

The Company has not amended and does not intend to amend any of its other previously-filed reports on Form 10-K or Form 10-Q for the periods affected by the Restatement other than those specifically stated above and its Quarterly Report on Form 10-Q/A for the three (3) month period ended June 30, 2006 and Quarterly Report on Form 10-Q/A for the three (3) and six (6) month period ended September 30, 2006. As previously disclosed, the consolidated financial statements and related financial information contained in such previously filed reports should no longer be relied upon.

**Restatement through March 31, 2006**

**Background**

On November 13, 2006, Black Box received a letter of informal inquiry from the Enforcement Division of the Securities and Exchange Commission (the SEC ) relating to the Company s stock option practices from January 1, 1997 to present. As a result, the Audit Committee, with the assistance of outside legal counsel, commenced an independent review of the Company s historical stock option grant practices and related accounting for stock option grants during the period from 1992 to the present (the Review Period ).

On February 1, 2007, the Company announced that, while the review of option grant practices was continuing, it believed that it would need to record additional non-cash charges for stock-based compensation expense relating to certain stock option grants and, accordingly, cautioned investors about relying on its historical financial statements until the Company could determine with certainty whether a restatement would be required and, if so, the extent of any such restatement and the periods affected.

On March 19, 2007, although the Audit Committee had not yet completed its review, the Audit Committee concluded that the exercise price of certain stock option grants differed from the fair market value of the underlying shares on the appropriate measurement date. At that time, the Company and the Audit Committee announced that it was currently expected that the Company s additional non-cash, pre-tax charges for stock-based compensation expense relating to certain stock option grants would approximate \$63 million for the Review Period. In addition, the Company and the Audit Committee concluded that the Company would need to restate its previously-issued financial statements contained in reports previously filed by the Company with the SEC. Accordingly, on March 19, 2007, the Company and the Audit Committee concluded that the Company s previously-issued financial statements and other historical

financial information and related disclosures for the Review Period, including applicable reports of its current or former independent registered public accounting firms and related press releases, should not be relied upon.

On May 25, 2007, the Company was advised by the Enforcement Division of the SEC that a Formal Order of Private Investigation arising out of the Company's stock option practices had been entered and on May 29, 2007 the Company received a subpoena that was issued by the SEC.

On May 31, 2007, the Company announced that, as a result of the ongoing review of stock option practices, Company management and

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the Audit Committee expected that the Company's additional non-cash, pre-tax charges for stock-based compensation expense relating to certain stock option grants would approximate \$70 million for the Review Period.

**Findings of the Audit Committee**

During the Review Period, the Company granted stock options pursuant to an employee stock option plan and a director stock option plan to acquire approximately 10.9 million shares of common stock. Such plans at all relevant times provided for option grants to be approved by a designated committee of non-employee directors or, in the case of the director stock option plan, by the Board. Approximately 2,000 stock option grants were awarded during the Review Period with 69 recorded grant dates. No stock options have been granted since September, 2006. The Audit Committee reviewed all stock options granted during the Review Period, including option grants to the Company's directors, officers and rank and file employees (including grants to new employees, grants awarded in connection with Company acquisitions and grants made as individual or group performance awards). The Audit Committee's review of the Company's stock option granting practices included a comprehensive examination of reasonably available relevant physical and electronic documents as well as interviews with current and former directors, officers and Company personnel.

The Audit Committee's review was initially focused on determining whether the Company's prior stock option granting practices were in compliance with the plans' granting provisions and applicable law or called into question its accounting for such options. Once it became evident that such issues and accounting implications existed, the inquiry focused on those matters necessary: to determine whether any accounting charges were material and whether a restatement of the Company's previously-issued financial statements would be required; to establish a basis for effecting any required restatement; to assure that, on as timely a basis as possible, the Company could file any required curative disclosures with the SEC and assure its continued eligibility for listing on The NASDAQ Stock Market (NASDAQ); and to provide an informed basis for the Company's response to the identified issues, including appropriate corrective and remedial actions.

The following information summarizes certain of the findings of the Audit Committee. The findings identified approximately \$71.5 million of unrecorded expense at the time of grant (i.e., the difference between the fair market value of the common stock on the appropriate measurement date and the stated exercise price), net of forfeitures, during the Review Period, of which \$70.0 million was recorded in the Company's Consolidated Financial Statements through March 31, 2006 and \$1.5 million of unrecorded expense at the time of grant will be included, beginning at April 1, 2006, in the Company's computation of compensation expense in accordance with Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004) Share-Based Payment (SFAS 123(R)). The following summarizes the unrecorded expense at the time of grant by time period and category of recipient:

\$4.2 million for the period from Fiscal 1993 through Fiscal 1997 (\$0.2 million for directors, \$2.5 million for officers and \$1.5 million for rank and file employees)

\$45.6 million for the period from Fiscal 1998 through August 2002 (\$1.1 million for directors, \$25.7 million for officers and \$18.7 million for rank and file employees)

\$21.8 million for the period from August 2002 to the present (\$0.04 million for directors, \$0.6 million for officers and \$21.1 million for rank and file employees)

The Audit Committee's additional key findings are summarized below:

**Lack of Adequate Documentation:** For a majority of grants issued by the Company during the Review Period, there is either no or inadequate documentation of approval actions that satisfies the requisites for establishing a measurement date under Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25). Of the 69 recorded grant dates, there are documented approval actions by the Board or the Option or Compensation Committee of the Board (the Compensation Committee) with respect to particular grants for 12 dates. In the period December 1992 to May 1996, neither the minutes of the Compensation Committee nor of the Board reflect any action to approve specific grants. In some instances, evidence of single director (the chairman of the Compensation Committee) approval actions exists. This absence of non-employee director level documentation also applies to a majority of grants with a recorded grant date after 1996. In some cases, Compensation Committee minutes

contain a reference to reports on the status of the option pool but do not document any action to approve specific grants. Approval documentation for certain grants has internal inconsistencies or conflicts with other documents thereby rendering this documentation unreliable as a basis for establishing a measurement date. In some cases, the only existing documentation is the executed option agreement and/or the entry of the option grant into the option database. Notwithstanding these approval documentation inadequacies, the Company entered into option agreements with grantees and has honored such grants.

**Grant Approvals:** During the Review Period, relatively few option grants were approved in complete compliance with the Company's stock option plans. Available documentation reflects that the Company approved option grants in a variety of ways. With respect to the employee stock option plan, grants were approved by the Compensation Committee as contemplated by the plan at various times, by the



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full Board in 1998 and 1999, by a single director (the chairman of the Compensation Committee) on nine recorded grant dates during the period 1994 through 2001 and by the Company's Chief Executive Officer ( CEO ) at various times. With respect to the director stock option plan, grants were generally approved by the designated Board committee and, in a few cases, by the chairman of the Compensation Committee. In one instance in 2000, there is no conclusive documentary evidence of the approval of director grants other than the signed director option agreements. The delegation of authority by the Compensation Committee to the CEO with respect to grants to rank and file employees was not fully documented. However, there was an understood and accepted practice between the CEO and the Compensation Committee whereby the CEO made certain awards to individual employees. In some instances, this involved the allocation among rank and file employees of blocks of shares approved by the Compensation Committee; in three (3) such instances, the number of shares ultimately awarded pursuant to this process exceeded the approved size of the block, which was contrary to the understanding of the Compensation Committee members. Further, contrary to the understanding of Committee members, the award and/or documentation of those individual grants often significantly lagged the approval of the block grant. In August 2005, the Compensation Committee specifically acknowledged a prior grant of delegated authority to the CEO to make option grants to rank and file employees and ratified all prior awards by the CEO. In some cases, documentation of approval action is either inconclusive or missing, and the Company therefore has been unable to determine what entity or person actually approved specific grants.

**Option Pricing:** The recorded grant dates for a majority of grants do not match the applicable measurement dates as determined under APB 25. The grants of options with exercise prices lower than the fair market values of the stock on the actual measurement dates did not satisfy the fair market pricing requirement in the Company's plans, as amended in 1998, and were not consistent with the Company's disclosures in SEC filings stating that the exercise price of options was equal to the fair market value of the stock on the date of the grant.

The relationship between the stated exercise price of options and the fair market value of the Company's stock on the date of the identifiable approval actions varied from grant to grant. In some cases, the exercise price of grants reflected the fair market value of the underlying shares on the date of any documented approval action. In other cases, the exercise prices reflected the fair market value of the underlying shares on a date either prior or subsequent to any such documented approval action and the exercise price was lower than the fair market value on the date of any such action. In several such cases before August 2002, the use of such grant dates and lower exercise prices (together with other available evidence) supports a finding that the recorded grant dates and corresponding exercise prices were selected with the benefit of hindsight. For certain grants where the mismatch between the recorded grant date and the approval action was only a matter of days, however, the mismatch appears to have been attributable to inaccurate recording or administrative delays. In some cases, the apparent approval action did not identify all grantees; for example, there are cases where a block grant was approved subject to a later determination of individual grant recipients and grants were recorded with a grant date, and corresponding exercise price, that matched the date of the apparent approval of the block grant and the fair market value of the common stock on that date although individual grant recipients may have been identified some time after approval of the block grant. Finally, in some cases, the approval action for specific grants is not adequately documented. Where the recorded grant date did not satisfy the requisites for a measurement date under APB 25, the Company relied on default methodologies to determine an appropriate measurement date.

**Internal Controls:** As outlined above, the Company's historical administration of its options program lacked discipline as it relates to proper adherence to the plan requirements, corporate recordkeeping and documentation. Since November 2003, however, the Company has properly administered the stock option program as it relates to awards to directors and officers. During the investigation, the Company identified control gaps related to grants made throughout the Review Period. As of March 31, 2007, the Company implemented additional procedures to its process that are focused on formalized documentation of appropriate approvals and determination of grant terms to employees.

**Procedural and Remedial Actions**

The Audit Committee and other relevant Board committees are committed to a continued review and implementation of procedural enhancements and remedial actions in light of the foregoing findings. Consistent with its obligation to

act in the best interests of the Company taking into account all relevant facts and circumstances, the Audit Committee is continuing to assess the appropriateness of a broad range of possible procedural enhancements and potential remedial measures in light of the findings of its investigation. While the Audit Committee has not completed its consideration of all such steps, procedural enhancements may include recommendations regarding improved stock option administration procedures and controls, training and monitoring compliance with those procedures, corporate recordkeeping, corporate risk assessment, evaluation of the internal compliance environment and other remedial steps that may be appropriate. The Audit Committee is also expected to address issues of individual conduct or responsibility, including those of the Board, CEOs and Chief Financial Officers ( CFOs ) serving during the Review Period. Potential remedial measures may include an evaluation of the role of and possible claims or other remedial actions against current and former Company personnel who may be found to have been responsible for identified problems during the Review Period. The Audit Committee expects to recommend to the Board and/or its appropriate committees procedural enhancements and remedial measures that appropriately address the issues raised by its findings. In advance of action by the Audit Committee, as noted above, the Company has implemented additional procedures to its process for approving stock option grants that are focused on formalized documentation of appropriate approvals and determination of grant terms to employees.

**Table of Contents****Restatement Methodologies**

As of April 1, 2006, the Company adopted SFAS 123(R) using the modified prospective transition method. Under this transition method, compensation expense is to be recognized for all share-based compensation awards granted after the date of adoption and for all unvested awards existing on the date of adoption. Prior to April 1, 2006, the Company accounted for stock-based compensation awards to directors, officers and rank and file employees using the intrinsic value method in accordance with APB 25 as allowed under SFAS No. 123 Accounting for Stock-Based Compensation ( SFAS 123 ). Under the intrinsic value method, no share-based compensation expense related to stock options was required to be recognized if the exercise price of the stock option was at least equal to the fair market value of the common stock on the measurement date. APB 25 defines the measurement date as the first date on which are known both (1) the number of shares that an individual grant recipient is entitled to receive and (2) the option or purchase price, if any.

In light of the Audit Committee's review of the Company's stock option granting practices during the Review Period and as to those cases in which the Company previously used a recorded grant date as the measurement date that the Company determined could no longer be relied upon, the Company has developed and applied the following methodologies to remeasure those stock option grants and record the relevant charges in accordance with APB 25 by considering the following sources of information: (i) meeting minutes of the Board and of committees thereof and related materials, (ii) Unanimous Written Consents of the Board and of committees thereof, (iii) the dates on which stock option grants were entered into the Company's stock option database ( create date ), (iv) relevant email correspondence reflecting stock option grant approval actions, (v) individual stock option agreements and related materials, (vi) employee and Board offer letters, (vii) documents relating to acquisitions, (viii) reports on Form 4 filed with the SEC and (ix) guidance of the Office of the Chief Accountant of the SEC on stock option matters as set forth in its letter dated September 19, 2006.

***Grants with Appropriate Committee Approval.*** With respect to grants of approximately 1.0 million shares, or approximately 9% of the total grants in the Review Period, the Company has evidence to support the approval of the grant under the stock option plans by the relevant committee of the Board, and such evidence includes the number of options each individual was entitled to receive and the option price. However, the relationship between these documented approval actions and the originally-recorded grant dates and exercise prices for the options so approved varied during the Review Period. In some cases, grants were recorded with a grant date and a corresponding exercise price that matched the date of the approval action or were otherwise consistent with the terms of the approval actions. In other cases, however, the recorded grant dates and corresponding exercise prices of the grants reflected the fair market value of the common stock on a date prior to the committee's documented approval actions. The Company has restated the compensation expense for stock option grants relating to approximately 0.4 million shares of common stock by using the date of the documented approval action as the measurement date. The total additional non-cash, pre-tax charge for these grants is approximately \$1.8 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.07 million relates to director options, \$1.3 million relates to officer options and \$0.4 million relates to rank and file employee options.

***Grants with Other Approvals.*** With respect to grants of approximately 1.9 million shares, or approximately 18% of the total grants in the Review Period, the Company has evidence to support the approval of the grant by the Board, an outside director or the Company's CEO and the identification of the number of options each individual was entitled to receive together with the option price. These grants are distinguished from the grants described in the prior paragraph in that the nature of the approval was not fully consistent with the terms of the relevant stock option plan. As with the grants discussed in the preceding paragraph, the relationship between these documented approval actions and the originally-recorded grant dates and exercise prices for the options so approved varied during the Review Period. In some cases, grants were recorded with a grant date and a corresponding exercise price that matched the date of the approval action or were otherwise consistent with the terms of the approval action. In other cases, however, the recorded grant dates and corresponding exercise prices of the grants reflected the fair market value of the Company's stock on a date prior to the approval action. The Company has restated the compensation expense for stock option grants relating to approximately 1.6 million shares of common stock by using the date of the documented approval action as the measurement date. The total additional non-cash, pre-tax charge for these grants is approximately

\$7.6 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.5 million relates to director options, \$2.6 million relates to officer options and \$4.5 million relates to rank and file employee options.

***Grants Lacking Adequate Documentation.*** With respect to grants of approximately 7.9 million shares (5.0 million shares to rank and file employees), or 73.0% of the total grants in the Review Period, the Company has been unable to locate adequate documentation of approval actions that would satisfy the requisites for a measurement date under APB 25. For these grants, management considered all available relevant information to form a reasonable conclusion as to the most reasonable measurement date. For all grants in this category, the Company has established default methodologies for determining the most appropriate measurement date under APB 25.

With respect to grants entered into the Company's stock option database after September 9, 1999, when the database began to reflect a create date which is the date on which a grant was entered into the system, the Company has determined to use the individual create

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date for each grant as the APB 25 measurement date, which was in most cases different from the originally-recorded grant date. The Company believes that this create date is the most appropriate methodology in the absence of sufficient evidence of approvals for these grants as it represents the earliest point in time at which the evidence shows that all requisites for the establishment of the measurement date had been satisfied. Such create dates preceded, often by a significant amount of time, the execution of stock option agreements, which, generally, were manually signed by the Company's CEO and manually signed and dated by the grantee. In addition, in almost all cases, a grant entered into the database, which established the create date, ultimately resulted in the creation of a stock option agreement reflecting such grant. Accordingly, while execution of the stock option agreements constituted a clear acknowledgement by the grantee and the Company of the grantee's legal entitlement to the grant the Company believes the create date more accurately reflects the date of approval than does the signed option agreement. The Company has restated the compensation expense for stock option grants relating to approximately 4.2 million shares of common stock by using the create date as the measurement date. The total additional non-cash, pre-tax charge for these grants is approximately \$49.8 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.5 million relates to director options, \$17.2 million relates to officer options and \$32.2 million relates to rank and file employee options. The Company's procedures for evaluating the appropriateness of measurement dates fixed with reference to such create dates included a sensitivity analysis which provided an understanding of the differences between the additional recorded charge for stock-based compensation expense and the charges that would result from using other identified alternative methods for determining measurement dates. The Company's sensitivity analysis included identifying the range of potential grant dates defined by the recorded grant date and the create date for each grant. The Company then identified the low and high closing prices of the common stock within that range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted for which the create date methodology was utilized to determine the range of potential adjustments to stock-based compensation expense for these grants, which was \$0.09 million to \$73.8 million, net of forfeitures, as compared to the additional non-cash, pre-tax charge for these grants of approximately \$49.8 million, net of forfeitures, included in the Restatement.

For options entered into the Company's option database before September 9, 1999, the Company determined the measurement date generally by reference to signed option agreements (or the deemed signature date for certain options as discussed below). The executed option agreements (hereinafter signed option agreements), manually signed by the Company's CEO and manually signed and dated by the grantee, constituted an acknowledgement by the grantee and the Company of the grantee's legal entitlement to the grant and, in the absence of authoritative information as to when all the requisites for the establishment of the measurement date had been satisfied, provides a measurement date framework based on entitlement. The Company has restated the compensation expense for stock option grants relating to approximately 1.4 million shares of common stock by using the signed option agreements as the measurement date. The total additional non-cash, pre-tax charge for these grants is approximately \$6.4 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.3 million relates to director options, \$3.6 million relates to officer options and \$2.5 million relates to rank and file employee options. The Company believes this methodology was the most appropriate in the absence of sufficient evidence of approvals for these grants as it represents the earliest point in time at which the evidence shows that all requisites for the establishment of the measurement date had been satisfied for these grants. The Company's procedures for evaluating the appropriateness of measurement dates fixed with reference to the dating of signed option agreements included a sensitivity analysis which provided an understanding of the differences between the additional recorded charge for stock-based compensation expense and the charges that would result from using other identified alternative methods for determining measurement dates. The Company's sensitivity analysis included identifying the range of potential grant dates defined by the recorded grant date and the date of the grantee's signature on the stock option agreement for each grant. The Company then identified the low and high closing prices of the common stock within that range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted for which the signed option agreements methodology was utilized to determine the range of potential adjustments to stock-based compensation expense for these grants, which was \$0.03 million to \$9.6 million, net of forfeitures, as compared to the additional non-cash, pre-tax charge for these grants of approximately \$6.4 million, net

of forfeitures, included in the Restatement.

In those cases where no reliably-dated signed option agreement could be located and where no post-September 9, 1999 create date exists (stock option grants totaling approximately 0.9 million shares), the Company used the average period between recorded grant date and date of the signatures on all other grantee signed option agreements with the same grant date as the measurement date. For example, if there were four stock option grants with a grant date of January 1, 1996, the Company had the signed option agreements for three of these stock option grants and the average number of days between the grant date and the signature dates of these three signed option agreements was 20 days, January 21, 1996 was used as the measurement date for the grant for which no signed option agreement could be located. The Company has restated the compensation expense for stock option grants relating to approximately 0.7 million shares of common stock using this average days to sign agreement method. The total additional non-cash, pre-tax charge for these grants is approximately \$4.4 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.06 million relates to director options, \$4.2 million relates to officer options and \$0.2 million relates to rank and file employee options. The Company believes this methodology was the most appropriate in the absence of sufficient evidence of approvals for these grants because it gives a reasonable approximation of the measurement date related to these options in light of the available evidence. The Company conducted a sensitivity analysis by comparing the Company's current default methodology (i.e., average days to sign agreement) with another default methodology. For this analysis, the Company identified the range of potential grant dates defined by the earliest signed option agreement and the latest signed option agreement. The Company then identified the

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low and high closing prices of the common stock over the range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted to determine the range of potential adjustments to stock-based compensation expense for these grants, which was \$2.6 million to \$5.9 million, net of forfeitures. The Company's analyses indicate that stock-based compensation expense computed using other identified alternative default methodologies would not materially differ from stock-based compensation expense computed using the average days to sign agreement methodology. The Company's procedures for evaluating the appropriateness of measurement dates fixed with reference to the average days to sign agreements also included a sensitivity analysis which provided an understanding of the differences between the additional recorded charge for stock-based compensation expense and the charges that would result from using other identified alternative methods for determining measurement dates. The Company's sensitivity analysis included identifying the range of potential grant dates defined by the recorded grant date and the average days to sign agreement for each grant. The Company then identified the low and high closing prices of the common stock within that range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted to determine the range of potential adjustments to stock-based compensation expense for these grants, which was \$0.03 million to \$6.1 million, net of forfeitures, as compared to the additional non-cash, pre-tax charge for these grants of approximately \$4.4 million, net of forfeitures, included in the Restatement.

Given the volatility of the common stock during much of the Review Period, the use of methodologies and measurement dates different from those described above could have resulted in a higher or lower cumulative compensation expense which would have caused net income or loss to be different from the amounts reported in the restated consolidated financial statements. The Company's procedures for evaluating the appropriateness of measurement dates fixed using the default methodologies described above also included a sensitivity analysis which provided an understanding of the differences between the additional recorded charge for stock-based compensation expense and the charges that would result from using other identified alternative methods for determining measurement dates. The Company's sensitivity analysis included identifying the range of potential grant dates defined by the recorded grant date and the appropriate measurement date for each grant. The Company then identified the low and high closing prices of the common stock within that range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted to determine the range of potential adjustments to stock-based compensation expense for these grants, which was \$9.3 million to \$99.3 million, net of forfeitures, as compared to the additional non-cash, pre-tax charge for these grants of approximately \$70.0 million, net of forfeitures, included in the Restatement.

**Other adjustments through March 31, 2006**

From 1994 through 1998, the Company did not properly account for stock options for one officer that were modified after the grant date pursuant to a separation agreement. Some of these modifications were not identified in the Company's financial reporting processes and were therefore not properly reflected in its financial statements. As a result, the Company has recorded a non-cash charge for stock-based compensation of \$1.0 million during Fiscal 1999.

**Summary**

In summary, the Company recorded cumulative non-cash charges for stock-based compensation of \$70.9 million through March 31, 2006, offset in part by a cumulative income tax benefit of \$27.7 million, for a total after-tax charge of \$43.2 million. These charges had no impact on net sales or cash and cash equivalents as previously reported in the Company's financial statements; as a result, no changes to these items are reflected in the Restatement. Non-cash charges for stock-based compensation expense have been recorded as adjustments to Selling, General, and Administrative Expenses within the Company's Consolidated Statements of Income.

**1Q07 and 2Q07 Restatement****Stock-based compensation expense**

In addition to the Restatement noted above through March 31, 2006, the Company has recorded a non-cash charge for stock-based compensation of \$0.8 million and \$2.4 million for the three (3) and six (6) month periods ended September 30, 2006, offset in part by income tax benefits of \$0.3 million and \$1.0 million, or total after-tax charges of \$0.5 million and \$1.4 million. This charge was recorded to reflect additional non-cash, stock-based compensation expense recognized under the fair value method (SFAS 123(R)) because the exercise price for certain stock option

grants prior to, but not vested as of March 31, 2006, differed from the fair market value of the underlying shares on the appropriate measurement date, some of which occurred during Fiscal 2007.

Accounting for derivatives

On July 26, 2006, the Company entered into an interest rate swap to reduce its exposure from fluctuating interest rates. SFAS No.133 Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ) requires that all derivative instruments be recorded on the balance sheet as either an asset or liability measured at their fair value, and that changes in the derivatives fair value be recognized currently in earnings unless specific hedge accounting criteria are met. From inception of the hedge, the Company had applied a method



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of cash flow hedge accounting under SFAS 133 to account for the interest rate swap that allowed the Company to assume no ineffectiveness in such agreements, called the short-cut method.

Subsequently, the Company analyzed its eligibility for the short-cut method in light of certain clarifications delivered by the Office of the Chief Accountant of the SEC, and determined that its interest rate swap did not qualify for the short-cut method under SFAS 133 because certain prepayment features relating to the underlying actual debt were not identical to those contained in the interest rate swap. Because the Company's documentation at hedge inception reflected the short-cut method rather than the long haul method for determining hedge ineffectiveness, the derivative did not meet the requirements for a cash flow hedge. Documentation for the long haul method of accounting at hedge inception cannot be retrospectively applied under SFAS 133. Therefore, fluctuations in the interest rate swap's fair value should have been recorded through the Company's Consolidated Statement of Income instead of through Other Comprehensive Income (Loss), which is a component of stockholders' equity. The adjustment for 2Q07 will decrease reported net income and increase Other Comprehensive Income by approximately \$1.4 million. This change in accounting for this derivative instrument could result in significant volatility in the Company's reported net income and earnings per share due to increases and decreases in the fair value of the interest rate swap. However, the derivative instrument remains highly effective and the change in accounting for this derivative instrument does not impact operating cash flows or total stockholders equity.

The table below reflects the impact of the additional non-cash charges for stock-based compensation expense and the non-cash charge related to the interest rate swap on the Company's Consolidated Statements of Income, including the cumulative adjustment to Retained Earnings as of March 31, 2006 and September 30, 2006 on the Company's Consolidated Balance Sheet. See Note 3 of the Notes to Consolidated Financial Statements for reference to footnote disclosure that reconciles the previously filed annual financial information to the restated annual financial information. All dollar amounts are presented in thousands except per share amounts. Per share amounts may not total due to rounding.

	(As previously reported) Net Income	Adjust- ment, Pre-Tax	Income Tax Benefit	Adjust- ment, Net of Tax	(As Restated) Net Income	(As previously reported) Diluted EPS	Adjust- ment	(As Restated) Diluted EPS
FY 94	\$ 13,370	\$ 43	\$ (19)	\$ 24	\$ 13,346	\$ 0.83	\$ --	\$ 0.83
FY 95	14,515	461	(144)	317	14,198	0.89	(0.02)	0.87
FY 96	18,278	406	(151)	255	18,023	1.10	(0.01)	1.09
FY 97	24,792	1,172	(456)	716	24,076	1.40	(0.04)	1.36
FY 98	32,404	3,595	(1,393)	2,202	30,202	1.79	(0.12)	1.67
FY 99	38,145	4,506	(1,732)	2,774	35,371	2.09	(0.15)	1.94
FY 00	48,852	5,778	(2,209)	3,569	45,283	2.60	(0.19)	2.41
FY 01	64,190	10,290	(3,953)	6,337	57,853	3.22	(0.32)	2.90
FY 02	62,042	11,333	(4,381)	6,952	55,090	2.97	(0.33)	2.64
FY 03	48,685	8,927	(2,328)	6,599	42,086	2.39	(0.32)	2.07
FY 04	47,243	8,197	(4,156)	4,041	43,202	2.52	(0.22)	2.30
FY 05	29,912	5,178	(2,312)	2,866	27,046	1.68	(0.16)	1.52
Cumulative 03/31/05	\$ 442,428	\$ 59,886	\$ (23,234)	\$ 36,652	\$ 405,776	\$ 23.48	\$ (1.89)	\$ 21.59
1Q06	7,394	1,120	(442)	678	6,716	0.43	(0.04)	0.39
2Q06	12,797	1,126	(444)	682	12,115	0.74	(0.04)	0.70

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3Q06	12,511	2,431	(959)	1,472	11,039	0.70	(0.08)	0.62
4Q06	4,656	6,368	(2,612)	3,756	900	0.26	(0.21)	0.05
FY 06	\$ 37,358	\$11,045	\$ (4,457)	\$ 6,588	\$ 30,770	\$ 2.13	\$(0.37)	\$ 1.76
Cumulative 03/31/06	\$ 479,786	\$70,931	\$(27,691)	\$43,240	\$ 436,546	\$ 25.61	\$(2.26)	\$ 23.35
1Q07	7,807	1,629	(635)	994	6,813	0.43	(0.06)	0.37
2Q07	13,079	2,210	(806)	1,404	11,675	0.74	(0.08)	0.66
2QYTD07	\$ 20,886	\$ 3,839	\$ (1,441)	\$ 2,398	\$ 18,488	\$ 1.18	\$(0.14)	\$ 1.04
Cumulative 09/30/06	\$ 500,672	\$74,770	\$(29,132)	\$45,638	\$ 455,034	\$ 26.78	\$(2.39)	\$ 24.39

**Income Tax Considerations**

In the course of the investigation, the Company determined that a number of officers may have exercised options for which the application of Section 162(m) of the Internal Revenue Code of 1986, as amended (the Code), may apply. It is possible that these options will be treated as having been granted at less than fair market value for federal income tax purposes because the Company

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incorrectly applied the measurement date as defined in APB 25. If such options are deemed to be granted at less than fair market value, pursuant to Section 162(m) of the Code ( Section 162(m) ), any compensation to officers, including proceeds from options exercised in any given tax year, in excess of \$1.0 million will be disallowed as a deduction for tax purposes. The Company estimates that the potential tax effected liability for any such disallowed Section 162(m) deduction would approximate \$3.6 million. The Company may also incur interest and penalties if it were to incur any such tax liability, which could be material.

In addition, the Company is considering the application of Section 409A of the Code ( Section 409A ) to those options for which it incorrectly applied the measurement date as defined in APB 25. It is possible that these options will be treated as having been granted at less than fair market value for federal income tax purposes and thus subject to Section 409A. Accordingly, the Company may adopt measures to address the application of Section 409A. The Company does not currently know what impact Section 409A will have, or any such measures, if adopted, would have, on its results of operations, financial position or cash flows, although such impact could be material.

**Expenses Incurred by the Company**

The Company has incurred expenses for legal fees and external audit firm fees, in the aggregate amount of approximately \$0.6 million, in the fiscal year ended March 31, 2007, in relation to (i) the Audit Committee s review of the Company s historical stock option practices and related accounting for stock option grants, (ii) the informal inquiry and formal order of investigation by the Securities and Exchange Commission regarding its past stock option practices, (iii) the derivative action relating to the Company s historical stock option practices filed against the Company as a nominal defendant and certain of the Company s current and former directors and officers as to whom it may have indemnification obligations and (iv) related matters. Further, the Company expects to incur significant additional expense related to the foregoing matters in the fiscal year ending March 31, 2008. It is anticipated that certain of those expenses will be reimbursed under the Company s directors & officers indemnification insurance.

**Table of Contents****PART I - FINANCIAL INFORMATION****Item 1. Financial Statements.****BLACK BOX CORPORATION  
CONSOLIDATED BALANCE SHEETS <sup>(1)</sup>**

<b>In thousands, except par value</b>	<b>December 30, 2006 (Unaudited)</b>	<b>(As Restated) March 31, 2006 (Unaudited)</b>
<b>Assets</b>		
Cash and cash equivalents	\$ 15,362	\$ 11,207
Accounts Receivable, net of allowance for doubtful accounts of \$13,750 and \$9,517	184,403	116,713
Inventories, net	74,077	53,926
Costs/estimated earnings in excess of billings on uncompleted contracts	59,200	23,803
Deferred tax asset	10,456	8,973
Prepaid and other current assets	26,045	16,502
<b>Total current assets</b>	<b>369,543</b>	<b>231,124</b>
Property, plant and equipment, net	39,252	35,124
Goodwill, net	588,556	468,724
Intangibles:		
Customer relationships, net	55,962	24,657
Other intangibles, net	36,493	30,783
Deferred tax asset	17,920	19,909
Other assets	4,192	5,091
<b>Total assets</b>	<b>\$ 1,111,918</b>	<b>\$ 815,412</b>
<b>Liabilities</b>		
Accounts payable	\$ 75,982	\$ 44,943
Accrued compensation and benefits	23,443	13,954
Deferred revenue	48,998	22,211
Restructuring reserve	10,168	3,292
Billings in excess of costs/estimated earnings on uncompleted contracts	21,444	8,648
Current maturities of long-term debt	587	1,049
Other liabilities	62,042	37,358
<b>Total current liabilities</b>	<b>242,664</b>	<b>131,455</b>
Long-term debt	253,938	122,673
Other liabilities	26,754	8,293

<b>Total liabilities</b>	<b>523,356</b>	<b>262,421</b>
<b>Stockholders Equity</b>		
Preferred Stock authorized 5,000, par value \$1.00, none issued	--	--
Common Stock authorized 100,000, par value \$.001, 17,448 and 17,593 shares outstanding	25	25
Additional paid-in capital	437,096	418,141
Treasury stock, at cost 7,436 and 6,935 shares	(317,030)	(296,824)
Accumulated other comprehensive income	24,025	13,036
Retained earnings	444,446	418,613
<b>Total stockholders equity</b>	<b>588,562</b>	<b>552,991</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 1,111,918</b>	<b>\$ 815,412</b>

(1) *See Note 3 of the  
Notes to the  
Consolidated  
Financial  
Statements*

*See Notes to the Consolidated Financial Statements*

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**BLACK BOX CORPORATION**  
**CONSOLIDATED STATEMENTS OF INCOME** <sup>(1)</sup>

<b>In thousands, except per share amounts</b>	<i>(Unaudited)</i> <b>Three months ended December 30 and 31</b>		<i>(Unaudited)</i> <b>Nine months ended December 30 and 31</b>	
	<b>2006</b>	<b>(As Restated) 2005</b>	<b>2006</b>	<b>(As Restated) 2005</b>
<b>Revenues:</b>				
Hotline products	\$ 57,770	\$ 52,771	\$ 165,058	\$ 160,279
On-Site services	207,036	129,364	601,468	386,188
Total	264,806	182,135	766,526	546,467
<b>Cost of Sales:</b>				
Hotline products	29,887	26,308	83,195	79,011
On-Site services	138,234	82,425	401,766	249,232
Total	168,121	108,733	484,961	328,243
<b>Gross profit</b>	<b>96,685</b>	<b>73,402</b>	<b>281,565</b>	<b>218,224</b>
Selling, general & administrative expenses	73,940	52,872	217,741	156,685
Restructuring and other charges	--	--	--	5,290
Intangibles amortization	2,677	1,349	6,114	4,235
<b>Operating income</b>	<b>20,068</b>	<b>19,181</b>	<b>57,710</b>	<b>52,014</b>
Interest expense (income), net	4,061	2,397	13,222	6,686
Other expenses (income), net	(122)	114	65	79
Income before provision for income taxes	16,129	16,670	44,423	45,249
Provision for income taxes	5,636	5,631	15,442	15,379
<b>Net income</b>	<b>\$ 10,493</b>	<b>\$ 11,039</b>	<b>\$ 28,981</b>	<b>\$ 29,870</b>
Earnings per common share:				
Basic	\$ 0.60	\$ 0.64	\$ 1.66	\$ 1.75
Diluted	\$ 0.59	\$ 0.62	\$ 1.63	\$ 1.72

Weighted average common shares outstanding				
Basic	17,398	17,286	17,451	17,050
Diluted	17,780	17,786	17,809	17,362
Dividends per share	\$ 0.06	\$ 0.06	\$ 0.18	\$ 0.18

(1) **See Note 3 of  
the Notes to the  
Consolidated  
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Statements**

**See Notes to the Consolidated Financial Statements**

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**BLACK BOX CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS <sup>(1)</sup>**

	<i>(Unaudited)</i>	
	Nine months ended	
	December 30 and 31	
<b>In thousands</b>	<b>2006</b>	<b>(As Restated) 2005</b>
<b>Operating Activities</b>		
Net income	\$ 28,981	\$ 29,870
Adjustments to reconcile net income to net cash provided by (used for) operating activities:		
Intangibles amortization and depreciation	15,333	11,013
Deferred taxes	(730)	487
Stock compensation expense	7,476	4,677
Tax benefit from exercised stock options	662	(1,068)
Change in fair value of interest rate swap	1,308	--
Changes in operating assets and liabilities:		
Accounts receivable, net	(644)	73
Inventories, net	(6,629)	5,673
All other current assets excluding deferred tax asset	707	(3,678)
Liabilities exclusive of long term debt	(21,868)	(8,135)
<b>Net cash provided by (used for) operating activities</b>	<b>\$ 24,596</b>	<b>\$ 38,912</b>
<b>Investing Activities</b>		
Capital expenditures	\$ (3,475)	\$ (3,151)
Capital disposals	543	1,232
Acquisition of businesses (payments)/recoveries	(132,878)	(40,682)
Prior merger-related (payments)/recoveries	(1,431)	(378)
<b>Net cash provided by (used for) investing activities</b>	<b>\$ (137,241)</b>	<b>\$ (42,979)</b>
<b>Financing Activities</b>		
Proceeds from borrowings	\$ 314,021	\$ 157,280
Repayment of borrowings	(184,946)	(164,698)
Repayment on discounted lease rentals	(27)	(847)
Proceeds from exercise of options	12,141	16,344
Payment of dividends	(3,157)	(3,049)
Purchase of treasury stock	(20,206)	(14)
<b>Net cash provided by (used for) financing activities</b>	<b>\$ 117,826</b>	<b>\$ 5,016</b>
Foreign currency exchange impact on cash	\$ (1,026)	\$ (398)
<b>Increase / (decrease) in cash and cash equivalents</b>	<b>\$ 4,155</b>	<b>\$ 551</b>



Cash and cash equivalents at beginning of period	\$ 11,207	\$ 11,592
Cash and cash equivalents at end of period	\$ 15,362	\$ 12,143
Supplemental Cash Flow:		
Cash paid for interest	\$ 11,264	\$ 5,817
Cash paid for income taxes	13,850	13,539
Non-cash financing activities:		
Dividends payable	1,047	1,044
Capital leases	349	834

(1) **See Note 3 of  
the Notes to the  
Consolidated  
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*See Notes to the Consolidated Financial Statements*

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**BLACK BOX CORPORATION**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
**(UNAUDITED)**

**Note 1: Basis of Presentation**

The accompanying unaudited interim consolidated financial statements of Black Box Corporation (the Company) have been prepared in accordance with accounting principles generally accepted in the United States and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States for complete financial statements. The Company believes that these consolidated financial statements reflect all normal, recurring adjustments needed to present fairly the Company's results for the interim periods presented. The results for interim periods may not be indicative of the results of operations for any other interim period or for the full year. As previously disclosed, the financial statements and notes thereto included in the Company's most recent Annual Report on Form 10-K as filed with the Securities and Exchange Commission (SEC) for the fiscal year ended March 31, 2006 (Form 10-K) will need to be restated and, therefore, should not be relied upon. See Note 3 of the Notes to the Consolidated Financial Statements.

The Company's fiscal year ends on March 31. The fiscal quarters consist of 13 weeks and end on the Saturday nearest each calendar quarter end. The actual ending dates for the periods presented in these Notes to the Consolidated Financial Statements as of December 31, 2006 and 2005 were December 30, 2006 and December 31, 2005. References to Fiscal Year or Fiscal mean the Company's fiscal year ended March 31 for the year referenced. All references to dollar amounts herein are presented in thousands, except per share amounts.

**Principles of Consolidation**

The consolidated financial statements include the accounts of the parent company and its subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

**Use of Estimates**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Significant estimates in these financial statements include allowances for doubtful accounts receivable, sales returns, net realizable value of inventories, loss contingencies, warranty reserves, intangible assets and goodwill. Actual results could differ from those estimates. Management believes the estimates made are reasonable.

**Reclassification**

Certain reclassifications have been made to the financial statements for prior periods in order to conform to the presentation for the three (3) and nine (9) months ended December 30, 2006.

**Note 2: Significant Accounting Policies / Recent Accounting Pronouncements**

**Significant Accounting Policies**

The significant accounting policies used in the preparation of the Company's Consolidated Financial Statements are disclosed Note 1 within the Notes to the Consolidated Financial Statements for the year ended March 31, 2006 contained in Form 10-K. Additional significant accounting policies adopted during Fiscal 2007 are disclosed below.

***Stock-Based Compensation***

On April 1, 2006, the Company adopted Statement of Financial Accounting Standards (SFAS) No. 123 (revised 2004), Share-Based Payment (SFAS 123(R)) which requires companies to estimate the fair value of share-based payment awards and recognize compensation expense over the requisite service period for the portion of the award that is ultimately expected to vest. Prior to the adoption of SFAS 123(R), the Company accounted for share-based awards to employees and directors using the intrinsic value method in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees (APB 25) as allowed under SFAS No. 123, Accounting for Stock-Based Compensation (SFAS 123). Under the intrinsic value method, no stock-based compensation expense related to stock options was required to be recognized if the exercise price of the Company's stock options granted to employees and directors was equal to or greater than the fair market value of the underlying stock on the measurement

date.  
The Company adopted SFAS 123(R) using the modified prospective transition method which requires compensation cost to be recognized for all share-based payments granted after the date of adoption and for all unvested awards existing on the date of adoption. In accordance with the modified prospective transition method, the Company's Consolidated Financial Statements for prior periods have not been retroactively adjusted to reflect, and do not include, the impact of SFAS 123(R). However, the modified prospective transition

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method does require the Company to provide pro-forma disclosure of specific income statement line items for periods prior to the adoption of SFAS 123(R) as if the fair-value-based method had been applied to all awards. See Note 14 of the Notes to the Consolidated Financial Statements.

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards on the grant-date using an option-pricing model. Upon adoption of SFAS 123(R), the Company began using the Black-Scholes option pricing model as the method of valuation for the Company's stock options. The model requires the use of various assumptions. The key assumptions are summarized as follows:

*Expected volatility:* The Company estimates the volatility of the common stock at the date of grant based on the historical volatility of its common stock.

*Dividend yield:* The Company estimates the dividend yield assumption based on the Company's historical and projected dividend payouts.

*Risk-free interest rate:* The Company bases risk-free interest rate on the observed interest rates appropriate for the term of the Company's employee stock options.

*Annual forfeiture rate and expected holding period:* The Company estimates the annual forfeiture rate and expected holding period based on historical experience.

*Amortization period:* The Company recognizes the fair value of awards into expense over the requisite service periods associated with the award.

**Recent Accounting Pronouncements*****Fair Value Option for Financial Assets and Financial Liabilities***

In February 2007, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* ( SFAS 159 ). SFAS 159 permits an entity to elect to measure eligible items at fair value ( fair value option ) including many financial instruments. The provisions of SFAS 159 are effective for the Company as of April 1, 2008. If the fair value option is elected, the Company will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. The fair value option may be applied for a single eligible item without electing it for other identical items, with certain exceptions, and must be applied to the entire eligible item and not to a portion of the eligible item. The Company is currently evaluating the irrevocable election of the fair value option pursuant to SFAS 159.

***Prior Year Misstatements on Current Year Financial Statements***

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* ( SAB 108 ). SAB 108 provides interpretive guidance on how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements for the purpose of a materiality assessment. The SEC staff believes that registrants should quantify errors using both a balance sheet and an income statement approach and evaluate whether either approach results in quantifying a misstatement that, when all relevant quantitative and qualitative factors are considered, is material. SAB 108 is effective as of the Company's fiscal year end March 31, 2007. The Company adopted SAB 108 as of March 31, 2007. The adoption of SAB 108 did not have a material impact on its consolidated financial statements.

***Fair Value Measurements***

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective for the Company beginning on April 1, 2008. The requirements of SFAS 157 will be applied prospectively except for certain derivative instruments that would be adjusted through the opening balance of retained earnings in the period of adoption. The Company is evaluating the impact of the adoption of SFAS 157 on the Company's consolidated financial statements.

***Defined Benefit Pension and Other Postretirement Plans***

In September 2006, the FASB issued SFAS No 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* ( SFAS 158 ) that would amend SFAS No. 87, *Employers Accounting for Pensions*, SFAS

No. 88, *Employers Accounting for Settlements and Curtailments of Defined Benefit Pension Plans and for Termination Benefits*, SFAS No. 106, *Employers*

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*Accounting for Postretirement Benefits Other Than Pensions* and SFAS No. 132 (Revised 2003), *Employers Disclosures about Pensions and Other Postretirement Benefits*. This standard requires, among other things, companies to recognize on the balance sheet the funded or unfunded status of pension and other postretirement benefit plans and to recognize the change in funded status in the period the change occurs through comprehensive income. The provisions of SFAS 158 are effective as of the Company's fiscal year end March 31, 2007. The Company adopted SFAS 158 as of March 31, 2007. The adoption of SFAS 158 had no impact on the Company's Statement of Operations on the date of adoption. However, the Company did record a gain into other comprehensive income of approximately \$2.7 million (1.7 million, net of tax.)

*Uncertainty in Income Taxes*

In July 2006, the FASB issued FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). This Interpretation requires that realization of an uncertain income tax position must be more likely than not (*i.e.*, greater than 50% likelihood of receiving a benefit) before it can be recognized in the financial statements. Further, FIN 48 prescribes the benefit to be recorded in the financial statements as the amount most likely to be realized assuming a review by tax authorities having all relevant information and applying current conventions. The Interpretation also clarifies the financial statement classification of tax-related penalties and interest and sets forth new disclosures regarding unrecognized tax benefits. FIN 48 is effective for the next fiscal year beginning after December 15, 2006. The Company plans to adopt the Interpretation as of April 1, 2007 as required. The Interpretation is currently being evaluated by the Company for its full impact and, at this time, the Company believes it has properly and adequately provided for all income tax positions and therefore expects minimal impact from adopting the Interpretation.

*Definition of Settlement in FIN 48*

In May 2007, the FASB issued staff position No. FIN 48-1, *Definition of Settlement in FASB Interpretation No. 48* (FSP FIN 48-1) which amended FIN 48 to provide guidance about how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. Under FSP FIN 48-1, a tax position could be effectively settled on completion of an examination by a taxing authority. The Company plans to adopt FSP FIN 48-1 in conjunction with adoption of FIN 48 as of April 1, 2007. This staff position is currently being evaluated by the Company for its full impact and, at this time, the Company believes it has properly and adequately provided for all income tax positions and therefore expects minimal impact from adoption.

*Stock-Based Compensation*

In December 2004, the FASB issued SFAS 123(R). SFAS 123(R) is a revision of SFAS No. 123, supersedes APB 25 and amends SFAS No. 95, *Statement of Cash Flows*. SFAS 123(R) requires that companies recognize all share-based payments to employees, including grants of employee stock options, in the financial statements. The recognized cost is based on the fair value of the equity or liability instruments issued. Pro-forma disclosure of this cost is no longer an alternative under SFAS 123(R). This Statement was effective for public companies at the beginning of the first annual reporting period beginning after June 15, 2005.

As permitted by SFAS 123, the Company accounted for its stock-based compensation plans under APB 25's intrinsic value method and, as such, recognized stock-based compensation expense if the exercise price of the Company's stock options granted to employees and directors was equal to or greater than the fair market value of the underlying stock on the measurement date. The adoption of SFAS 123(R)'s fair value method has had no impact on the Company's overall financial position or cash flows. Based on SFAS 123(R), the Company transitioned to the new requirements by using the modified prospective transition method. This transition method requires compensation cost to be recognized for all share-based payments granted after the date of adoption and for all unvested awards existing on the date of adoption.

SFAS 123(R) also requires the benefits of tax deductions in excess of recognized compensation cost be reported as a financing cash flow, rather than as an operating cash flow as required under past standards. This requirement will reduce net operating cash flows and increase net financing cash flows in periods after adoption when the benefits of tax deductions are in excess of recognized compensation cost.

The Company adopted the provisions of SFAS 123(R) as of April 1, 2006. For the three and nine month periods ended December 31, 2006, the Company recognized compensation expense of \$1,840 (\$1,196 net of tax) or \$0.07 per

diluted share and \$7,476 (\$4,860 net of tax) or \$0.27 per diluted share, respectively on the Company's Consolidated Statements of Income. See Significant Accounting Policies (within this Note 2 of the Notes to the Consolidated Financial Statements) and Note 14 of the Notes to the Consolidated Financial Statements for further reference to the disclosures required by SFAS 123(R).

*Tax Effects of Share-Based Payment Awards*

On November 10, 2005, the FASB issued Staff Position No. SFAS 123(R)-3, Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards (SFAS 123(R)-3). The alternative transition method includes simplified methods to establish the beginning balance of the additional paid-in capital pool (APIC pool) related to the tax effects of employee share-based compensation, and to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows of the tax effects of employee share-based compensation awards that are outstanding upon adoption of SFAS 123(R). The company has elected this transition method for calculating tax effects of share-based payment awards.

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**Note 3: Restatement of Consolidated Financial Statements**

**Restatement through March 31, 2006**

**Background**

On November 13, 2006, Black Box received a letter of informal inquiry from the Enforcement Division of the SEC relating to the Company's stock option practices from January 1, 1997 to present. As a result, the Audit Committee, with the assistance of outside legal counsel, commenced an independent review of the Company's historical stock option grant practices and related accounting for stock option grants during the period from 1992 to the present (the Review Period).

On February 1, 2007, the Company announced that, while the review of option grant practices was continuing, it believed that it would need to record additional non-cash charges for stock-based compensation expense relating to certain stock option grants and, accordingly, cautioned investors about relying on its historical financial statements until the Company could determine with certainty whether a restatement would be required and, if so, the extent of any such restatement and the periods affected.

On March 19, 2007, although the Audit Committee had not yet completed its review, the Audit Committee concluded that the exercise price of certain stock option grants differed from the fair market value of the underlying shares on the appropriate measurement date. At that time, the Company and the Audit Committee announced that it was currently expected that the Company's additional non-cash, pre-tax charges for stock-based compensation expense relating to certain stock option grants would approximate \$63 million for the Review Period. In addition, the Company and the Audit Committee concluded that the Company would need to restate its previously-issued financial statements contained in reports previously filed by the Company with the SEC. Accordingly, on March 19, 2007, the Company and the Audit Committee concluded that the Company's previously-issued financial statements and other historical financial information and related disclosures for the Review Period, including applicable reports of its current or former independent registered public accounting firms and related press releases, should not be relied upon.

On May 25, 2007, the Company was advised by the Enforcement Division of the SEC that a Formal Order of Private Investigation arising out of the Company's stock option practices had been entered and on May 29, 2007 the Company received a subpoena that was issued by the SEC.

On May 31, 2007, the Company announced that, as a result of the ongoing review of stock option practices, Company management and the Audit Committee expected that the Company's additional non-cash, pre-tax charges for stock-based compensation expense relating to certain stock option grants would approximate \$70 million for the Review Period.

**Findings of the Audit Committee**

During the Review Period, the Company granted stock options pursuant to an employee stock option plan and a director stock option plan to acquire approximately 10.9 million shares of the Company's common stock, par value \$.001 per share (the common stock). Such plans at all relevant times provided for option grants to be approved by a designated committee of non-employee directors or, in the case of the director stock option plan, by the Company's Board of Directors (the Board). Approximately 2,000 stock option grants were awarded during the Review Period with 69 recorded grant dates. No stock options have been granted since September, 2006. The Audit Committee reviewed all stock options granted during the Review Period, including option grants to the Company's directors, officers and rank and file employees (including grants to new employees, grants awarded in connection with Company acquisitions and grants made as individual or group performance awards). The Audit Committee's review of the Company's stock option granting practices included a comprehensive examination of reasonably available relevant physical and electronic documents as well as interviews with current and former directors, officers and Company personnel.

The Audit Committee's review was initially focused on determining whether the Company's prior stock option granting practices were in compliance with the plans' granting provisions and applicable law or called into question its accounting for such options. Once it became evident that such issues and accounting implications existed, the inquiry focused on those matters necessary: to determine whether any accounting charges were material and whether a restatement of the Company's previously-issued financial statements would be required; to establish a basis for effecting any required restatement; to assure that, on as timely a basis as possible, the Company could file any



required curative disclosures with the SEC and assure its continued eligibility for listing on The NASDAQ Stock Market; and to provide an informed basis for the Company's response to the identified issues, including appropriate corrective and remedial actions.

The following information summarizes certain of the findings of the Audit Committee. The findings identified approximately \$71.5 million of unrecorded expense at the time of grant (i.e., the difference between the fair market value of the common stock on the

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appropriate measurement date and the stated exercise price), net of forfeitures, during the Review Period, of which \$70.0 million was recorded in the Company's Consolidated Financial Statements through March 31, 2006 and \$1.5 million of unrecorded expense at the time of grant will be included, beginning at April 1, 2006, in the Company's computation of compensation expense in accordance with SFAS 123(R). The following summarizes the unrecorded expense at the time of grant by time period and category of recipient:

\$4.2 million for the period from Fiscal 1993 through Fiscal 1997 (\$0.2 million for directors, \$2.5 million for officers and \$1.5 million for rank and file employees)

\$45.6 million for the period from Fiscal 1998 through August 2002 (\$1.1 million for directors, \$25.7 million for officers and \$18.7 million for rank and file employees)

\$21.8 million for the period from August 2002 to the present (\$0.04 million for directors, \$0.6 million for officers and \$21.1 million for rank and file employees)

The Audit Committee's additional key findings are summarized below:

**Lack of Adequate Documentation:** For a majority of grants issued by the Company during the Review Period, there is either no or inadequate documentation of approval actions that satisfies the requisites for establishing a measurement date under APB 25. Of the 69 recorded grant dates, there are documented approval actions by the Board or the Option or Compensation Committee of the Board (the Compensation Committee) with respect to particular grants for 12 dates. In the period December 1992 to May 1996, neither the minutes of the Compensation Committee nor of the Board reflect any action to approve specific grants. In some instances, evidence of single director (the chairman of the Compensation Committee) approval actions exists. This absence of non-employee director level documentation also applies to a majority of grants with a recorded grant date after 1996. In some cases, Compensation Committee minutes contain a reference to reports on the status of the option pool but do not document any action to approve specific grants. Approval documentation for certain grants has internal inconsistencies or conflicts with other documents thereby rendering this documentation unreliable as a basis for establishing a measurement date. In some cases, the only existing documentation is the executed option agreement and/or the entry of the option grant into the option database. Notwithstanding these approval documentation inadequacies, the Company entered into option agreements with grantees and has honored such grants.

**Grant Approvals:** During the Review Period, relatively few option grants were approved in complete compliance with the Company's stock option plans. Available documentation reflects that the Company approved option grants in a variety of ways. With respect to the employee stock option plan, grants were approved by the Compensation Committee as contemplated by the plan at various times, by the full Board in 1998 and 1999, by a single director (the chairman of the Compensation Committee) on nine recorded grant dates during the period 1994 through 2001 and by the Company's Chief Executive Officer (CEO) at various times. With respect to the director stock option plan, grants were generally approved by the designated Board committee and, in a few cases, by the chairman of the Compensation Committee. In one instance in 2000, there is no conclusive documentary evidence of the approval of director grants other than the signed director option agreements.

The delegation of authority by the Compensation Committee to the CEO with respect to grants to rank and file employees was not fully documented. However, there was an understood and accepted practice between the CEO and the Compensation Committee whereby the CEO made certain awards to individual employees. In some instances, this involved the allocation among rank and file employees of blocks of shares approved by the Compensation Committee; in three (3) such instances, the number of shares ultimately awarded pursuant to this process exceeded the approved size of the block, which was contrary to the understanding of the Compensation Committee members. Further, contrary to the understanding of Committee members, the award and/or documentation of those individual grants often significantly lagged the approval of the block grant. In August 2005, the Compensation Committee specifically acknowledged a prior grant of delegated authority to the CEO to make option grants to rank and file employees and ratified all prior awards by the CEO. In some cases, documentation of approval action is either inconclusive or missing, and the Company therefore has been unable to determine what entity or person actually approved specific grants.

**Option Pricing:** The recorded grant dates for a majority of grants do not match the applicable measurement dates as determined under APB 25. The grants of options with exercise prices lower than the fair market values of the stock on the actual measurement dates did not satisfy the fair market pricing requirement in the Company's plans, as amended in 1998, and were not consistent with the Company's disclosures in SEC filings stating that the exercise price of options was equal to the fair market value of the stock on the date of the grant.

The relationship between the stated exercise price of options and the fair market value of the Company's stock on the date of the identifiable approval actions varied from grant to grant. In some cases, the exercise price of grants reflected the fair market value of the underlying shares on the date of any documented approval action. In other cases, the exercise prices reflected the fair market value of the underlying shares on a date either prior or subsequent to any such documented approval action and the exercise price was lower than the fair market value on the date of any such action. In several such cases before August 2002, the use of such grant dates and lower exercise prices (together with other available evidence) supports a finding that the recorded grant dates and corresponding exercise prices were

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selected with the benefit of hindsight. For certain grants where the mismatch between the recorded grant date and the approval action was only a matter of days, however, the mismatch appears to have been attributable to inaccurate recording or administrative delays. In some cases, the apparent approval action did not identify all grantees; for example, there are cases where a block grant was approved subject to a later determination of individual grant recipients and grants were recorded with a grant date, and corresponding exercise price, that matched the date of the apparent approval of the block grant and the fair market value of the common stock on that date although individual grant recipients may have been identified some time after approval of the block grant. Finally, in some cases, the approval action for specific grants is not adequately documented. Where the recorded grant date did not satisfy the requisites for a measurement date under APB 25, the Company relied on default methodologies to determine an appropriate measurement date.

**Internal Controls:** As outlined above, the Company's historical administration of its options program lacked discipline as it relates to proper adherence to the plan requirements, corporate recordkeeping and documentation. Since November 2003, however, the Company has properly administered the stock option program as it relates to awards to directors and officers. During the investigation, the Company identified control gaps related to grants made throughout the Review Period. As of March 31, 2007, the Company implemented additional procedures to its process that are focused on formalized documentation of appropriate approvals and determination of grant terms to employees.

**Procedural and Remedial Actions**

The Audit Committee and other relevant Board committees are committed to a continued review and implementation of procedural enhancements and remedial actions in light of the foregoing findings. Consistent with its obligation to act in the best interests of the Company taking into account all relevant facts and circumstances, the Audit Committee is continuing to assess the appropriateness of a broad range of possible procedural enhancements and potential remedial measures in light of the findings of its investigation. While the Audit Committee has not completed its consideration of all such steps, procedural enhancements may include recommendations regarding improved stock option administration procedures and controls, training and monitoring compliance with those procedures, corporate recordkeeping, corporate risk assessment, evaluation of the internal compliance environment and other remedial steps that may be appropriate. The Audit Committee is also expected to address issues of individual conduct or responsibility, including those of the Board, CEOs and Chief Financial Officers ( CFOs ) serving during the Review Period. Potential remedial measures may include an evaluation of the role of and possible claims or other remedial actions against current and former Company personnel who may be found to have been responsible for identified problems during the Review Period. The Audit Committee expects to recommend to the Board and/or its appropriate committees procedural enhancements and remedial measures that appropriately address the issues raised by its findings. In advance of action by the Audit Committee, as noted above, the Company has implemented additional procedures to its process for approving stock option grants that are focused on formalized documentation of appropriate approvals and determination of grant terms to employees.

**Restatement Methodologies**

As of April 1, 2006, the Company adopted SFAS 123(R) using the modified prospective transition method. Under this transition method, compensation expense is to be recognized for all share-based compensation awards granted after the date of adoption and for all unvested awards existing on the date of adoption. Prior to April 1, 2006, the Company accounted for stock-based compensation awards to directors, officers and rank and file employees using the intrinsic value method in accordance with APB 25 as allowed under SFAS 123. Under the intrinsic value method, no share-based compensation expense related to stock options was required to be recognized if the exercise price of the stock option was at least equal to the fair market value of the common stock on the measurement date. APB 25 defines the measurement date as the first date on which are known both (1) the number of shares that an individual grant recipient is entitled to receive and (2) the option or purchase price, if any.

In light of the Audit Committee's review of the Company's stock option granting practices during the Review Period and as to those cases in which the Company previously used a recorded grant date as the measurement date that the Company determined could no longer be relied upon, the Company has developed and applied the following methodologies to remeasure those stock option grants and record the relevant charges in accordance with APB 25 by

considering the following sources of information: (i) meeting minutes of the Board and of committees thereof and related materials, (ii) Unanimous Written Consents of the Board and of committees thereof, (iii) the dates on which stock option grants were entered into the Company's stock option database (create date), (iv) relevant email correspondence reflecting stock option grant approval actions, (v) individual stock option agreements and related materials, (vi) employee and Board offer letters, (vii) documents relating to acquisitions, (viii) reports on Form 4 filed with the SEC and (ix) guidance of the Office of the Chief Accountant of the SEC on stock option matters as set forth in its letter dated September 19, 2006.

***Grants with Appropriate Committee Approval.*** With respect to grants of approximately 1.0 million shares, or approximately 9% of the total grants in the Review Period, the Company has evidence to support the approval of the grant under the stock option plans by the relevant committee of the Board, and such evidence includes the number of options each individual was entitled to receive and the option price. However, the relationship between these documented approval actions and the originally-recorded grant dates and exercise prices

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for the options so approved varied during the Review Period. In some cases, grants were recorded with a grant date and a corresponding exercise price that matched the date of the approval action or were otherwise consistent with the terms of the approval actions. In other cases, however, the recorded grant dates and corresponding exercise prices of the grants reflected the fair market value of the common stock on a date prior to the committee's documented approval actions. The Company has restated the compensation expense for stock option grants relating to approximately 0.4 million shares of common stock by using the date of the documented approval action as the measurement date. The total additional non-cash, pre-tax charge for these grants is approximately \$1.8 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.07 million relates to director options, \$1.3 million relates to officer options and \$0.4 million relates to rank and file employee options.

***Grants with Other Approvals.*** With respect to grants of approximately 1.9 million shares, or approximately 18% of the total grants in the Review Period, the Company has evidence to support the approval of the grant by the Board, an outside director or the Company's CEO and the identification of the number of options each individual was entitled to receive together with the option price. These grants are distinguished from the grants described in the prior paragraph in that the nature of the approval was not fully consistent with the terms of the relevant stock option plan. As with the grants discussed in the preceding paragraph, the relationship between these documented approval actions and the originally-recorded grant dates and exercise prices for the options so approved varied during the Review Period. In some cases, grants were recorded with a grant date and a corresponding exercise price that matched the date of the approval action or were otherwise consistent with the terms of the approval action. In other cases, however, the recorded grant dates and corresponding exercise prices of the grants reflected the fair market value of the Company's stock on a date prior to the approval action. The Company has restated the compensation expense for stock option grants relating to approximately 1.6 million shares of common stock by using the date of the documented approval action as the measurement date. The total additional non-cash, pre-tax charge for these grants is approximately \$7.6 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.5 million relates to director options, \$2.6 million relates to officer options and \$4.5 million relates to rank and file employee options.

***Grants Lacking Adequate Documentation.*** With respect to grants of approximately 7.9 million shares (5.0 million shares to rank and file employees), or 73.0% of the total grants in the Review Period, the Company has been unable to locate adequate documentation of approval actions that would satisfy the requisites for a measurement date under APB 25. For these grants, management considered all available relevant information to form a reasonable conclusion as to the most reasonable measurement date. For all grants in this category, the Company has established default methodologies for determining the most appropriate measurement date under APB 25.

With respect to grants entered into the Company's stock option database after September 9, 1999, when the database began to reflect a create date which is the date on which a grant was entered into the system, the Company has determined to use the individual create date for each grant as the APB 25 measurement date, which was in most cases different from the originally-recorded grant date. The Company believes that this create date is the most appropriate methodology in the absence of sufficient evidence of approvals for these grants as it represents the earliest point in time at which the evidence shows that all requisites for the establishment of the measurement date had been satisfied. Such create dates preceded, often by a significant amount of time, the execution of stock option agreements, which, generally, were manually signed by the Company's CEO and manually signed and dated by the grantee. In addition, in almost all cases, a grant entered into the database, which established the create date, ultimately resulted in the creation of a stock option agreement reflecting such grant. Accordingly, while execution of the stock option agreements constituted a clear acknowledgement by the grantee and the Company of the grantee's legal entitlement to the grant the Company believes the create date more accurately reflects the date of approval than does the signed option agreement. The Company has restated the compensation expense for stock option grants relating to approximately 4.2 million shares of common stock by using the create date as the measurement date. The total additional non-cash, pre-tax charge for these grants is approximately \$49.8 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.5 million relates to director options, \$17.2 million relates to officer options and \$32.2 million relates to rank and file employee options. The Company's procedures for evaluating the appropriateness of measurement dates fixed with reference to such create dates included a sensitivity analysis which

provided an understanding of the differences between the additional recorded charge for stock-based compensation expense and the charges that would result from using other identified alternative methods for determining measurement dates. The Company's sensitivity analysis included identifying the range of potential grant dates defined by the recorded grant date and the create date for each grant. The Company then identified the low and high closing prices of the common stock within that range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted for which the create date methodology was utilized to determine the range of potential adjustments to stock-based compensation expense for these grants, which was \$0.09 million to \$73.8 million, net of forfeitures, as compared to the additional non-cash, pre-tax charge for these grants of approximately \$49.8 million, net of forfeitures, included in the Restatement.

For options entered into the Company's option database before September 9, 1999, the Company determined the measurement date generally by reference to signed option agreements (or the deemed signature date for certain options as discussed below). The executed option agreements (hereinafter signed option agreements), manually signed by the Company's CEO and manually signed and dated by the grantee, constituted an acknowledgement by the grantee and the Company of the grantee's legal entitlement to the grant and, in the absence of authoritative information as to when all the requisites for the establishment of the measurement date had been satisfied, provides a measurement date framework based on entitlement. The Company has restated the compensation expense for stock option

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grants relating to approximately 1.4 million shares of common stock by using the signed option agreements as the measurement date. The total additional non-cash, pre-tax charge for these grants is approximately \$6.4 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.3 million relates to director options, \$3.6 million relates to officer options and \$2.5 million relates to rank and file employee options. The Company believes this methodology was the most appropriate in the absence of sufficient evidence of approvals for these grants as it represents the earliest point in time at which the evidence shows that all requisites for the establishment of the measurement date had been satisfied for these grants. The Company's procedures for evaluating the appropriateness of measurement dates fixed with reference to the dating of signed option agreements included a sensitivity analysis which provided an understanding of the differences between the additional recorded charge for stock-based compensation expense and the charges that would result from using other identified alternative methods for determining measurement dates. The Company's sensitivity analysis included identifying the range of potential grant dates defined by the recorded grant date and the date of the grantee's signature on the stock option agreement for each grant. The Company then identified the low and high closing prices of the common stock within that range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted for which the signed option agreements methodology was utilized to determine the range of potential adjustments to stock-based compensation expense for these grants, which was \$0.03 million to \$9.6 million, net of forfeitures, as compared to the additional non-cash, pre-tax charge for these grants of approximately \$6.4 million, net of forfeitures, included in the Restatement.

In those cases where no reliably-dated signed option agreement could be located and where no post-September 9, 1999 create date exists (stock option grants totaling approximately 0.9 million shares), the Company used the average period between recorded grant date and date of the signatures on all other grantee signed option agreements with the same grant date as the measurement date. For example, if there were four stock option grants with a grant date of January 1, 1996, the Company had the signed option agreements for three of these stock option grants and the average number of days between the grant date and the signature dates of these three signed option agreements was 20 days, January 21, 1996 was used as the measurement date for the grant for which no signed option agreement could be located. The Company has restated the compensation expense for stock option grants relating to approximately 0.7 million shares of common stock using this average days to sign agreement method. The total additional non-cash, pre-tax charge for these grants is approximately \$4.4 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.06 million relates to director options, \$4.2 million relates to officer options and \$0.2 million relates to rank and file employee options. The Company believes this methodology was the most appropriate in the absence of sufficient evidence of approvals for these grants because it gives a reasonable approximation of the measurement date related to these options in light of the available evidence. The Company conducted a sensitivity analysis by comparing the Company's current default methodology (i.e., average days to sign agreement) with another default methodology. For this analysis, the Company identified the range of potential grant dates defined by the earliest signed option agreement and the latest signed option agreement. The Company then identified the low and high closing prices of the common stock over the range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted to determine the range of potential adjustments to stock-based compensation expense for these grants, which was \$2.6 million to \$5.9 million, net of forfeitures. The Company's analyses indicate that stock-based compensation expense computed using other identified alternative default methodologies would not materially differ from stock-based compensation expense computed using the average days to sign agreement methodology. The Company's procedures for evaluating the appropriateness of measurement dates fixed with reference to the average days to sign agreements also included a sensitivity analysis which provided an understanding of the differences between the additional recorded charge for stock-based compensation expense and the charges that would result from using other identified alternative methods for determining measurement dates. The Company's sensitivity analysis included identifying the range of potential grant dates defined by the recorded grant date and the average days to sign agreement for each grant. The Company then identified the low and high closing prices of the common stock within that range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted to determine the range of potential adjustments to stock-based compensation expense for these grants, which was \$0.03 million to



\$6.1 million, net of forfeitures, as compared to the additional non-cash, pre-tax charge for these grants of approximately \$4.4 million, net of forfeitures, included in the Restatement.

Given the volatility of the common stock during much of the Review Period, the use of methodologies and measurement dates different from those described above could have resulted in a higher or lower cumulative compensation expense which would have caused net income or loss to be different from the amounts reported in the restated consolidated financial statements. The Company's procedures for evaluating the appropriateness of measurement dates fixed using the default methodologies described above also included a sensitivity analysis which provided an understanding of the differences between the additional recorded charge for stock-based compensation expense and the charges that would result from using other identified alternative methods for determining measurement dates. The Company's sensitivity analysis included identifying the range of potential grant dates defined by the recorded grant date and the appropriate measurement date for each grant. The Company then identified the low and high closing prices of the common stock within that range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted to determine the range of potential adjustments to stock-based compensation expense for these grants, which was \$9.3 million to \$99.3 million, net of forfeitures, as compared to the additional non-cash, pre-tax charge for these grants of approximately \$70.0 million, net of forfeitures, included in the Restatement.

**Table of Contents****Other adjustments through March 31, 2006**

From 1994 through 1998, the Company did not properly account for stock options for one officer that were modified after the grant date pursuant to a separation agreement. Some of these modifications were not identified in the Company's financial reporting processes and were therefore not properly reflected in its financial statements. As a result, the Company has recorded a non-cash charge for stock-based compensation of \$1.0 million during Fiscal 1999.

**Summary**

In summary, the Company recorded cumulative non-cash charges for stock-based compensation of \$70.9 million through March 31, 2006, offset in part by a cumulative income tax benefit of \$27.7 million, for a total after-tax charge of \$43.2 million. These charges had no impact on net sales or cash and cash equivalents as previously reported in the Company's financial statements; as a result, no changes to these items are reflected in the Restatement. Non-cash charges for stock-based compensation expense have been recorded as adjustments to Selling, General, and Administrative Expenses within the Company's Consolidated Statements of Income.

**1Q07 and 2Q07 Restatement****Stock-based compensation expense**

In addition to the Restatement noted above through March 31, 2006, the Company has recorded a non-cash charge for stock-based compensation of \$0.8 million and \$2.4 million for the three (3) and six (6) month periods ended September 30, 2006, offset in part by income tax benefits of \$0.3 million and \$1.0 million, or total after-tax charges of \$0.5 million and \$1.4 million. This charge was recorded to reflect additional non-cash, stock-based compensation expense recognized under the fair value method (SFAS 123(R)) because the exercise price for certain stock option grants prior to, but not vested as of March 31, 2006, differed from the fair market value of the underlying shares on the appropriate measurement date, some of which occurred during Fiscal 2007.

**Accounting for derivatives**

On July 26, 2006, the Company entered into an interest rate swap to reduce its exposure from fluctuating interest rates. SFAS No.133 Accounting for Derivative Instruments and Hedging Activities ( SFAS 133 ) requires that all derivative instruments be recorded on the balance sheet as either an asset or liability measured at their fair value, and that changes in the derivatives' fair value be recognized currently in earnings unless specific hedge accounting criteria are met. From inception of the hedge, the Company had applied a method of cash flow hedge accounting under SFAS 133 to account for the interest rate swap that allowed the Company to assume no ineffectiveness in such agreements, called the short-cut method.

Subsequently, the Company analyzed its eligibility for the short-cut method in light of certain clarifications delivered by the Office of the Chief Accountant of the SEC, and determined that its interest rate swap did not qualify for the short-cut method under SFAS 133 because certain prepayment features relating to the underlying actual debt were not identical to those contained in the interest rate swap. Because the Company's documentation at hedge inception reflected the short-cut method rather than the long haul method for determining hedge ineffectiveness, the derivative did not meet the requirements for a cash flow hedge. Documentation for the long haul method of accounting at hedge inception cannot be retrospectively applied under SFAS 133. Therefore, fluctuations in the interest rate swap's fair value should have been recorded through the Company's Consolidated Statement of Income instead of through Other Comprehensive Income (Loss), which is a component of stockholders' equity. The adjustment for 2Q07 will decrease reported net income and increase Other Comprehensive Income by approximately \$1.4 million. This change in accounting for this derivative instrument could result in significant volatility in the Company's reported net income and earnings per share due to increases and decreases in the fair value of the interest rate swap. However, the derivative instrument remains highly effective and the change in accounting for this derivative instrument does not impact operating cash flows or total stockholders equity.

The table below reflects the impact of the additional non-cash charges for stock-based compensation expense and the non-cash charge related to the interest rate swap on the Company's Consolidated Statements of Income, including the cumulative adjustment to Retained Earnings as of March 31, 2006 and September 30, 2006 on the Company's Consolidated Balance Sheet. All dollar amounts are presented in thousands except per share amounts. Per share amounts may not total due to rounding.



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	(As previously reported) Net Income	Adjust- ment, Pre-Tax	Income Tax Benefit	Adjust- ment, Net of Tax	(As previously reported) Diluted EPS	Adjust- ment	(As Restated) Diluted EPS	
FY 94	\$ 13,370	\$ 43	\$ (19)	\$ 24	\$ 13,346	\$ 0.83	\$ --	\$ 0.83
FY 95	14,515	461	(144)	317	14,198	0.89	(0.02)	0.87
FY 96	18,278	406	(151)	255	18,023	1.10	(0.01)	1.09
FY 97	24,792	1,172	(456)	716	24,076	1.40	(0.04)	1.36
FY 98	32,404	3,595	(1,393)	2,202	30,202	1.79	(0.12)	1.67
FY 99	38,145	4,506	(1,732)	2,774	35,371	2.09	(0.15)	1.94
FY 00	48,852	5,778	(2,209)	3,569	45,283	2.60	(0.19)	2.41
FY 01	64,190	10,290	(3,953)	6,337	57,853	3.22	(0.32)	2.90
FY 02	62,042	11,333	(4,381)	6,952	55,090	2.97	(0.33)	2.64
FY 03	48,685	8,927	(2,328)	6,599	42,086	2.39	(0.32)	2.07
FY 04	47,243	8,197	(4,156)	4,041	43,202	2.52	(0.22)	2.30
FY 05	29,912	5,178	(2,312)	2,866	27,046	1.68	(0.16)	1.52
Cumulative 03/31/05	\$ 442,428	\$ 59,886	\$ (23,234)	\$ 36,652	\$ 405,776	\$ 23.48	\$ (1.89)	\$ 21.59
1Q06	7,394	1,120	(442)	678	6,716	0.43	(0.04)	0.39
2Q06	12,797	1,126	(444)	682	12,115	0.74	(0.04)	0.70
3Q06	12,511	2,431	(959)	1,472	11,039	0.70	(0.08)	0.62
4Q06	4,656	6,368	(2,612)	3,756	900	0.26	(0.21)	0.05
FY 06	\$ 37,358	\$ 11,045	\$ (4,457)	\$ 6,588	\$ 30,770	\$ 2.13	\$ (0.37)	\$ 1.76
Cumulative 03/31/06	\$ 479,786	\$ 70,931	\$ (27,691)	\$ 43,240	\$ 436,546	\$ 25.61	\$ (2.26)	\$ 23.35
1Q07	7,807	1,629	(635)	994	6,813	0.43	(0.06)	0.37
2Q07	13,079	2,210	(806)	1,404	11,675	0.74	(0.08)	0.66
2QYTD07	\$ 20,886	\$ 3,839	\$ (1,441)	\$ 2,398	\$ 18,488	\$ 1.18	\$ (0.14)	\$ 1.04
Cumulative 09/30/06	\$ 500,672	\$ 74,770	\$ (29,132)	\$ 45,638	\$ 455,034	\$ 26.78	\$ (2.39)	\$ 24.39

**Income Tax Considerations**

In the course of the investigation, the Company determined that a number of officers may have exercised options for

which the application of Section 162(m) of the Internal Revenue Code of 1986, as amended (the Code), may apply. It is possible that these options will be treated as having been granted at less than fair market value for federal income tax purposes because the Company incorrectly applied the measurement date as defined in APB 25. If such options are deemed to be granted at less than fair market value, pursuant to Section 162(m) of the Code (Section 162(m)), any compensation to officers, including proceeds from options exercised in any given tax year, in excess of \$1.0 million will be disallowed as a deduction for tax purposes. The Company estimates that the potential tax effected liability for any such disallowed Section 162(m) deduction would approximate \$3.6 million. The Company may also incur interest and penalties if it were to incur any such tax liability, which could be material.

In addition, the Company is considering the application of Section 409A of the Code (Section 409A) to those options for which it incorrectly applied the measurement date as defined in APB 25. It is possible that these options will be treated as having been granted at less than fair market value for federal income tax purposes and thus subject to Section 409A. Accordingly, the Company may adopt measures to address the application of Section 409A. The Company does not currently know what impact Section 409A will have, or any such measures, if adopted, would have on its results of operations, financial position or cash flows, although such impact could be material.

**Expenses Incurred by the Company**

The Company has incurred expenses for legal fees and external audit firm fees, in the aggregate amount of approximately \$0.6 million, in the fiscal year ended March 31, 2007, in relation to (i) the Audit Committee's review of the Company's historical stock option practices and related accounting for stock option grants, (ii) the informal inquiry and formal order of investigation by the Securities and Exchange Commission regarding its past stock option practices, (iii) the derivative action relating to the Company's historical stock option practices filed against the Company as a nominal defendant and certain of the Company's current and former directors and officers as to whom it may have indemnification obligations and (iv) related matters. Further, the Company expects to incur significant additional expense related to the foregoing matters in the fiscal year ending March 31, 2008. It is anticipated that certain of those expenses will be reimbursed under the Company's directors' & officers' indemnification insurance.

**Table of Contents****Restatement Impact on the Consolidated Statements of Income**

The following tables reconcile the Company's Consolidated Statements of Income from the previously reported results to the restated results for the three (3) and nine (9) month periods ended December 31, 2005. All dollar amounts are in thousands, except per share amounts. Per share amounts may not total due to rounding.

	<b>Three Month Period Ended December 31, 2005 (Unaudited)</b>		
	<b>As Previously Reported</b>	<b>Adjustment</b>	<b>As Restated</b>
<b>Revenues:</b>			
Hotline products	\$ 52,771	\$ --	\$ 52,771
On-Site services	129,364	--	129,364
Total	182,135	--	182,135
<b>Cost of sales:</b>			
Hotline products	26,308	--	26,308
On-Site services	82,425	--	82,425
Total	108,733	--	108,733
<b>Gross profit</b>	<b>73,402</b>	<b>--</b>	<b>73,402</b>
Selling, general & administrative expenses	50,441	2,431	52,872
Restructuring and other charges	--	--	--
Intangibles amortization	1,349	--	1,349
<b>Operating income</b>	<b>21,612</b>	<b>(2,431)</b>	<b>19,181</b>
Interest expense (income), net	2,397	--	2,397
Other expenses (income), net	114	--	114
Income before provision for income taxes	19,101	(2,431)	16,670
Provision for income taxes	6,590	(959)	5,631
<b>Net income</b>	<b>\$ 12,511</b>	<b>\$ (1,472)</b>	<b>\$ 11,039</b>
Earnings per common share:			
Basic	\$ 0.72	\$ (0.08)	\$ 0.64
Diluted	\$ 0.70	\$ (0.08)	\$ 0.62

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Weighted average common shares outstanding				
Basic	17,286	--		17,286
Diluted	17,786	--		17,786
Dividends per share	\$ 0.06	\$ --		\$ 0.06

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	<b>Nine Month Period Ended December 31, 2005 (Unaudited)</b>		
	<b>As Previously Reported</b>	<b>Adjustment</b>	<b>As Restated</b>
<b>Revenues:</b>			
Hotline products	\$ 160,279	\$ --	\$ 160,279
On-Site services	386,188	--	386,188
Total	546,467	--	546,467
<b>Cost of sales:</b>			
Hotline products	79,011	--	79,011
On-Site services	249,232	--	249,232
Total	328,243	--	328,243
<b>Gross profit</b>	<b>218,224</b>	<b>--</b>	<b>218,224</b>
Selling, general & administrative expenses	152,008	4,677	156,685
Restructuring and other charges	5,290	--	5,290
Intangibles amortization	4,235	--	4,235
<b>Operating income</b>	<b>56,691</b>	<b>(4,677)</b>	<b>52,014</b>
Interest expense (income), net	6,686	--	6,686
Other expenses (income), net	79	--	79
Income before provision for income taxes	49,926	(4,677)	45,249
Provision for income taxes	17,224	(1,845)	15,379
<b>Net income</b>	<b>\$ 32,702</b>	<b>\$ (2,832)</b>	<b>\$ 29,870</b>
Earnings per common share:			
Basic	\$ 1.92	\$ (0.17)	\$ 1.75
Diluted	\$ 1.88	\$ (0.16)	\$ 1.72
Weighted average common shares outstanding			
Basic	17,050	--	17,050



Diluted	17,362	--	17,362
Dividends per share	\$ 0.18	\$ --	\$ 0.18

**Table of Contents****Restatement Impact on the Consolidated Balance Sheets**

The following tables reconcile the Company's Consolidated Balance Sheets from the previously reported results to the restated results as of March 31, 2006. All dollar amounts are in thousands.

	<b>March 31, 2006 (Unaudited)</b>		
	<b>As Previously</b>		<b>As</b>
	<b>Reported</b>	<b>Adjustment</b>	<b>Restated</b>
<b>Assets</b>			
Cash and cash equivalents	\$ 11,207	\$ --	\$ 11,207
Accounts receivable, net	116,713	--	116,713
Inventories, net	53,926	--	53,926
Costs / estimated earnings in excess of billings on uncompleted contracts	23,803	--	23,803
Deferred tax asset	8,973	--	8,973
Prepaid and other current assets	16,502	--	16,502
<b>Total current assets</b>	<b>231,124</b>	<b>--</b>	<b>231,124</b>
Property, plant and equipment, net	35,124	--	35,124
Goodwill, net	468,724	--	468,724
Intangibles:			
Customer relationships, net	24,657	--	24,657
Other intangibles, net	30,783	--	30,783
Deferred tax asset	4,231	15,678	19,909
Other assets	5,091	--	5,091
<b>Total assets</b>	<b>\$ 799,734</b>	<b>\$ 15,678</b>	<b>\$ 815,412</b>
<b>Liabilities</b>			
Accounts payable	\$ 44,943	\$ --	\$ 44,943
Accrued compensation and benefits	13,954	--	13,954
Deferred revenue	22,211	--	22,211
Restructuring reserve	3,292	--	3,292
Billings in excess of costs / estimated earnings on uncompleted contracts	8,648	--	8,648
Current maturities of long-term debt	1,049	--	1,049
Other liabilities	33,771	3,587	37,358
<b>Total current liabilities</b>	<b>127,868</b>	<b>3,587</b>	<b>131,455</b>
Long-term debt	122,673	--	122,673
Other liabilities	8,293	--	8,293
<b>Total liabilities</b>	<b>258,834</b>	<b>3,587</b>	<b>262,421</b>

**Stockholders Equity**

Preferred Stock	--	--	--
Common Stock	25	--	25
Additional paid-in capital	362,810	55,331	418,141
Treasury stock	(296,824)	--	(296,824)
Accumulated other comprehensive income	13,036	--	13,036
Retained earnings	461,853	(43,240)	418,613
<b>Total stockholders equity</b>	<b>540,900</b>	<b>12,091</b>	<b>552,991</b>
<b>Total liabilities and stockholders equity</b>	<b>\$ 799,734</b>	<b>\$ 15,678</b>	<b>\$ 815,412</b>

**Table of Contents****Restatement Impact on the Consolidated Statement of Cash Flows**

The following tables reconcile the Company's Consolidated Statements of Cash Flows from the previously reported results to the restated results for the nine (9) month period ended December 31, 2005. All dollar amounts are in thousands.

	<b>Nine Month Period Ended December 31, 2005</b>		
	<b>(Unaudited)</b>		
	<b>As Previously Reported</b>	<b>Adjustment</b>	<b>As Restated</b>
<b>Operating Activities</b>			
Net income	\$ 32,702	\$ (2,832)	\$ 29,870
Adjustments to reconcile net income to net cash provided by (used for) operating activities:			
Intangibles amortization and depreciation	11,013	--	11,013
Deferred taxes	(2,083)	2,570	487
Stock compensation expense	--	4,677	4,677
Tax benefit from exercised stock options	(3,347)	2,279	(1,068)
Changes in operating assets and liabilities:			
Accounts receivable, net	73	--	73
Inventories, net	5,673	--	5,673
All other current assets excluding deferred tax asset	3,016	(6,694)	(3,678)
Liabilities exclusive of long term debt	(8,135)	--	(8,135)
<b>Net cash provided by (used for) operating activities</b>	<b>\$ 38,912</b>	<b>\$ --</b>	<b>\$ 38,912</b>
<b>Investing Activities</b>			
Capital expenditures	\$ (3,151)	\$ --	\$ (3,151)
Capital disposals	1,232	--	1,232
Acquisition of businesses (payments)/recoveries	(40,682)	--	(40,682)
Prior merger-related (payments)/recoveries	(378)	--	(378)
<b>Net cash provided by (used for) investing activities</b>	<b>\$ (42,979)</b>	<b>\$ --</b>	<b>\$ (42,979)</b>
<b>Financing Activities</b>			
Proceeds from borrowings	\$ 157,280	\$ --	\$ 157,280
Repayment of borrowings	(164,698)	--	(164,698)
Repayment on discounted lease rentals	(847)	--	(847)
Proceeds from exercise of options	16,344	--	16,344
Payment of dividends	(3,049)	--	(3,049)
Purchase of treasury stock	(14)	--	(14)
<b>Net cash provided by (used for) financing activities</b>	<b>\$ 5,016</b>	<b>\$ --</b>	<b>\$ 5,016</b>
Foreign currency exchange impact on cash	\$ (398)	\$ --	\$ (398)
<b>Increase / (decrease) in cash and cash equivalents</b>	<b>\$ 551</b>	<b>\$ --</b>	<b>\$ 551</b>
Cash and cash equivalents at beginning of period	\$ 11,592	\$ --	\$ 11,592

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Cash and cash equivalents at end of period	\$	12,143	\$	--	\$	12,143
Supplemental Cash Flow:						
Cash paid for interest	\$	5,817	\$	--	\$	5,817
Cash paid for income taxes		13,539		--		13,539
Non-cash financing activities:						
Dividends payable		1,044		--		1,044
Capital leases		834		--		834

**Table of Contents****Note 4: Inventories**

The Company's inventories consist of the following:

	December 31, 2006	March 31, 2006
Raw materials	\$ 1,743	\$ 1,426
Finished goods	97,415	66,787
Subtotal	99,158	68,213
Excess and obsolete inventory reserves	(25,081)	(14,287)
Inventory, net	\$ 74,077	\$ 53,926

**Note 5: Goodwill and Other Intangible Assets**

As required by SFAS No. 142 Goodwill and Other Intangible Assets, goodwill and intangible assets with indefinite useful lives are not amortized. The Company is required to perform an impairment test annually, or as often as impairment indicators are present. The Company's policy is to evaluate its non-amortizable intangible assets for impairment during the third quarter of each fiscal year. The Company performed the most recent test during the third quarter of Fiscal 2007, and concluded that no impairment existed. The Company's intangibles, as identified in SFAS No. 141 Business Combinations (SFAS 141), other than goodwill, are its trademarks, non-compete agreements, customer relationships and acquired backlog.

The following table summarizes changes to goodwill at the Company's reporting units during the period:

	North		All	Total
	America	Europe	Other	
Balance as of March 31, 2006	\$ 400,998	\$ 65,684	\$ 2,042	\$ 468,724
Currency translation	7	7,010	46	7,063
Current period acquisitions (Note 10)	119,535	--	--	119,535
Prior period acquisitions	(6,785)	--	--	(6,785)
Earn-out payments	--	--	--	--
Other	19	--	--	19
Balance as of December 31, 2006	\$ 513,774	\$ 72,694	\$ 2,088	\$ 588,556

At December 31, 2006, certain merger agreements provided for contingent payments (earn-out) of up to \$4,588. If future operating performance goals of acquired companies are met, goodwill will be adjusted for the amount of the contingent payments.

The following table summarizes the gross carrying amount, accumulated amortization and net carrying amount by major intangible asset class:

	December 31, 2006			March 31, 2006		
	Gross Carrying Amount	Accum. Amort.	Net Carrying Amount	Gross Carrying Amount	Accum. Amort.	Net Carrying Amount

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**Definite-lived**

Non-compete agreements	\$ 8,017	\$ 3,053	\$ 4,964	\$ 4,894	\$ 1,851	\$ 3,043
Customer relationships	59,137	3,175	55,962	25,654	997	24,657
Acquired backlog	10,593	6,803	3,790	3,935	3,934	1
Total	\$ 77,747	\$ 13,031	\$ 64,716	\$ 34,483	\$ 6,782	\$ 27,701

**Indefinite-lived**

Trademarks	35,992	8,253	27,739	35,992	8,253	27,739
Total	\$ 113,739	\$ 21,284	\$ 92,455	\$ 70,475	\$ 15,035	\$ 55,440

The Company's indefinite lived intangible assets not subject to amortization consist solely of the Company's trademark portfolio obtained through business acquisitions. The Company's definite-lived intangible assets subject to amortization are comprised of employee non-compete contracts, backlog and customer relationships also obtained through business acquisitions. Intangible asset amortization is computed using the straight-line method based upon the estimated useful lives of the respective assets, which range from one to 20 years.

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The following table summarizes the changes to carrying amounts of intangible assets during the period.

	<b>Trademarks</b>	<b>Non-Competes and Backlog</b>	<b>Customer Relationships</b>	<b>Total</b>
Balance at March 31, 2006	\$ 27,739	\$ 3,044	\$ 24,657	\$ 55,440
Amortization expense	--	(3,936)	(2,178)	(6,114)
Currency translation	--	52	--	52
Current period acquisitions (Note 10)	--	8,839	27,079	35,918
Prior period acquisitions	--	755	6,404	7,159
Balance at December 31, 2006	\$ 27,739	\$ 8,754	\$ 55,962	\$ 92,455

Intangible asset amortization expense was \$2,677 and \$6,114 for the three and nine months ended December 31, 2006, respectively. Intangible asset amortization expense was \$1,349 and \$4,235 for the three and nine months ended December 31, 2005, respectively. The Company acquired definite-lived intangibles from the completion of three (3) acquisitions during the nine-month period ended December 31, 2006 (*see* Note 10 of the Notes to the Consolidated Financial Statements). The estimated definite-lived intangibles recorded of \$35,918 were based on a preliminary allocation pending completion of third party valuation. The Company recorded amortization expense of \$1,933 and \$4,043 for the three and nine month periods ended December 31, 2006 for these newly acquired definite-lived assets. The following table details estimated future intangible amortization expense. These estimates are based on the carrying amounts of intangible assets as of December 31, 2006 that are subject to change pending the outcome of purchase accounting related to our current acquisitions:

**Years Ending March 31,**

2007 (4Q07 only)	\$ 3,964
2008	5,433
2009	4,330
2010	4,196
2011	3,620
2012	3,113
Thereafter	40,060
Total	\$ 64,716

**Note 6: Indebtedness**

The Company's long-term debt consists of the following:

	<b>December 31, 2006</b>	<b>March 31, 2006</b>
Revolving credit agreement	\$ 251,410	\$ 121,303
Interest rate swap fair value ( <i>see</i> Note 7)	1,308	--
Capital lease obligations	1,671	1,891
Other	136	528
Total debt	\$ 254,525	\$ 123,722



Less: current portion	(587)	(1,049)
Long-term debt	\$ 253,938	\$ 122,673

Revolving credit agreement:

On March 28, 2006, the Company entered into a Second Amendment to the Second Amended and Restated Credit Agreement dated January 24, 2005, as amended February 17, 2005 (collectively, the Credit Agreement ) with Citizens Bank of Pennsylvania, as agent, and a group of lenders. The Credit Agreement expires on March 28, 2011. Borrowings under the Credit Agreement are permitted up to a maximum amount of \$310,000, which includes up to \$15,000 of swing line loans and \$25,000 of letters of credit. The Credit Agreement may be increased by the Company up to an additional \$90,000 with the approval of the lenders and may be unilaterally and permanently reduced by the Company to not less than the then outstanding amount of all borrowings. Interest on outstanding indebtedness under the Credit Agreement accrues, at the Company's option, at a rate based on either: (a) the greater of (i) the prime rate per annum of the agent then in effect and (ii) 0.50% plus the rate per annum announced by the Federal Reserve Bank of New York as being the weighted average of the rates on overnight Federal funds transactions arranged by Federal funds brokers on the previous trading day or (b) a rate per annum equal to the LIBOR rate plus 0.75% to 1.25% (determined by a leverage ratio based on the Company's EBITDA). The Credit Agreement requires the Company to maintain compliance with certain non-financial and financial covenants such as minimum net worth, leverage and fixed charge coverage ratios. As of December 31, 2006, the Company was in compliance with all required covenants under the Credit Agreement.

During the nine month period ended December 31, 2006, the Company increased net borrowings under the Credit Agreement by

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approximately \$130,107. The Company primarily utilized the proceeds from net borrowings to fund the acquisitions of the USA Commercial and Government and Canadian operations of NextiraOne, LLC ( NextiraOne ), Nu-Vision Technologies, Inc. and Nu-Vision Technologies, LLC (collectively referred to as NUVT ) during the first quarter Fiscal 2007 and Nortech Telecommunications, Inc. ( NTI ) during the third quarter Fiscal 2007 (see Note 10 of the Notes to the Consolidated Financial Statements) and to repurchase common stock during the second and third quarters Fiscal 2007.

During the three month period ended December 31, 2006, the maximum amount and weighted average balance outstanding under the Credit Agreement were \$276,985 and \$266,763, respectively. The weighted average interest rate on all outstanding debt was approximately 6.25% and 5.59% for the three month periods ended December 31, 2006 and 2005, respectively. During the nine month period ended December 31, 2006, the maximum amount and weighted average balance outstanding under the Credit Agreement were \$284,470 and \$251,153, respectively. The weighted average interest rate on all outstanding debt was approximately 6.20% and 4.86% for the nine month periods ended December 31, 2006 and 2005, respectively.

**Capital Lease Obligations:**

The capital lease obligations are primarily for facilities and equipment. The lease agreements have remaining terms ranging from less than one year to four years with interest rates ranging from 3.83% to 10.83%.

**Other:**

Other debt is comprised of various bank and third party loans secured by specific pieces of equipment and real property. The loans have remaining terms of less than one year to five years with interest rates ranging from 0.0% to 7.1%.

**Unused Available Borrowings:**

As of December 31, 2006, the Company had \$4,009 outstanding in letters of credit and \$54,581 available under the Credit Agreement.

**Note 7: Derivative Instruments and Hedging Activities****Foreign Currency Forward Contracts:**

The Company enters into foreign currency forward contracts to hedge exposure to variability in expected fluctuations in foreign currencies. As of December 31, 2006, the Company had open contracts in Australian and Canadian dollar, Danish krone, Euro, Japanese yen, Norwegian kroner, Pound sterling, Swedish krona and Swiss franc, which have been designated as cash flow hedges. These contracts had a notional amount of approximately \$63,994 and a fair value of \$63,692 and mature within the next twenty seven months.

As of December 31, 2006, an unrecognized gain of \$896 on all open foreign currency forward contracts is included in the Company's Consolidated Balance Sheets as a component of Other Comprehensive Income (loss) ( OCI ). This unrecognized gain is expected to be credited to earnings over the life of the maturing contracts as the hedged forecasted transaction occurs and it is expected that the gain will be offset by currency losses on the items being hedged.

The Company recognized gains of \$17 and \$309 into earnings on matured contracts for the three and nine month periods ending December 31, 2006, respectively. There was no hedge ineffectiveness during the nine month period ending December 31, 2006.

**Interest Rate Swap:**

To mitigate the risk of interest-rate fluctuations associated with the Company's variable rate long term debt, the Company has implemented an interest-rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings caused by interest rate volatility. The Company's goal is to manage interest-rate sensitivity by modifying the re-pricing characteristics of certain balance sheet liabilities so that the net-interest margin is not, on a material basis, adversely affected by the movements in interest rates.

On July 26, 2006, the Company entered into an interest rate swap which has been used to effectively convert a portion of the Company's variable rate debt to fixed rate. The interest rate swap has a notional value of \$100,000 reducing to \$50,000 after three years and does not qualify for hedge accounting. For the three and nine month periods ended December 31, 2006, the Company recognized an \$87 gain and a \$1,308 loss, respectively, related to the change in fair

value of the interest rate swap included in Interest Expense (Income) in the Company's Consolidated Statements of Income. The loss is recorded as a component of Long Term Debt in the Company's Consolidated Balance Sheet.

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**Table of Contents****Note 8: Earnings Per Share**

The following table details the computation of basic and diluted earnings per common share from continuing operations:

	<b>Three month period ended December 31,</b>		<b>Nine month period ended December 31,</b>	
		(As Restated)		(As Restated)
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net income, as reported	\$ 10,493	\$ 11,039	\$ 28,981	\$ 29,870
Weighted average common shares outstanding (basic)	17,398	17,286	17,451	17,050
Effect of dilutive securities from employee stock options	382	500	358	312
Weighted average common shares outstanding (diluted)	17,780	17,786	17,809	17,362
Basic earnings per common share	\$ 0.60	\$ 0.64	\$ 1.66	\$ 1.75
Dilutive earnings per common share	\$ 0.59	\$ 0.62	\$ 1.63	\$ 1.72

The Weighted Average Common Shares Outstanding (diluted) computation is not impacted during any period where the exercise price of a stock option is greater than the average market price. There were 824,240 and 563,406 non-dilutive stock options outstanding during the three month periods ended December 31, 2006 and 2005, respectively, that are not included in the corresponding period Weighted Average Common Shares Outstanding (diluted) computation. There were 825,240 and 2,494,091 non-dilutive stock options outstanding during the nine month periods ended December 31, 2006 and 2005, respectively that are not included in the corresponding period Weighted Average Common Shares Outstanding (diluted) computation.

**Note 9: Comprehensive Income and Stockholders Equity**

The following table details the computation of comprehensive income:

	<b>Three month period ended December 31,</b>		<b>Nine month period ended December 31,</b>	
		(As Restated)		(As Restated)
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Net income	\$ 10,493	\$ 11,039	\$ 28,981	\$ 29,870
Foreign currency translation adjustment	5,191	(2,246)	11,235	(11,292)
Unrealized gains/(losses) on derivatives designated and qualified as cash flow hedges, net of reclassification of unrealized gains/(losses) on expired derivatives	(307)	(358)	(246)	(125)

Comprehensive income (loss)	\$ 15,377	\$ 8,435	\$39,970	\$ 18,453
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The components of Accumulated Other Comprehensive Income consisted of the following:

	<b>December 31, 2006</b>	<b>March 31, 2006</b>
Foreign currency translation adjustment	\$ 23,129	\$ 11,894
Unrealized gains/(losses) on derivatives designated and qualified as cash flow hedges, net of reclassification of unrealized gains/(losses) on expired derivatives	896	1,142
Total accumulated other comprehensive income	\$ 24,025	\$ 13,036

**Note 10: Acquisitions**

During third quarter Fiscal 2007, the Company acquired NTI, a privately-held company based out of Chicago, IL. In connection with the NTI acquisition, the Company has made a preliminary allocation to goodwill and definite-lived intangible assets, respectively. The definite-lived intangible assets recorded represent the estimated fair market value of customer relationships and non-compete agreements. The Company estimates that the definite-lived intangibles are to be amortized over a period of five to 20 years.

During the first quarter Fiscal 2007, the Company acquired NextiraOne. The following table summarizes the preliminary fair value of the NextiraOne assets acquired and liabilities assumed at the date of acquisition.

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	<b>At April 30, 2006</b>
Current assets, primarily consisting of accounts receivable and inventories	\$ 88,477
Property, plant and equipment	10,030
Other non-current assets	1,386
Intangible assets	21,962
Goodwill	93,914
 Total assets acquired	 \$ 215,769
 Current liabilities, primarily consisting of deferred revenue, restructuring reserve and accrued expenses	 \$ 105,981
Other non-current liabilities, primarily consisting of restructuring reserve	22,319
 Total liabilities acquired	 \$ 128,300
 Net assets acquired	 \$ 87,469

The following table details the amounts recorded to each major intangible asset class:

	<b>At April 30, 2006</b>
Backlog	\$ 6,662
Customer relationships and contracts	15,300
 Total intangible assets*	 \$ 21,962

\* The estimated weighted average amortization period for these definite-lived assets is 14.2 years.

The transaction resulted in \$93,914 of goodwill. The Company paid this premium for NextiraOne in order to further expand its operational footprint in the voice and data technology markets. In addition, the purchase increased the Company's solutions offerings, providing for a stronger worldwide technical services partner for its collective clients. The Company paid a cash total of \$97,305 for the outstanding interests in NextiraOne which included an estimate for the equity book value (total assets less total liabilities, as adjusted by the parties for certain items) as of the closing date. The actual equity book value adjustment is expected to be confirmed during the fourth quarter, at which time the final purchase price will be determined.

As of December 31, 2006, the equity book value adjustment resulted in a \$10,535 receivable from the seller. This receivable is recorded in Other Current Assets and is considered fully collectible. The costs of the acquisitions were funded with borrowings under the Credit Agreement described in Note 6 of the Notes to the Consolidated Financial Statements.

Included in the total cash paid at closing was \$42,143 that was allocated to escrow accounts, including a general escrow, and an escrow for certain specified items regarding litigation, accounts receivable, deposits and credits, equipment leases, accounts payable, worker's compensation and real estate leases. The amounts in escrow have been and will continue to be released to NextiraOne's seller or to the Company in accordance with the terms of the agreements.

After consummation of the acquisition, the Company began to integrate NextiraOne products, employees and facilities with its own. In so doing, the Company incurred \$15,726 of costs related to facility consolidations and \$8,857 of

severance costs for the separation of approximately 250 employees. In accordance with SFAS 141, these costs were properly included in the purchase price allocation for NextiraOne. The majority of the severance costs will be paid in Fiscal 2007 with certain facility costs extending through Fiscal 2014.

In connection with the NextiraOne acquisition, the Company obtained various contractual obligations in the form of operating leases for facilities and vehicles of approximately \$35,120 at the acquisition date. The following table summarizes the payments due by period related to those contractual obligations as of December 30, 2006:

**Payments Due by Period**

Less than 1 year	\$ 13,745
1-3 years	13,327
<b>Total</b>	<b>\$ 27,072</b>

Also, during first quarter Fiscal 2007, the Company acquired NUVT. In connection with the NUVT acquisition, the Company has made a preliminary allocation of \$24,113 and \$12,673 to goodwill and definite-lived intangible assets, respectively. The definite-lived intangible assets recorded represent the estimated fair market value of acquired backlog, customer relationships and non-compete agreements. The Company estimates that the definite-lived intangibles are to be amortized over a period of one to 20 years.

The allocation of the purchase price for these Fiscal 2007 acquisitions is based on preliminary estimates of the fair values of certain assets acquired and liabilities assumed as of the date of the acquisition. Management, with the assistance of independent valuation specialists, is currently assessing the fair values of the tangible and intangible assets acquired and liabilities assumed. The preliminary allocations of

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purchase price are dependant upon certain estimates and assumptions, which are preliminary and may vary from the amounts reported herein.

NextiraOne and NUVT contributed on-site services revenues of \$82,734 and \$231,024 during the three and nine month periods ended December 31, 2006, respectively.

The following unaudited pro-forma summary presents the Company's results of operations as if the acquisitions of NextiraOne and NUVT had occurred on April 1, 2005 and does not purport to represent what the Company's results of operations would have been had the acquisitions occurred on such date or at the beginning of the period indicated, or to project the Company's results of operations for any future date or period, or to be a fair reflection of the assets purchased at the date of acquisition. The pro-forma results of operations exclude the impact of nonrecurring or extraordinary adjustments, together with related income tax effects. These pro-forma results of operations do not include the effects of cost synergies and one-time nonrecurring transactions associated with the acquisition.

	<b>For the three months ended December 31,</b>		<b>For the nine months ended December 31,</b>	
		<b>(As Restated)</b>		<b>(As Restated)</b>
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Revenue (Pro-forma)	\$ 264,806	\$ 293,696	\$ 797,172	\$ 940,134
Net Income from continuing operations (Pro-forma), net of tax	\$ 10,491	\$ 9,544	\$ 27,181	\$ 32,400
Earnings per common share (Pro-forma)				
Basic	\$ 0.60	\$ 0.55	\$ 1.56	\$ 1.90
Diluted	\$ 0.59	\$ 0.54	\$ 1.53	\$ 1.87

**Purchase Price Allocation Update (prior year acquisitions):**

During first quarter Fiscal 2006, the Company acquired 100% of the issued and outstanding equity interests of Telecommunication Systems Management, Inc. ( TSM ), GTC Technology Group, Inc. and Technology Supply, Inc. (collectively referred to as GTC ) and Business Communications, Inc., Bainbridge Communication, Inc., BCI of Tampa, LLC and Networx, L.L.C. (collectively referred to as BCI ). These companies primarily provide full-service voice communication solutions and services in the Florida and Virginia markets. In connection with the acquisitions, the Company has allocated \$8,385 and \$5,846 to goodwill and definite-lived intangible assets, respectively. The definite-lived intangible assets recorded represent the fair market value of acquired customer relationships and non-compete agreements. The definite-lived intangibles are being amortized over a period of five to 20 years.

During second quarter Fiscal 2006, the Company acquired substantially all of the assets and certain liabilities of Universal Solutions of North America, L.L.C. and related entities ( Universal ). Universal primarily provides planning, installation and maintenance services for voice and data network systems in 14 states. In connection with the acquisition, the Company has allocated \$9,430 and \$8,000 to goodwill and definite-lived intangible assets, respectively. The definite-lived intangible assets recorded represent the estimated fair market value of acquired customer relationships and non-compete agreements. The definite-lived intangibles are being amortized over a period of five to 20 years.

During third quarter Fiscal 2006, the Company purchased 100% of the issued and outstanding equity interests of Communication is World InterActive Networking, Inc. ( C=WIN ) and Converged Solutions Group, LLC ( CSG ). C=WIN has an active customer base which includes commercial and various government agency accounts. CSG has an active customer base which includes commercial, education, health care and various government agency accounts. The C=WIN and CSG acquisitions primarily provide planning, installation and maintenance services for voice and data network systems in 15 states. In connection with the acquisitions, the Company has allocated \$6,074 and \$9,620 to goodwill and definite-lived intangible assets, respectively. The definite-lived intangible assets recorded represent the estimated fair market value of acquired customer relationships and non-compete agreements. The Company



estimates that the definite-lived intangibles are to be amortized over a period of four to 20 years.

The results of operations of TSM, GTC, BCI, Universal, C=WIN and CSG are included in the Company's Consolidated Statements of Income beginning on their respective acquisition dates. The acquisitions taken individually did not have a material impact on the Company's results of operations.

The following acquired companies will collectively be referred to as Acquired Companies : TSM, GTC, BCI, Universal, C=WIN, CSG, NextiraOne, NUVT, and NTL.

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**Note 11: Commitments and Contingencies**

**Regulatory Matters**

As previously disclosed, on November 13, 2006, the Company received a letter of informal inquiry from the Enforcement Division of the SEC relating to the Company's stock option practices from January 1, 1997 to present. On May 24, 2007, the SEC issued a formal order of investigation in connection with this matter, and, on May 29, 2007, the Company received a document subpoena from the SEC acting pursuant to such order. The Company has cooperated with the SEC in this matter and intends to continue to do so.

As previously disclosed, the Audit Committee, with the assistance of outside legal counsel, is conducting an independent review of the Company's historical stock option grant practices and related accounting for stock option grants. See the Explanatory Note preceding Part I, Item 1 of this Form 10-Q for more information regarding this and related matters.

On September 20, 2006, the Company received formal notice from the Internal Revenue Service ( IRS ) regarding its intent to begin an audit of the Company's tax years 2004 and 2005. In connection with this normal recurring audit, the IRS has requested certain documentation with respect to stock options for the Company's 2004 and 2005 tax years. The Company has produced various documents requested by the IRS and is currently in the process of responding to additional documentation requests.

At the conclusion of these regulatory matters, the Company could be subject to additional taxes, fines or penalties which could be material.

**Litigation Matters**

In November 2006, two stockholder derivative lawsuits were filed against the Company itself, as a nominal defendant, and several of the Company's current and former officers and directors in the United States District Court for the Western District of Pennsylvania. The two substantially identical stockholder derivative complaints allege that the individual defendants improperly backdated grants of stock options to several officers and directors in violation of the Company's stockholder-approved stock option plans during the period 1996-2002, improperly recorded and accounted for backdated stock options in violation of generally accepted accounting principles, improperly took tax deductions based on backdated stock options in violation of the Internal Revenue Code of 1986, as amended, produced and disseminated false financial statements and SEC filings to the Company's stockholders and to the market that improperly recorded and accounted for the backdated option grants, concealed the alleged improper backdating of stock options and obtained substantial benefits from sales of Company stock while in the possession of material inside information. The complaints seek damages on behalf of the Company against certain current and former officers and directors and allege breach of fiduciary duty, unjust enrichment, securities law violations and other claims. The two lawsuits have been consolidated into a single action as *In re Black Box Corporation Derivative Litigation*, Master File No. 2:06-CV-1531-TMH, and plaintiffs filed a consolidated amended complaint on January 29, 2007. The parties have stipulated that responses by the defendants, including the Company, are due on or before August 1, 2007. The Company may have indemnification obligations arising out of this matter to its current and former directors and officers named in this litigation. The Company has made a claim for such costs under an insurance policy.

The Company is, as a normal part of its business operations, a party to legal proceedings in addition to those described in current and previous filings.

As previously disclosed, the Company received a subpoena, dated December 8, 2004, from the United States General Services Administration ( GSA ), Office of Inspector General. The subpoena requires production of documents and information. The Company understands that the materials are being sought in connection with an investigation regarding potential violations of the terms of a GSA Multiple Award Schedule contract. The Company has not received any communication on this matter from the GSA since June 2005.

Based on the facts currently available to the Company, management believes the matters described under this caption

Litigation Matters are adequately provided for, covered by insurance, without merit or not probable that an unfavorable outcome will result.

**Product Warranties**

Estimated future warranty costs related to certain products are charged to operations in the period the related revenue is recognized. The product warranty liability reflects the Company's best estimate of probable liability under those

warranties. As of December 31, 2006 and March 31, 2006, the Company has recorded a warranty reserve of \$4,570 and \$1,383, respectively.

There has been no significant or unusual activity during the three and nine month periods ended December 31, 2006 other than the acquisitions as discussed in Note 10 of the Notes to the Consolidated Financial Statements.

**Note 12: Pension Plan Costs**

On April 30, 2006, the Company acquired NextiraOne who is a sponsor of a non-contributory defined benefit plan (the CWA Plan ) for the Communication Workers of America Local 1109 ( CWA 1109 ). Benefits from the CWA Plan are based upon years of service and

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rates negotiated by the Company and CWA 1109. Pension costs are funded to satisfy minimum requirements prescribed by the Employee Retirement Income Security Act of 1974.

The following table summarizes the components of net periodic benefit cost for the three and nine month periods ended December 31, 2006. Nine month results include the net periodic benefit cost from May 1, 2006 (date following acquisition) through December 31, 2006:

	<b>For the three months ended December 31, 2006</b>	<b>For the nine months ended December 31, 2006</b>
Service cost	\$ 131	\$ 350
Interest cost	349	930
Expected return on plan assets	(373)	(995)
Amortization of prior service cost	--	--
Amortization of unrealized gains and losses	--	--
Net periodic benefit cost	\$ 107	\$ 285

As of April 30, 2006, the projected benefit obligation, accumulated benefit obligation and fair value of plan assets were \$25,400, \$25,400 and \$18,697, respectively. A liability of \$6,703 representing the unfunded portion of the CWA Plan is included in Other Liabilities within the Consolidated Balance Sheets.

The following are the weighted-average assumptions utilized for this plan:

	<b>April 30, 2006</b>
Discount rate	5.50%
Rate of compensation increase	N/A
Expected long-term rate of return	8.00%

**Note 13: Restructuring and Other Charges**

The Company incurred \$15,726 of costs related to facility consolidations and \$8,857 of severance costs for the separation of approximately 250 employees. In accordance with SFAS 141, these costs were properly included in the purchase price allocation for NextiraOne. The majority of the severance costs will be paid in Fiscal 2007 with certain facility costs extending through Fiscal 2014. The Company paid \$4,578 and \$11,710 during the three and nine month periods ended December 31, 2006, respectively, relating to such obligations.

The following table summarizes the changes to the restructuring reserve during the period:

	<b>Employee Severance</b>	<b>Facility Closures</b>	<b>Total</b>
Balance at March 31, 2006	\$ 260	\$ 10,438	\$ 10,698
Acquisition adjustments ( <i>see</i> Note 10)	8,857	15,843	24,700
Cash expenditures	(6,636)	(7,831)	(14,467)
Balance at December 31, 2006	\$ 2,481	\$ 18,450	\$ 20,931

**Note 14: Stock-based Compensation**

The Company has two stock option plans, the 1992 Stock Option Plan, as amended (the Employee Plan ), and the 1992 Director Stock Option Plan, as amended (the Director Plan ). As of December 31, 2006, the Employee Plan is authorized to issue stock options and stock appreciation rights ( SARs ) for up to 9,200,000 shares of common stock. The Employee Plan provides that options are to be granted by a committee appointed by the Company s Board to key employees of the Company; such stock options generally become exercisable in equal amounts over a three-year period. As of December 31, 2006, the Director Plan is authorized to issue stock options and SARs for up to 270,000 shares of common stock. The Director Plan provides that options are to be granted by the Board or a committee appointed by the Board; such options generally become exercisable in equal amounts over a three-year period. No SARs have been issued under either plan.

Stock-based compensation expense includes (i) compensation expense for share-based awards granted prior to, but not yet vested as of March 31, 2006, based on the grant-date fair value estimated in accordance with the pro-forma provisions of SFAS 123 and (ii) compensation expense for the share-based payment awards granted subsequent to March 31, 2006 based on the grant-date fair value estimated in accordance with the provisions of SFAS 123(R). For the three and nine month periods ended December 31, 2006, the Company recognized compensation expense of \$1,840 (\$1,196 net of tax) or \$0.07 per diluted share and \$7,476 (\$4,860 net of tax) or \$0.27 per diluted share, respectively which is recorded to Selling, General and Administrative expense on the Company s Consolidated Statements of Income.

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As a result of the Restatement, the Company has restated its stock-based compensation expense recognized under the intrinsic value method (APB 25) for the three (3) and nine (9) month periods ended December 31, 2005. The following table reconciles the Company's stock-based compensation expense from the previously reported results to the restated results for the three (3) and nine (9) month periods ended December 31, 2005.

	<b>Stock-Based Compensation Expense, Pre-Tax</b>		
	(As		
	<b>Previously</b>		(As
	<b>Reported)</b>	<b>Adjustment</b>	<b>Restated)</b>
Three Months Ended December 31, 2005	\$ --	\$ 2,431	\$ 2,431
Nine Months Ended December 31, 2005	--	4,677	4,677

As noted above, the restated stock-based compensation expense for the three (3) and nine (9) months ended December 31, 2005 was \$2,431 (\$1,580 net of tax), or approximately \$0.09 per diluted share and \$4,677 (\$3,040 net of tax), or approximately \$0.18 per diluted share, respectively.

The following table summarizes the changes in the Company's outstanding stock options as of and for the period ending December 31, 2006.

	<b>Nine month period ended December 31,</b>	
	<b>2006</b>	
		<b>Weighted-Average</b>
		<b>Exercise</b>
	<b>Shares</b>	<b>Price (per share)</b>
Outstanding at March 31, 2006	5,055	\$ 38.29
Granted	70	39.12
Exercised	(356)	34.13
Forfeited or expired	(58)	38.62
Outstanding at December 31, 2006	4,711	\$ 38.61
Exercisable at December 31, 2006	4,219	\$ 39.06
Weighted average fair value of options granted during the period using Black-Scholes option pricing model		\$ 17.88

The weighted average fair value of stock options granted during the period and the stock-based compensation expense recognized during the three (3) and nine (9) month periods ended December 31, 2006 were based on the Black-Scholes option pricing model using the following weighted average assumptions.

	<b>3Q07</b>
Expected life (in years)	5.7
Risk free interest rate	4.18%
Annual forfeiture rate	1.53%
Volatility	45.47%
Dividend yield	0.60%

The following table summarizes certain information regarding the Company's outstanding stock options at December 31, 2006:

Range of Exercise Prices	Options Outstanding				Options Exercisable		
	Shares Outstanding	Weighted Average Remaining Contractual Life (Years)	Weighted Average Exercise Price	Average Intrinsic Value (000 s)	Shares Exercisable (000 s)	Weighted Average Exercise Price	Average Intrinsic Value (000 s)
\$19.95 -26.60	257	1.5	\$21.85	\$ 5,329	257	\$21.85	\$ 5,329
\$26.60 -33.25	330	2.2	30.14	4,104	330	30.14	4,104
\$33.25 -39.90	1,826	8.4	37.14	9,904	1,333	38.02	6,050
\$39.90 -46.55	2,140	5.0	42.38	392	2,140	42.38	392
\$46.55 -53.20	154	2.8	49.39	--	154	49.39	--
\$53.20 -59.85	2	3.0	55.88	--	2	55.88	--
\$59.85 -66.50	2	3.0	63.22	--	2	63.22	--
\$19.95 - \$66.50	4,711	5.8	\$38.61	\$19,729	4,219	\$39.06	15,875

The aggregate intrinsic value in the preceding table represents the total pre-tax intrinsic value, based on the Company's average stock price on December 31, 2006 of \$42.56, which would have been received by the option holders had all option holders exercised their options as of that date. As of December 31, 2006, there was approximately \$6,223 of total unrecognized pre-tax compensation expense related to non-vested stock options granted under the plans which is expected to be recognized over a period of 2.7 years.

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The Company adopted SFAS 123(R) using the modified prospective transition method. The modified prospective transition method requires the Company to provide pro-forma disclosure of specific income statement line items for periods prior to the adoption of SFAS 123(R) as if the fair-value-based method had been applied to all awards. The following table illustrates the pro-forma effect on net income (loss) and net income (loss) per share prior to the adoption of SFAS 123(R). This table only shows pro-forma amounts for the three (3) and nine (9) month period ending December 31, 2005 since the Company adopted the fair value recognition provisions of SFAS 123(R) on April 1, 2006 and, therefore, compensation expenses are recognized in the consolidated income statement for all share-based payments granted prior to, but not yet vested as of March 31, 2006. Per share amounts may not total due to rounding.

	<b>Three months ended December 31, 2005</b>		
	<b>As previously reported</b>	<b>Adjustment</b>	<b>As Restated</b>
Net income (Loss) - As reported	\$ 12,511	\$ (1,472)	\$ 11,039
Plus: Stock-based compensation expense included in reported net income, net of related tax	--	2,431	2,431
Less: Stock-based compensation expense determined by the fair value method for all awards, net of related tax	(17,703)	(12,723)	(30,426)
Net Income (Loss) - Pro-forma	\$ (5,192)	\$ (11,764)	\$ (16,956)
Earnings per common share			
Basic as reported	\$ 0.72	\$ (0.08)	\$ 0.64
Basic pro-forma	\$ (0.30)	\$ (0.68)	\$ (0.98)
Diluted as reported	\$ 0.70	\$ (0.08)	\$ 0.62
Diluted pro-forma	\$ (0.29)	\$ (0.66)	\$ (0.95)

	<b>Nine months ended December 31, 2005</b>		
	<b>As previously reported</b>	<b>Adjustment</b>	<b>As Restated</b>
Net income (Loss) - As reported	\$ 32,702	\$ (2,832)	\$ 29,870
Plus: Stock-based compensation expense included in reported net income, net of related tax	--	4,677	4,677
Less: Stock-based compensation expense determined by the fair value method for all awards, net of related tax	(22,925)	(18,666)	(41,591)
Net Income (Loss) - Pro-forma	\$ 9,777	\$ (16,821)	\$ (7,044)
Earnings per common share			
Basic as reported	\$ 1.92	\$ (0.17)	\$ 1.75
Basic pro-forma	\$ 0.57	\$ (0.98)	\$ (0.41)



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Diluted as reported	\$ 1.88	\$ (0.16)	\$ 1.72
Diluted pro-forma	\$ 0.56	\$ (0.96)	\$ (0.40)

The pro-forma impacts computed above were based on the Black-Scholes option pricing model using the following weighted average assumptions.

	<b>3Q06</b>
Expected life (in years)	5.6
Risk free interest rate	4.17%
Volatility	49.0%
Dividend yield	0.60%

On October 31, 2005, in response to the issuance of SFAS No. 123(R), the Compensation Committee of the Board of Directors of the Company authorized the acceleration of the vesting of all of the Company's outstanding out-of-the-money unvested stock options held by current employees, including officers, and directors. Approximately 405,224 options that would otherwise have vested from time to time over the next three years became immediately exercisable. Such stock options had an exercise price greater than \$39.77, the approximate

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fair market value of the common stock on October 31, 2005. The accelerated vesting of these options increased the pro-forma compensation expense for the three months ended December 31, 2005 by approximately \$4,217, net of tax. On October 31, 2005, the Company issued options to purchase approximately 989,700 shares of common stock which were granted fully vested, the effect of which increased the pro-forma compensation expense for the three months ended December 31, 2005 by approximately \$14,656, net of tax.

**Note 15: Segment Reporting**

Management reviews financial information for the consolidated Company accompanied by disaggregated information on net revenues, operating income and assets by geographic region for the purpose of making operational decisions and assessing financial performance. Additionally, Management is presented with and reviews net revenues and gross profit by service type. The accounting policies of the individual operating segments are the same as those of the Company.

The following table presents financial information about the Company's reportable segments by geographic region:

	Three months ended December 31,		Nine months ended December 31,	
	2006	(As Restated) 2005	2006	(As Restated) 2005
<b>North America</b>				
Revenues	\$ 220,391	\$ 143,173	\$ 644,260	\$ 426,788
Operating income	13,685	13,309	41,204	39,459
Depreciation	3,047	2,093	8,788	6,110
Amortization	2,644	1,272	6,012	3,747
Segment assets (as of December 31)	1,033,503	776,746	1,033,503	776,746
<b>Europe</b>				
Revenues	\$ 34,610	\$ 29,950	\$ 94,799	\$ 92,899
Operating income	4,502	4,101	11,134	7,161
Depreciation	133	155	364	517
Amortization	23	70	74	463
Segment assets (as of December 31)	133,554	122,829	133,554	122,829
<b>All Other</b>				
Revenues	\$ 9,805	\$ 9,012	\$ 27,467	\$ 26,780
Operating income	1,881	1,771	5,372	5,394
Depreciation	23	36	67	151
Amortization	10	7	28	25
Segment assets (as of December 31)	17,065	16,258	17,065	16,258

The sum of segment revenues, operating income, depreciation and amortization equals the consolidated revenues, operating income, depreciation and amortization. The following reconciles segment assets to total consolidated assets:

	December 31, 2006	(As Restated) March 31, 2006
Segment assets for North America, Europe and All Other	\$ 1,184,122	\$ 894,557
Corporate eliminations	(72,204)	(79,145)
Total consolidated assets	\$ 1,111,918	\$ 815,412

The following table presents financial information about the Company by service type:

	<b>Three months ended</b>		<b>Nine months ended</b>	
	<b>December 31,</b>		<b>December 31,</b>	
	<b>2006</b>	<b>2005</b>	<b>2006</b>	<b>2005</b>
Data Services				
Revenues	\$ 46,350	\$ 47,083	\$ 137,328	\$ 152,568
Gross Profit	14,236	14,794	41,460	45,800
Voice Services				
Revenues	\$ 160,686	\$ 82,281	\$ 464,140	\$ 233,620
Gross Profit	54,566	32,145	158,242	91,156
Hotline Services				
Revenues	\$ 57,770	\$ 52,771	\$ 165,058	\$ 160,279
Gross Profit	27,883	26,463	81,863	81,268

The sum of service type revenues and gross profit equals consolidated revenues and gross profit.

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**Note 16: Subsequent Events**

On February 2, 2007, the Company announced the acquisition of ADS Telecom, Inc. ( ADS ), a privately-held company based out of Orlando, FL. ADS has an active customer base which includes commercial, financial, healthcare and various government agency accounts. Annual historical revenues of ADS are approximately \$14 million.

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

**The discussion and analysis for the three (3) and nine (9) month periods ended December 31, 2005 as set forth below in this Item 2 has been amended to reflect the Restatement as described in the Explanatory Note and in Note 3 of the Notes to the Consolidated Financial Statements. For this reason, the data set forth in this section may not be comparable to discussions and data in the Company's previously filed Quarterly Reports on Form 10-Q. All dollar amounts are presented in thousands unless otherwise noted.**

**Restatement through March 31, 2006**

**Background**

On November 13, 2006, Black Box received a letter of informal inquiry from the Enforcement Division of the SEC relating to the Company's stock option practices from January 1, 1997 to present. As a result, the Audit Committee, with the assistance of outside legal counsel, commenced an independent review of the Company's historical stock option grant practices and related accounting for stock option grants during the Review Period.

On February 1, 2007, the Company announced that, while the review of option grant practices was continuing, it believed that it would need to record additional non-cash charges for stock-based compensation expense relating to certain stock option grants and, accordingly, cautioned investors about relying on its historical financial statements until the Company could determine with certainty whether a restatement would be required and, if so, the extent of any such restatement and the periods affected.

On March 19, 2007, although the Audit Committee had not yet completed its review, the Audit Committee concluded that the exercise price of certain stock option grants differed from the fair market value of the underlying shares on the appropriate measurement date. At that time, the Company and the Audit Committee announced that it was currently expected that the Company's additional non-cash, pre-tax charges for stock-based compensation expense relating to certain stock option grants would approximate \$63 million for the Review Period. In addition, the Company and the Audit Committee concluded that the Company would need to restate its previously-issued financial statements contained in reports previously filed by the Company with the SEC. Accordingly, on March 19, 2007, the Company and the Audit Committee concluded that the Company's previously-issued financial statements and other historical financial information and related disclosures for the Review Period, including applicable reports of its current or former independent registered public accounting firms and related press releases, should not be relied upon.

On May 25, 2007, the Company was advised by the Enforcement Division of the SEC that a Formal Order of Private Investigation arising out of the Company's stock option practices had been entered and on May 29, 2007 the Company received a subpoena that was issued by the SEC.

On May 31, 2007, the Company announced that, as a result of the ongoing review of stock option practices, Company management and the Audit Committee expected that the Company's additional non-cash, pre-tax charges for stock-based compensation expense relating to certain stock option grants would approximate \$70 million for the Review Period.

**Findings of the Audit Committee**

During the Review Period, the Company granted stock options pursuant to an employee stock option plan and a director stock option plan to acquire approximately 10.9 million shares of common stock. Such plans at all relevant times provided for option grants to be approved by a designated committee of non-employee directors or, in the case of the director stock option plan, by the Board. Approximately 2,000 stock option grants were awarded during the Review Period with 69 recorded grant dates. No stock options have been granted since September, 2006. The Audit Committee reviewed all stock options granted during the Review Period, including option grants to the Company's directors, officers and rank and file employees (including grants to new employees, grants awarded in connection with Company acquisitions and grants made as individual or group performance awards). The Audit Committee's review of the Company's stock option granting practices included a comprehensive examination of reasonably available relevant physical and electronic documents as well as interviews with current and former directors, officers and Company personnel.

The Audit Committee's review was initially focused on determining whether the Company's prior stock option granting practices were in compliance with the plans' granting provisions and applicable law or called into question its accounting for such options. Once it became evident that such issues and accounting implications existed, the inquiry

focused on those matters necessary: to determine whether any accounting charges were material and whether a restatement of the Company's previously-issued financial statements would be required; to establish a basis for effecting any required restatement; to assure that, on as timely a basis as possible, the Company could file any

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required curative disclosures with the SEC and assure its continued eligibility for listing on NASDAQ; and to provide an informed basis for the Company's response to the identified issues, including appropriate corrective and remedial actions.

The following information summarizes certain of the findings of the Audit Committee. The findings identified approximately \$71.5 million of unrecorded expense at the time of grant (i.e., the difference between the fair market value of the common stock on the appropriate measurement date and the stated exercise price), net of forfeitures, during the Review Period, of which \$70.0 million was recorded in the Company's Consolidated Financial Statements through March 31, 2006 and \$1.5 million of unrecorded expense at the time of grant will be included, beginning at April 1, 2006, in the Company's computation of compensation expense in accordance with SFAS 123(R). The following summarizes the unrecorded expense at the time of grant by time period and category of recipient:

\$4.2 million for the period from Fiscal 1993 through Fiscal 1997 (\$0.2 million for directors, \$2.5 million for officers and \$1.5 million for rank and file employees)

\$45.6 million for the period from Fiscal 1998 through August 2002 (\$1.1 million for directors, \$25.7 million for officers and \$18.7 million for rank and file employees)

\$21.8 million for the period from August 2002 to the present (\$0.04 million for directors, \$0.6 million for officers and \$21.1 million for rank and file employees)

The Audit Committee's additional key findings are summarized below:

**Lack of Adequate Documentation:** For a majority of grants issued by the Company during the Review Period, there is either no or inadequate documentation of approval actions that satisfies the requisites for establishing a measurement date under APB 25. Of the 69 recorded grant dates, there are documented approval actions by the Board or the Option or Compensation Committee with respect to particular grants for 12 dates. In the period December 1992 to May 1996, neither the minutes of the Compensation Committee nor of the Board reflect any action to approve specific grants. In some instances, evidence of single director (the chairman of the Compensation Committee) approval actions exists. This absence of non-employee director level documentation also applies to a majority of grants with a recorded grant date after 1996. In some cases, Compensation Committee minutes contain a reference to reports on the status of the option pool but do not document any action to approve specific grants. Approval documentation for certain grants has internal inconsistencies or conflicts with other documents thereby rendering this documentation unreliable as a basis for establishing a measurement date. In some cases, the only existing documentation is the executed option agreement and/or the entry of the option grant into the option database. Notwithstanding these approval documentation inadequacies, the Company entered into option agreements with grantees and has honored such grants.

**Grant Approvals:** During the Review Period, relatively few option grants were approved in complete compliance with the Company's stock option plans. Available documentation reflects that the Company approved option grants in a variety of ways. With respect to the employee stock option plan, grants were approved by the Compensation Committee as contemplated by the plan at various times, by the full Board in 1998 and 1999, by a single director (the chairman of the Compensation Committee) on nine recorded grant dates during the period 1994 through 2001 and by the Company's CEO at various times. With respect to the director stock option plan, grants were generally approved by the designated Board committee and, in a few cases, by the chairman of the Compensation Committee. In one instance in 2000, there is no conclusive documentary evidence of the approval of director grants other than the signed director option agreements.

The delegation of authority by the Compensation Committee to the CEO with respect to grants to rank and file employees was not fully documented. However, there was an understood and accepted practice between the CEO and the Compensation Committee whereby the CEO made certain awards to individual employees. In some instances, this involved the allocation among rank and file employees of blocks of shares approved by the Compensation Committee; in three (3) such instances, the number of shares ultimately awarded pursuant to this process exceeded the approved size of the block, which was contrary to the understanding of the Compensation Committee members. Further, contrary to the understanding of Committee members, the award and/or documentation of those individual grants

often significantly lagged the approval of the block grant. In August 2005, the Compensation Committee specifically acknowledged a prior grant of delegated authority to the CEO to make option grants to rank and file employees and ratified all prior awards by the CEO. In some cases, documentation of approval action is either inconclusive or missing, and the Company therefore has been unable to determine what entity or person actually approved specific grants.

**Option Pricing:** The recorded grant dates for a majority of grants do not match the applicable measurement dates as determined under APB 25. The grants of options with exercise prices lower than the fair market values of the stock on the actual measurement dates did not satisfy the fair market pricing requirement in the Company's plans, as amended in 1998, and were not consistent with the Company's disclosures in SEC filings stating that the exercise price of options was equal to the fair market value of the stock on the date of the grant.

The relationship between the stated exercise price of options and the fair market value of the Company's stock on the date of the



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identifiable approval actions varied from grant to grant. In some cases, the exercise price of grants reflected the fair market value of the underlying shares on the date of any documented approval action. In other cases, the exercise prices reflected the fair market value of the underlying shares on a date either prior or subsequent to any such documented approval action and the exercise price was lower than the fair market value on the date of any such action. In several such cases before August 2002, the use of such grant dates and lower exercise prices (together with other available evidence) supports a finding that the recorded grant dates and corresponding exercise prices were selected with the benefit of hindsight. For certain grants where the mismatch between the recorded grant date and the approval action was only a matter of days, however, the mismatch appears to have been attributable to inaccurate recording or administrative delays. In some cases, the apparent approval action did not identify all grantees; for example, there are cases where a block grant was approved subject to a later determination of individual grant recipients and grants were recorded with a grant date, and corresponding exercise price, that matched the date of the apparent approval of the block grant and the fair market value of the common stock on that date although individual grant recipients may have been identified some time after approval of the block grant. Finally, in some cases, the approval action for specific grants is not adequately documented. Where the recorded grant date did not satisfy the requisites for a measurement date under APB 25, the Company relied on default methodologies to determine an appropriate measurement date.

**Internal Controls:** As outlined above, the Company's historical administration of its options program lacked discipline as it relates to proper adherence to the plan requirements, corporate recordkeeping and documentation. Since November 2003, however, the Company has properly administered the stock option program as it relates to awards to directors and officers. During the investigation, the Company identified control gaps related to grants made throughout the Review Period. As of March 31, 2007, the Company implemented additional procedures to its process that are focused on formalized documentation of appropriate approvals and determination of grant terms to employees.

**Procedural and Remedial Actions**

The Audit Committee and other relevant Board committees are committed to a continued review and implementation of procedural enhancements and remedial actions in light of the foregoing findings. Consistent with its obligation to act in the best interests of the Company taking into account all relevant facts and circumstances, the Audit Committee is continuing to assess the appropriateness of a broad range of possible procedural enhancements and potential remedial measures in light of the findings of its investigation. While the Audit Committee has not completed its consideration of all such steps, procedural enhancements may include recommendations regarding improved stock option administration procedures and controls, training and monitoring compliance with those procedures, corporate recordkeeping, corporate risk assessment, evaluation of the internal compliance environment and other remedial steps that may be appropriate. The Audit Committee is also expected to address issues of individual conduct or responsibility, including those of the Board, CEOs and CFOs serving during the Review Period. Potential remedial measures may include an evaluation of the role of and possible claims or other remedial actions against current and former Company personnel who may be found to have been responsible for identified problems during the Review Period. The Audit Committee expects to recommend to the Board and/or its appropriate committees procedural enhancements and remedial measures that appropriately address the issues raised by its findings. In advance of action by the Audit Committee, as noted above, the Company has implemented additional procedures to its process for approving stock option grants that are focused on formalized documentation of appropriate approvals and determination of grant terms to employees.

**Restatement Methodologies**

As of April 1, 2006, the Company adopted SFAS 123(R) using the modified prospective transition method. Under this transition method, compensation expense is to be recognized for all share-based compensation awards granted after the date of adoption and for all unvested awards existing on the date of adoption. Prior to April 1, 2006, the Company accounted for stock-based compensation awards to directors, officers and rank and file employees using the intrinsic value method in accordance with APB 25 as allowed under SFAS 123. Under the intrinsic value method, no share-based compensation expense related to stock options was required to be recognized if the exercise price of the stock option was at least equal to the fair market value of the common stock on the measurement date. APB 25 defines

the measurement date as the first date on which are known both (1) the number of shares that an individual grant recipient is entitled to receive and (2) the option or purchase price, if any.

In light of the Audit Committee's review of the Company's stock option granting practices during the Review Period and as to those cases in which the Company previously used a recorded grant date as the measurement date that the Company determined could no longer be relied upon, the Company has developed and applied the following methodologies to remeasure those stock option grants and record the relevant charges in accordance with APB 25 by considering the following sources of information: (i) meeting minutes of the Board and of committees thereof and related materials, (ii) Unanimous Written Consents of the Board and of committees thereof, (iii) create date, (iv) relevant email correspondence reflecting stock option grant approval actions, (v) individual stock option agreements and related materials, (vi) employee and Board offer letters, (vii) documents relating to acquisitions, (viii) reports on Form 4 filed with the SEC and (ix) guidance of the Office of the Chief Accountant of the SEC on stock option matters as set forth in its letter dated September 19, 2006.

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***Grants with Appropriate Committee Approval.*** With respect to grants of approximately 1.0 million shares, or approximately 9% of the total grants in the Review Period, the Company has evidence to support the approval of the grant under the stock option plans by the relevant committee of the Board, and such evidence includes the number of options each individual was entitled to receive and the option price. However, the relationship between these documented approval actions and the originally-recorded grant dates and exercise prices for the options so approved varied during the Review Period. In some cases, grants were recorded with a grant date and a corresponding exercise price that matched the date of the approval action or were otherwise consistent with the terms of the approval actions. In other cases, however, the recorded grant dates and corresponding exercise prices of the grants reflected the fair market value of the common stock on a date prior to the committee's documented approval actions. The Company has restated the compensation expense for stock option grants relating to approximately 0.4 million shares of common stock by using the date of the documented approval action as the measurement date. The total additional non-cash, pre-tax charge for these grants is approximately \$1.8 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.07 million relates to director options, \$1.3 million relates to officer options and \$0.4 million relates to rank and file employee options.

***Grants with Other Approvals.*** With respect to grants of approximately 1.9 million shares, or approximately 18% of the total grants in the Review Period, the Company has evidence to support the approval of the grant by the Board, an outside director or the Company's CEO and the identification of the number of options each individual was entitled to receive together with the option price. These grants are distinguished from the grants described in the prior paragraph in that the nature of the approval was not fully consistent with the terms of the relevant stock option plan. As with the grants discussed in the preceding paragraph, the relationship between these documented approval actions and the originally-recorded grant dates and exercise prices for the options so approved varied during the Review Period. In some cases, grants were recorded with a grant date and a corresponding exercise price that matched the date of the approval action or were otherwise consistent with the terms of the approval action. In other cases, however, the recorded grant dates and corresponding exercise prices of the grants reflected the fair market value of the Company's stock on a date prior to the approval action. The Company has restated the compensation expense for stock option grants relating to approximately 1.6 million shares of common stock by using the date of the documented approval action as the measurement date. The total additional non-cash, pre-tax charge for these grants is approximately \$7.6 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.5 million relates to director options, \$2.6 million relates to officer options and \$4.5 million relates to rank and file employee options.

***Grants Lacking Adequate Documentation.*** With respect to grants of approximately 7.9 million shares (5.0 million shares to rank and file employees), or 73.0% of the total grants in the Review Period, the Company has been unable to locate adequate documentation of approval actions that would satisfy the requisites for a measurement date under APB 25. For these grants, management considered all available relevant information to form a reasonable conclusion as to the most reasonable measurement date. For all grants in this category, the Company has established default methodologies for determining the most appropriate measurement date under APB 25.

With respect to grants entered into the Company's stock option database after September 9, 1999, when the database began to reflect a "create date" which is the date on which a grant was entered into the system, the Company has determined to use the individual "create date" for each grant as the APB 25 measurement date, which was in most cases different from the originally-recorded grant date. The Company believes that this "create date" is the most appropriate methodology in the absence of sufficient evidence of approvals for these grants as it represents the earliest point in time at which the evidence shows that all requisites for the establishment of the measurement date had been satisfied. Such "create dates" preceded, often by a significant amount of time, the execution of stock option agreements, which, generally, were manually signed by the Company's CEO and manually signed and dated by the grantee. In addition, in almost all cases, a grant entered into the database, which established the "create date," ultimately resulted in the creation of a stock option agreement reflecting such grant. Accordingly, while execution of the stock option agreements constituted a clear acknowledgement by the grantee and the Company of the grantee's legal entitlement to the grant the Company believes the "create date" more accurately reflects the date of approval than does the signed option agreement. The Company has restated the compensation expense for stock option grants relating to approximately 4.2 million

shares of common stock by using the create date as the measurement date. The total additional non-cash, pre-tax charge for these grants is approximately \$49.8 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.5 million relates to director options, \$17.2 million relates to officer options and \$32.2 million relates to rank and file employee options. The Company's procedures for evaluating the appropriateness of measurement dates fixed with reference to such create dates included a sensitivity analysis which provided an understanding of the differences between the additional recorded charge for stock-based compensation expense and the charges that would result from using other identified alternative methods for determining measurement dates. The Company's sensitivity analysis included identifying the range of potential grant dates defined by the recorded grant date and the create date for each grant. The Company then identified the low and high closing prices of the common stock within that range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted for which the create date methodology was utilized to determine the range of potential adjustments to stock-based compensation expense for these grants, which was \$0.09 million to \$73.8 million, net of forfeitures, as compared to the additional non-cash, pre-tax charge for these grants of approximately \$49.8 million, net of forfeitures, included in the Restatement.

For options entered into the Company's option database before September 9, 1999, the Company determined the measurement date

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generally by reference to signed option agreements (or the deemed signature date for certain options as discussed below). The executed option agreements (hereinafter "signed option agreements"), manually signed by the Company's CEO and manually signed and dated by the grantee, constituted an acknowledgement by the grantee and the Company of the grantee's legal entitlement to the grant and, in the absence of authoritative information as to when all the requisites for the establishment of the measurement date had been satisfied, provides a measurement date framework based on entitlement. The Company has restated the compensation expense for stock option grants relating to approximately 1.4 million shares of common stock by using the signed option agreements as the measurement date. The total additional non-cash, pre-tax charge for these grants is approximately \$6.4 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.3 million relates to director options, \$3.6 million relates to officer options and \$2.5 million relates to rank and file employee options. The Company believes this methodology was the most appropriate in the absence of sufficient evidence of approvals for these grants as it represents the earliest point in time at which the evidence shows that all requisites for the establishment of the measurement date had been satisfied for these grants. The Company's procedures for evaluating the appropriateness of measurement dates fixed with reference to the dating of signed option agreements included a sensitivity analysis which provided an understanding of the differences between the additional recorded charge for stock-based compensation expense and the charges that would result from using other identified alternative methods for determining measurement dates. The Company's sensitivity analysis included identifying the range of potential grant dates defined by the recorded grant date and the date of the grantee's signature on the stock option agreement for each grant. The Company then identified the low and high closing prices of the common stock within that range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted for which the signed option agreements methodology was utilized to determine the range of potential adjustments to stock-based compensation expense for these grants, which was \$0.03 million to \$9.6 million, net of forfeitures, as compared to the additional non-cash, pre-tax charge for these grants of approximately \$6.4 million, net of forfeitures, included in the Restatement.

In those cases where no reliably-dated signed option agreement could be located and where no post-September 9, 1999 "create date" exists (stock option grants totaling approximately 0.9 million shares), the Company used the average period between recorded grant date and date of the signatures on all other grantee signed option agreements with the same grant date as the measurement date. For example, if there were four stock option grants with a grant date of January 1, 1996, the Company had the signed option agreements for three of these stock option grants and the average number of days between the grant date and the signature dates of these three signed option agreements was 20 days, January 21, 1996 was used as the measurement date for the grant for which no signed option agreement could be located. The Company has restated the compensation expense for stock option grants relating to approximately 0.7 million shares of common stock using this "average days to sign agreement" method. The total additional non-cash, pre-tax charge for these grants is approximately \$4.4 million, net of forfeitures, amortized over the appropriate vesting period through March 31, 2006, of which \$0.06 million relates to director options, \$4.2 million relates to officer options and \$0.2 million relates to rank and file employee options. The Company believes this methodology was the most appropriate in the absence of sufficient evidence of approvals for these grants because it gives a reasonable approximation of the measurement date related to these options in light of the available evidence. The Company conducted a sensitivity analysis by comparing the Company's current default methodology (i.e., "average days to sign agreement") with another default methodology. For this analysis, the Company identified the range of potential grant dates defined by the earliest signed option agreement and the latest signed option agreement. The Company then identified the low and high closing prices of the common stock over the range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted to determine the range of potential adjustments to stock-based compensation expense for these grants, which was \$2.6 million to \$5.9 million, net of forfeitures. The Company's analyses indicate that stock-based compensation expense computed using other identified alternative default methodologies would not materially differ from stock-based compensation expense computed using the "average days to sign agreement" methodology. The Company's procedures for evaluating the appropriateness of measurement dates fixed with reference to the average days to sign agreements also included a sensitivity analysis which provided an understanding of the differences between the additional recorded charge for

stock-based compensation expense and the charges that would result from using other identified alternative methods for determining measurement dates. The Company's sensitivity analysis included identifying the range of potential grant dates defined by the recorded grant date and the average days to sign agreement for each grant. The Company then identified the low and high closing prices of the common stock within that range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted to determine the range of potential adjustments to stock-based compensation expense for these grants, which was \$0.03 million to \$6.1 million, net of forfeitures, as compared to the additional non-cash, pre-tax charge for these grants of approximately \$4.4 million, net of forfeitures, included in the Restatement.

Given the volatility of the common stock during much of the Review Period, the use of methodologies and measurement dates different from those described above could have resulted in a higher or lower cumulative compensation expense which would have caused net income or loss to be different from the amounts reported in the restated consolidated financial statements. The Company's procedures for evaluating the appropriateness of measurement dates fixed using the default methodologies described above also included a sensitivity analysis which provided an understanding of the differences between the additional recorded charge for stock-based compensation expense and the charges that would result from using other identified alternative methods for determining measurement dates. The Company's sensitivity analysis included identifying the range of potential grant dates defined by the recorded grant date and the appropriate measurement date for each grant. The Company then identified the low and high closing prices of the common stock within that range of potential grant dates and applied both the low and high closing prices of the common stock to the number of shares granted to determine the range of potential adjustments to stock-

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based compensation expense for these grants, which was \$9.3 million to \$99.3 million, net of forfeitures, as compared to the additional non-cash, pre-tax charge for these grants of approximately \$70.0 million, net of forfeitures, included in the Restatement.

**Other adjustments through March 31, 2006**

From 1994 through 1998, the Company did not properly account for stock options for one officer that were modified after the grant date pursuant to a separation agreement. Some of these modifications were not identified in the Company's financial reporting processes and were therefore not properly reflected in its financial statements. As a result, the Company has recorded a non-cash charge for stock-based compensation of \$1.0 million during Fiscal 1999.

**Summary**

In summary, the Company recorded cumulative non-cash charges for stock-based compensation of \$70.9 million through March 31, 2006, offset in part by a cumulative income tax benefit of \$27.7 million, for a total after-tax charge of \$43.2 million. These charges had no impact on net sales or cash and cash equivalents as previously reported in the Company's financial statements; as a result, no changes to these items are reflected in the Restatement. Non-cash charges for stock-based compensation expense have been recorded as adjustments to Selling, General, and Administrative Expenses within the Company's Consolidated Statements of Income.

**1Q07 and 2Q07 Restatement****Stock-based compensation expense**

In addition to the Restatement noted above through March 31, 2006, the Company has recorded a non-cash charge for stock-based compensation of \$0.8 million and \$2.4 million for the three (3) and six (6) month periods ended September 30, 2006, offset in part by income tax benefits of \$0.3 million and \$1.0 million, or total after-tax charges of \$0.5 million and \$1.4 million. This charge was recorded to reflect additional non-cash, stock-based compensation expense recognized under the fair value method (SFAS 123(R)) because the exercise price for certain stock option grants prior to, but not vested as of March 31, 2006, differed from the fair market value of the underlying shares on the appropriate measurement date, some of which occurred during Fiscal 2007.

**Accounting for derivatives**

On July 26, 2006, the Company entered into an interest rate swap to reduce its exposure from fluctuating interest rates. SFAS 133 requires that all derivative instruments be recorded on the balance sheet as either an asset or liability measured at their fair value, and that changes in the derivatives' fair value be recognized currently in earnings unless specific hedge accounting criteria are met. From inception of the hedge, the Company had applied a method of cash flow hedge accounting under SFAS 133 to account for the interest rate swap that allowed the Company to assume no ineffectiveness in such agreements, called the "short-cut" method.

Subsequently, the Company analyzed its eligibility for the short-cut method in light of certain clarifications delivered by the Office of the Chief Accountant of the SEC, and determined that its interest rate swap did not qualify for the short-cut method under SFAS 133 because certain prepayment features relating to the underlying actual debt were not identical to those contained in the interest rate swap. Because the Company's documentation at hedge inception reflected the short-cut method rather than the long haul method for determining hedge ineffectiveness, the derivative did not meet the requirements for a cash flow hedge. Documentation for the long haul method of accounting at hedge inception cannot be retrospectively applied under SFAS 133. Therefore, fluctuations in the interest rate swap's fair value should have been recorded through the Company's Consolidated Statement of Income instead of through Other Comprehensive Income (Loss), which is a component of stockholders' equity. The adjustment for 2Q07 will decrease reported net income and increase Other Comprehensive Income by approximately \$1.4 million. This change in accounting for this derivative instrument could result in significant volatility in the Company's reported net income and earnings per share due to increases and decreases in the fair value of the interest rate swap. However, the derivative instrument remains highly effective and the change in accounting for this derivative instrument does not impact operating cash flows or total stockholders' equity.

The table below reflects the impact of the additional non-cash charges for stock-based compensation expense and the non-cash charge related to the interest rate swap on the Company's Consolidated Statements of Income, including the cumulative adjustment to Retained Earnings as of March 31, 2006 and September 30, 2006 on the Company's Consolidated Balance Sheet. See Note 3 of the Notes to Consolidated Financial Statements for reference to footnote

disclosure that reconciles the previously filed annual financial information to the restated annual financial information. All dollar amounts are presented in thousands except per share amounts. Per share amounts may not total due to rounding.



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	(As previously reported) Net Income	Adjust- ment, Pre-Tax	Income Tax Benefit	Adjust- ment, Net of Tax	(As Restated) Net Income	(As previously reported) Diluted EPS	Adjust- ment	(As Restated) Diluted EPS
FY 94	\$ 13,370	\$ 43	\$ (19)	\$ 24	\$ 13,346	\$ 0.83	\$ --	\$ 0.83
FY 95	14,515	461	(144)	317	14,198	0.89	(0.02)	0.87
FY 96	18,278	406	(151)	255	18,023	1.10	(0.01)	1.09
FY 97	24,792	1,172	(456)	716	24,076	1.40	(0.04)	1.36
FY 98	32,404	3,595	(1,393)	2,202	30,202	1.79	(0.12)	1.67
FY 99	38,145	4,506	(1,732)	2,774	35,371	2.09	(0.15)	1.94
FY 00	48,852	5,778	(2,209)	3,569	45,283	2.60	(0.19)	2.41
FY 01	64,190	10,290	(3,953)	6,337	57,853	3.22	(0.32)	2.90
FY 02	62,042	11,333	(4,381)	6,952	55,090	2.97	(0.33)	2.64
FY 03	48,685	8,927	(2,328)	6,599	42,086	2.39	(0.32)	2.07
FY 04	47,243	8,197	(4,156)	4,041	43,202	2.52	(0.22)	2.30
FY 05	29,912	5,178	(2,312)	2,866	27,046	1.68	(0.16)	1.52
Cumulative 03/31/05	\$442,428	\$59,886	\$ (23,234)	\$36,652	\$405,776	\$ 23.48	\$ (1.89)	\$21.59
1Q06	7,394	1,120	(442)	678	6,716	0.43	(0.04)	0.39
2Q06	12,797	1,126	(444)	682	12,115	0.74	(0.04)	0.70
3Q06	12,511	2,431	(959)	1,472	11,039	0.70	(0.08)	0.62
4Q06	4,656	6,368	(2,612)	3,756	900	0.26	(0.21)	0.05
FY 06	\$ 37,358	\$11,045	\$ (4,457)	\$ 6,588	\$ 30,770	\$ 2.13	\$ (0.37)	\$ 1.76
Cumulative 03/31/06	\$479,786	\$70,931	\$ (27,691)	\$43,240	\$436,546	\$ 25.61	\$ (2.26)	\$23.35
1Q07	7,807	1,629	(635)	994	6,813	0.43	(0.06)	0.37
2Q07	13,079	2,210	(806)	1,404	11,675	0.74	(0.08)	0.66
2QYTD07	\$ 20,886	\$ 3,839	\$ (1,441)	\$ 2,398	\$ 18,488	\$ 1.18	\$ (0.14)	\$ 1.04
Cumulative 09/30/06	\$500,672	\$74,770	\$ (29,132)	\$45,638	\$455,034	\$ 26.78	\$ (2.39)	\$24.39

**Income Tax Considerations**

In the course of the investigation, the Company determined that a number of officers may have exercised options for which the application of Section 162(m) of the Code, may apply. It is possible that these options will be treated as having been granted at less than fair market value for federal income tax purposes because the Company incorrectly applied the measurement date as defined in APB 25. If such options are deemed to be granted at less than fair market

value, pursuant to Section 162(m), any compensation to officers, including proceeds from options exercised in any given tax year, in excess of \$1.0 million will be disallowed as a deduction for tax purposes. The Company estimates that the potential tax effected liability for any such disallowed Section 162(m) deduction would approximate \$3.6 million. The Company may also incur interest and penalties if it were to incur any such tax liability, which could be material.

In addition, the Company is considering the application of Section 409A to those options for which it incorrectly applied the measurement date as defined in APB 25. It is possible that these options will be treated as having been granted at less than fair market value for federal income tax purposes and thus subject to Section 409A. Accordingly, the Company may adopt measures to address the application of Section 409A. The Company does not currently know what impact Section 409A will have, or any such measures, if adopted, would have, on its results of operations, financial position or cash flows, although such impact could be material.

**Expenses Incurred by the Company**

The Company has incurred expenses for legal fees and external audit firm fees, in the aggregate amount of approximately \$0.6 million, in the fiscal year ended March 31, 2007, in relation to (i) the Audit Committee's review of the Company's historical stock option practices and related accounting for stock option grants, (ii) the informal inquiry and formal order of investigation by the Securities and Exchange Commission regarding its past stock option practices, (iii) the derivative action relating to the Company's historical stock option practices filed against the Company as a nominal defendant and certain of the Company's current and former directors and officers as to whom it may have indemnification obligations and (iv) related matters. Further, the Company expects to incur significant additional expense related to the foregoing matters in the fiscal year ending March 31, 2008. It is anticipated that certain of those expenses will be reimbursed under the Company's directors' & officers' indemnification insurance.

**Table of Contents****The Company**

The Company offers one-source network infrastructure services for: data networks (Data Services), including structured cabling for wired and wireless systems; voice systems (Voice Services), including new and upgraded telephony systems; and 24/7/365 hotline technical support (Hotline Services) for more than 118,000 network infrastructure products that it sells through its catalog, Internet Web site and on-site services offices.

Management is presented with and reviews revenues and operating income by geographical segment. In addition, revenues and gross profit information by service type are provided below for further analysis.

The Company has completed several acquisitions previously defined as the Acquired Companies from the first quarter of Fiscal 2006 through the third quarter of Fiscal 2007 that have a significant impact on the Company's consolidated financial statements and, more specifically, North America Voice Services for the periods under review. *See* Note 10 of the Notes to the Consolidated Financial Statements for reference to the Acquired Companies. In connection with certain acquisitions, the Company incurs expenses that it excludes when evaluating the continuing operations of the Company. The following table is included to provide a schedule of the current and an estimate of future acquisition related expenses based on the acquisition activity through December 31, 2006.

	1Q07	2Q07	3Q07	4Q07	FY07	FY08	Thereafter
SGA							
Asset write-up depreciation expense on acquisitions	\$ --	\$ 1,197	\$ 713	\$ 652	\$ 2,562	\$ 1,635	\$ 1,655
Amortization							
Amortization of intangible assets on acquisitions	1,440	1,892	2,621	3,918	9,871	5,257	55,031
Total	\$ 1,440	\$ 3,089	\$ 3,334	\$ 4,570	\$ 12,433	\$ 6,892	\$ 56,686

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Information on revenues and operating income by reportable geographic segment (North America, Europe and All Other) is presented below. The tables below should be read in conjunction with the following discussion. The additional non-cash charges for stock-based compensation expense for the three (3) and nine (9) month periods ended December 31, 2005 was recorded in Selling, General and Administrative expense which is included in the Company's measure of Operating Income. See Note 3 of the Notes to the Consolidated Financial Statements.

	Three months ended December 30 and 31,				Nine months ended December 30 and 31,			
	2006		(As Restated) 2005		2006		(As Restated) 2005	
	\$	% of total revenue	\$	% of total revenue	\$	% of total revenue	\$	% of total revenue
<b>Revenues:</b>								
North America	\$ 220,391	83.2%	\$ 143,173	78.6%	\$ 644,260	84.0%	\$ 426,788	78.1%
Europe	34,610	13.1%	29,950	16.4%	94,799	12.4%	92,899	17.0%
All Other	9,805	3.7%	9,012	4.9%	27,467	3.6%	26,780	4.9%
Total	\$ 264,806	100%	\$ 182,135	100%	\$ 766,526	100%	\$ 546,467	100%
<b>Operating Income:</b>								
North America	\$ 13,685		\$ 13,309		\$ 41,204		\$ 39,459	
% of North America revenues	6.2%		9.3%		6.4%		9.2%	
Europe	\$ 4,502		\$ 4,101		\$ 11,134		\$ 7,161	
% of Europe revenues	13.0%		13.7%		11.7%		7.7%	
All Other	\$ 1,881		\$ 1,771		\$ 5,372		\$ 5,394	
% of All Other revenues	19.2%		19.7%		19.6%		20.1%	
Total	\$ 20,068	7.6%	\$ 19,181	10.5%	\$ 57,710	7.5%	\$ 52,014	9.5%
<b>Reconciling items:</b>								
North America	\$ 5,174		\$ 3,676		\$ 16,443		\$ 11,575	
Europe	--		--		--		3,742	
All Other	--		--		--		--	
Total	\$ 5,174	2.0%	\$ 3,676	2.0%	\$ 16,443	2.1%	\$ 15,317	2.8%

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Information on revenues and gross profit by service type (Data Services, Voice Services and Hotline Services) is presented below. The additional non-cash charges for stock-based compensation expense were recorded in Selling, General and Administrative expense which is not included in the Company's measure of Gross Profit and therefore does not impact the following table or the corresponding discussions.

	Three months ended December 30 and 31, 2006		2005		Nine months ended December 30 and 31, 2006		2005	
	\$	% of total revenue	\$	% of total revenue	\$	% of total revenue	\$	% of total revenue
<b>Revenues:</b>								
Data Services <sup>(1)</sup>	\$ 46,350	17.5%	\$ 47,083	25.8%	\$ 137,328	17.9%	\$ 152,568	27.9%
Voice Services <sup>(1)</sup>	160,686	60.7%	82,281	45.2%	464,140	60.6%	233,620	42.8%
Hotline Services	57,770	21.8%	52,771	29.0%	165,058	21.5%	160,279	29.3%
<b>Total</b>	<b>\$ 264,806</b>	<b>100%</b>	<b>\$ 182,135</b>	<b>100%</b>	<b>\$ 766,526</b>	<b>100%</b>	<b>\$ 546,467</b>	<b>100%</b>
<b>Gross Profit</b>								
Data Services	\$ 14,236		\$ 14,794		\$ 41,460		\$ 45,800	
% of Data Services revenues	30.7%		31.4%		30.2%		30.0%	
Voice Services	\$ 54,566		\$ 32,145		\$ 158,242		\$ 91,156	
% of Voice Services revenues	34.0%		39.1%		34.1%		39.0%	
Hotline Services	\$ 27,883		\$ 26,463		\$ 81,863		\$ 81,268	
% of Hotline Services revenues	48.3%		50.1%		49.6%		50.7%	
<b>Total</b>	<b>\$ 96,685</b>	<b>36.5%</b>	<b>\$ 73,402</b>	<b>40.3%</b>	<b>\$ 281,565</b>	<b>36.7%</b>	<b>\$ 218,224</b>	<b>39.9%</b>

<sup>(1)</sup> Data Services and Voice Services may also be collectively referred to as On-Site Services.

**Third Quarter Fiscal 2007 (3Q07) Compared to Third Quarter Fiscal 2006 (3Q06):****Total Revenues**

Total revenues for 3Q07 were \$264,806, an increase of 45% compared to revenues for 3Q06 of \$182,135. The increase was primarily due to the incremental revenue from the Acquired Companies, which added revenues of \$98,054 and \$14,952 to 3Q07 and 3Q06, respectively. Excluding the effects of the acquisitions and the positive

impact of exchange rates of \$3,014 relative to the U.S. dollar, total revenues would have decreased 2% from \$167,183 to \$163,738 for the reasons discussed below.

**Revenues by Geography**

**North America Revenues**

Revenues in North America for 3Q07 were \$220,391, an increase of 54% compared to revenues for 3Q06 of \$143,173. The increase was primarily due to the incremental revenue from the Acquired Companies, which added \$98,054 and \$14,952 for 3Q07 and 3Q06, respectively. Excluding the effects of these acquisitions and the positive impact of exchange rates of \$187 relative to the U.S. dollar, North America revenues would have decreased 5% from \$128,221 to \$122,150. The Company believes the overall decrease is due to the completion of several nonrecurring projects, offset in part by success in the Company's Data, Voice and Hotline Services ( DVH ) cross-selling initiatives.

**Europe Revenues**

Revenues in Europe for 3Q07 were \$34,610, an increase of 16% compared to revenues for 3Q06 of \$29,950. Excluding the positive impact of exchange rates of \$2,745 relative to the U.S. dollar, Europe revenues would have increased 6% from \$29,950 to \$31,865. The Company believes the overall increase is due to the success in the Company's DVH cross-selling initiatives.

**Table of Contents****All Other Revenues**

Revenues for All Other for 3Q07 were \$9,805, an increase of 9% compared to revenues for 3Q06 of \$9,012. Excluding the positive impact of exchange rates of \$82 relative to the U.S. dollar, All Other revenues would have increased 8% from \$9,012 to \$9,723.

**Revenue by Service Type****Data Services**

Revenues from Data Services for 3Q07 were \$46,350, a decrease of 2% compared to revenues for 3Q06 of \$47,083. Excluding the positive impact of exchange rates of \$1,176 relative to the U.S. dollar for its International Data Services, Data Services revenues would have decreased 4% from \$47,083 to \$45,174 for 3Q07. The Company believes the overall decrease in Data Services revenue was due to the completion of several nonrecurring projects.

**Voice Services**

Revenues from Voice Services for 3Q07 were \$160,686, an increase of 95% compared to revenues for 3Q06 of \$82,281. The increase was primarily due to the incremental revenue from the Acquired Companies, which added \$98,054 and \$14,952 for 3Q07 and 3Q06, respectively. Excluding the effects of these acquisitions, Voice Services revenues would have decreased 7% from \$67,329 to \$62,632. The Company believes that this overall decrease in Voice Services revenue is primarily due to the completion of nonrecurring projects.

**Hotline Services**

Revenues from Hotline Services for 3Q07 were \$57,770, an increase of 9% compared to revenues for 3Q06 of \$52,771. Excluding the positive impact of exchange rates of \$1,831 relative to the U.S. dollar, Hotline Services revenues would have increased 6% from \$52,771 to \$55,939. The Company believes the overall increase in Hotline Services revenues was driven by the success in the Company's DVH cross-selling initiatives.

**Gross Profit**

Gross profit dollars for 3Q07 were \$96,685, an increase of 32% compared to gross profit dollars for 3Q06 of \$73,402. The Company believes the increase in gross profit dollars was due to the increase in revenues from the Acquired Companies. Gross profit as a percent of revenues for 3Q07 was 36.5%, a decrease of 3.8% compared to gross profit as a percentage of revenues for 3Q06 of 40.3%. The decrease in gross profit percentage was due primarily to the impact of lower gross profit in its Voice Services segment driven by the acquisition of NextiraOne and the impact of lower gross profit in its Hotline Services segment driven by increased product costs and product mix.

Gross profit dollars for Data Services for 3Q07 were \$14,236, or 30.7% of revenues, compared to gross profit dollars for 3Q06 of \$14,794, or 31.4% of revenues. Gross profit dollars for Voice Services for 3Q07 were \$54,566, or 34.0% of revenues, compared to gross profit dollars for 3Q06 of \$32,145, or 39.1% of revenues. Gross profit dollars for Hotline Services for 3Q07 were \$27,883, or 48.3% of revenues, compared to gross profit dollars for 3Q06 of \$26,463, or 50.1% of revenues.

**SG&A Expenses**

Selling, general and administrative ( SG&A ) expenses for 3Q07 were \$73,940, an increase of \$21,068 compared to SG&A expenses for 3Q06 of \$52,872. The increase in SG&A expense dollars over the prior year was due primarily to the Acquired Companies. SG&A expenses as a percent of revenue for 3Q07 were 27.9% compared to 29.0% for 3Q06. The decrease in SG&A as a percent of revenue was due primarily to lower SG&A as a percent of revenues related to the Acquired Companies, a \$700 benefit for the write-off of previously accrued vacation payables due to a change in the Company's vacation policy in some of the Acquired Companies, and a decrease to non-cash stock-based compensation expense of \$591.

**Intangibles Amortization**

Intangibles amortization for 3Q07 was \$2,677, an increase of \$1,328 compared to intangibles amortization for 3Q06 of \$1,349. The increase was primarily attributable to the amortization of intangible assets acquired through the purchase of the Acquired Companies. See Note 10 of the Notes to the Consolidated Financial Statements for further details related to the Acquired Companies.

**Table of Contents****Operating Income**

Operating income for 3Q07 was \$20,068, or 7.6% of revenues, an increase of \$887 compared to operating income for 3Q06 of \$19,181, or 10.5% of revenues.

**Interest Expense, Net**

Net interest expense for 3Q07 was \$4,061, an increase of \$1,664 compared to net interest expense for 3Q06 of \$2,397 due to an increase in the weighted average outstanding debt from \$266,763 for 3Q07 compared to approximately \$149,737 for 3Q06. The increase in debt relates primarily to the acquisitions of NextiraOne and NUVT during the first quarter Fiscal 2007. In addition, the weighted average interest rate outstanding for 3Q07 was 6.25%, an increase of 0.66% compared to the 3Q06 rate of 5.59%.

**Provision for Income Taxes**

The tax provision for 3Q07 was \$5,636, an effective tax rate of 34.9%. This compares to the tax provision for 3Q06 of \$5,631, an effective tax rate of 33.8%. The tax rate for 3Q07 was higher than 3Q06 due to the impact of book stock option expense and the associated tax asset and changes in the overall mix of taxable income among worldwide offices.

**Net Income**

As a result of the foregoing, net income for 3Q07 was \$10,493, or 4.0% of revenues, compared to \$11,039, or 6.1% of revenues, for 3Q06.

**Nine Months Fiscal 2007 (3QYTD07) Compared to Nine Months Fiscal 2006 (3QYTD06):****Total Revenues**

Total revenues for 3QYTD07 were \$766,526, an increase of 40% compared to revenues for 3QYTD06 of \$546,467. The increase was primarily due to the incremental revenue from the Acquired Companies, which added \$280,221 and \$34,345 of revenues to 3QYTD07 and 3QYTD06, respectively. Excluding the effects of the acquisitions and the positive impact of exchange rates of \$4,905 relative to the U.S. dollar, total revenues would have decreased 6% from \$512,122 to \$481,400 for the reasons discussed below.

**Revenues by Geography****North America Revenues**

Revenues in North America for 3QYTD07 were \$644,260, an increase of 51% compared to revenues for 3QYTD06 of \$426,788. The increase was primarily due to the incremental revenue from the Acquired Companies, which added \$280,221 and \$34,345 for 3QYTD07 and 3QYTD06, respectively. Excluding the effects of these acquisitions and the positive impact of exchange rates of \$1,094 relative to the U.S. dollar, North America revenues would have decreased 8% from \$392,443 to \$362,945. The Company believes the overall decrease is due to the completion of several nonrecurring projects, offset in part by success in the Company's DVH cross-selling initiatives.

**Europe Revenues**

Revenues in Europe for 3QYTD07 were \$94,799, an increase of 2% compared to revenues for 3QYTD06 of \$92,899. Excluding the positive impact of exchange rates of \$3,991 relative to the U.S. dollar, Europe revenues would have decreased 2% from \$92,899 to \$90,808. The Company believes the overall decrease is due to the completion of nonrecurring projects offset in part by the success in the Company's DVH cross-selling initiatives.



**Table of Contents****All Other Revenues**

Revenues for All Other for 3QYTD07 were \$27,467, an increase of 3% compared to revenues for 3QYTD06 of \$26,780. Excluding the negative impact of exchange rates of \$180 relative to the U.S. dollar, All Other revenues would have increased 3% from \$26,780 to \$27,647.

**Revenue by Service Type****Data Services**

Revenues from Data Services for 3QYTD07 were \$137,328, a decrease of 10% compared to revenues for 3QYTD06 of \$152,568. Excluding the positive impact of exchange rates of \$2,320 relative to the U.S. dollar for its International Data Services, Data Services revenues would have decreased 12% from \$152,568 to \$135,008. The Company believes the overall decrease in Data Services revenue was due to the completion of several nonrecurring projects.

**Voice Services**

Revenues from Voice Services for 3QYTD07 were \$464,140, an increase of 99% compared to revenues for 3QYTD06 of \$233,620. The increase was primarily due to the incremental revenue from the Acquired Companies, which added \$280,221 and \$34,345 for 3QYTD07 and 3QYTD06, respectively. Excluding the effects of these acquisitions, Voice Services revenues would have decreased 8% from \$199,275 to \$183,919 between periods. The Company believes that this overall decrease in Voice Services revenue is primarily due to the completion of several nonrecurring projects and planned post-merger client attrition from the acquisition of Norstan, Inc. in 4Q05.

**Hotline Services**

Revenues from Hotline Services for 3QYTD07 were \$165,058, an increase of 3% compared to revenues for 3QYTD06 of \$160,279. Excluding the positive impact of exchange rates of \$2,570 relative to the U.S. dollar, Hotline Services revenues would have increased 1% from \$160,279 to \$162,488. The Company believes the stabilization is due in part to the success in the Company's DVH cross-selling initiatives.

**Gross Profit**

Gross profit dollars for 3QYTD07 were \$281,565, an increase of 29% compared to gross profit dollars for 3QYTD06 of \$218,224. The Company believes the increase in gross profit dollars over the prior year was due to the increase in revenues from the Acquired Companies. Gross profit as a percent of revenues for 3QYTD07 was 36.7%, a decrease of 3.2% compared to gross profit as a percentage of revenues for 3QYTD06 of 39.9%. The decrease in gross profit percentage was due primarily to the impact of lower gross profit in its Voice Services segment driven by the acquisition of NextiraOne.

Gross profit dollars for Data Services for 3QYTD07 were \$41,460, or 30.2% of revenues, compared to gross profit dollars for 3QYTD06 of \$45,800, or 30.0% of revenues. Gross profit dollars for Voice Services for 3QYTD07 were \$158,242, or 34.1% of revenues, compared to gross profit dollars for 3QYTD06 of \$91,156, or 39.0% of revenues. Gross profit dollars for Hotline Services for 3QYTD07 were \$81,863, or 49.6% of revenues, compared to gross profit dollars for 3QYTD06 of \$81,268, or 50.7% of revenues.

**SG&A Expenses**

SG&A expenses for 3QYTD07 were \$217,741, an increase of \$61,056 compared to SG&A expenses for 3QYTD06 of \$156,685. The increase in SG&A expense dollars over the prior year was due primarily to the Acquired Companies. SG&A expenses as a percent of revenues for 3QYTD07 were 28.4% compared to 28.7% for 3QYTD06. The decrease in SG&A as a percent of revenue was due primarily to lower SG&A as a percent of revenues related to the Acquired Companies offset in part by an increase in non-cash stock-based compensation expense of \$2,799.

**Table of Contents****Restructuring Charges**

The Company did not record any restructuring charges during 3QYTD07. During 1Q06, the Company recorded a restructuring charge of \$5,290. This charge was comprised of \$3,473 for staffing level adjustments and \$1,817 for real estate consolidations in Europe and North America. Of this charge, \$3,742 and \$1,548 related to Europe and North America, respectively.

**Intangibles Amortization**

Intangibles amortization for 3QYTD07 was \$6,114, an increase of \$1,879 compared to intangible amortization for 3QYTD06 of \$4,235. The increase was primarily attributable to the amortization of intangible assets acquired through the purchase of the Acquired Companies. *See* Note 10 of the Notes to the Consolidated Financial Statements for further details related to the Acquired Companies.

**Operating Income**

Operating income for 3QYTD07 was \$57,710, or 7.5% of revenues, an increase of \$5,696 compared to operating income for 3QYTD06 of \$52,014, or 9.5% of revenues.

**Interest Expense, Net**

Net interest expense for 3QYTD07 was \$13,222, an increase of \$6,536 compared to net interest expense for 3QYTD06 of \$6,686. The increase in interest expense is due to an increase in the weighted average outstanding debt and weighted average interest rate from approximately \$159,476 and 4.86% for 3QYTD06, respectively, to approximately \$251,153 and 6.2% for 3QYTD07, respectively. The increase in debt relates primarily to the acquisitions of NextiraOne and NUVT during the first quarter Fiscal 2007. Also included in interest expense for 3QYTD07 is \$1,308 related to the change in fair value of the Company's interest rate swap.

**Provision for Income Taxes**

The tax provision for 3QYTD07 was \$15,442, an effective tax rate of 34.8%. This compares to the tax provision for 3QYTD06 of \$15,379, an effective tax rate of 34.0%. The tax rate for 3QYTD07 was higher than 3QYTD06 primarily due to changes in the overall mix of taxable income among worldwide offices.

**Net Income**

As a result of the foregoing, net income for 3QYTD07 was \$28,981, or 3.8% of revenues, compared to \$29,870, or 5.5% of revenues, for 3QYTD06.

**Liquidity and Capital Resources****Cash Flows from Operating Activities**

Net cash provided by operating activities during 3QYTD07 was \$24,596. Significant factors contributing to the source of cash were: net income of \$28,981 inclusive of non-cash charges of \$15,333 and \$7,476 for amortization / depreciation expense and stock compensation expense, respectively and an increase in billings in excess of costs and uncompleted contracts of \$5,700. Significant factors contributing to a use of cash were: increase in net inventory of \$6,629, an increase in costs in excess of billings of \$10,161, a decrease in restructuring reserve of \$13,992 and a decrease in deferred revenue of \$5,559. Changes in the above accounts are based on average Fiscal 2007 exchange rates.

Net cash provided by operating activities during 3QYTD06 was \$38,912. Significant factors contributing to a source of cash were: net income of \$29,870 inclusive of non-cash charges of \$11,013 and \$4,677 for amortization / depreciation expense and stock compensation expense, respectively, and a decrease in net inventory of \$5,673. Significant factor contributing to a use of cash was a decrease of accounts payable of \$7,204, a decrease of deferred revenue of 3,017 and a decrease of restructuring reserve of \$2,148. Changes in the above accounts are based on average Fiscal 2006 exchange rates.

As of December 31, 2006 and 2005, the Company had cash and cash equivalents of \$15,362 and \$12,143, respectively, working capital of \$126,879 and \$105,420, respectively, and a current ratio of 1.52 and 1.73, respectively.

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The Company believes that its cash provided by operating activities and availability under its credit facility will be sufficient to fund the Company's working capital requirements, capital expenditures, dividend program, potential stock repurchases, potential future acquisitions or strategic investments and other cash needs for the next 12 months.

**Cash Flows from Investing Activities**

Net cash used by investing activities during 3QYTD07 was \$137,241. Significant factors contributing to a use of cash were: \$3,475 for gross capital expenditures and \$132,878 to acquire NextiraOne, NUVT and NTL. *See* Note 10 of the Notes to the Consolidated Financial Statements for additional details regarding the acquisitions of NextiraOne, NUVT and NTL.

Net cash used by investing activities during 3QYTD06 was \$42,979. Significant factors contributing to a use of cash were: \$3,151 for gross capital expenditures and \$40,682 to acquire TSM, GTC, BCI, Universal, CWIN, and CSG.

**Cash Flows from Financing Activities**

Net cash provided by financing activities during 3QYTD07 was \$117,826. Significant factors contributing to the cash inflow were \$129,075 of net borrowings on long term debt and \$12,141 of proceeds from the exercise of stock options. Significant uses of cash were \$20,206 for the repurchase of common stock and \$3,157 for the payment of dividends.

Net cash provided by financing activities during 3QYTD06 was \$5,016. Significant factors contributing to the cash inflow were \$16,344 of proceeds from the exercise of stock options. Significant uses of cash were \$7,418 in long term debt payments and \$3,049 for the payment of dividends.

**Total Debt**

On March 28, 2006, the Company entered into a Second Amendment to the Second Amended and Restated Credit Agreement dated January 24, 2005, as amended February 17, 2005 (collectively, and previously defined as the "Credit Agreement") with Citizens Bank of Pennsylvania, as agent, and a group of lenders. The Credit Agreement expires on March 28, 2011. Borrowings under the Credit Agreement are permitted up to a maximum amount of \$310,000, which includes up to \$15,000 of swing line loans and \$25,000 of letters of credit. The Credit Agreement may be increased by the Company up to an additional \$90,000 with the approval of the lenders and may be unilaterally and permanently reduced by the Company to not less than the then outstanding amount of all borrowings. Interest on outstanding indebtedness under the Credit Agreement accrues, at the Company's option, at a rate based on either: (a) the greater of (i) the prime rate per annum of the agent then in effect and (ii) 0.50% plus the rate per annum announced by the Federal Reserve Bank of New York as being the weighted average of the rates on overnight Federal funds transactions arranged by Federal funds brokers on the previous trading day or (b) a rate per annum equal to the LIBOR rate plus 0.75% to 1.25% (determined by a leverage ratio based on the Company's EBITDA). The Credit Agreement requires the Company to maintain compliance with certain non-financial and financial covenants such as minimum net worth, leverage and fixed charge coverage ratios. As of December 31, 2006, the Company was in compliance with all required covenants under the Credit Agreement.

As of December 31, 2006, the Company had total debt outstanding of \$254,525. Total debt was comprised of \$251,410 outstanding under the credit agreement, \$1,308 for the fair value of the interest rate swap, \$1,671 of obligations under capital leases and \$136 of various other third-party, non-employee loans. The weighted average interest rate on all indebtedness of the Company during 3Q07 and 3QYTD07 was approximately 6.25% and 6.20% respectively. The weighted average interest rate on all indebtedness of the Company during 3Q06 and 3QYTD06 was approximately 5.59% and 4.86%, respectively.

**Dividends**

During 1Q07, the Board declared a cash dividend of \$0.06 per share on all outstanding shares of common stock. The dividend totaled \$1,061 and was paid on July 14, 2006 to stockholders of record at the close of business on June 30, 2006. During 2Q07, the Board declared a cash dividend of \$0.06 per share on all outstanding shares of common stock. The dividend totaled \$1,041 and was paid on October 13, 2006 to stockholders of record at the close of business on September 29, 2006. During 3Q07, the Board declared a cash dividend of \$0.06 per share on all outstanding shares of common stock. The dividend totaled \$1,047 and was paid on January 15, 2007 to stockholders of record at the close of business on December 29, 2006. In aggregate, the Company has declared cash dividends of \$3,149 or \$0.18 per share during the nine (9) month period ended December 31, 2006. While the Company expects to continue to declare

dividends for the foreseeable future, there can be no assurance as to the timing or amount of such dividends.

**Table of Contents****Repurchase of Common Stock**

During 2Q07, the Company repurchased approximately 441,000 shares of common stock for \$17,587. During 3Q07, the Company repurchased approximately 60,000 shares of common stock for \$2,620. Since inception of the repurchase program in April 1999 through December 31, 2006, the Company has repurchased in aggregate approximately 7,436,000 shares of common stock for approximately \$317,030. Funding for the stock repurchases came primarily from existing cash flow from operations. Additional repurchases of stock may occur from time to time depending upon factors such as the Company's cash flows and general market conditions. While the Company expects to continue to repurchase shares of common stock for the foreseeable future, there can be no assurance as to the timing or amount of such repurchases.

**Significant Accounting Policies**

The significant accounting policies used in the preparation of the Company's consolidated financial statements are disclosed in Note 1 within the Notes to the Consolidated Financial Statements for the year ended March 31, 2006 contained in Form 10-K. Additional significant accounting policies adopted during Fiscal 2007 are disclosed below.

*Stock-Based Compensation*

On April 1, 2006, the Company adopted SFAS 123(R) which requires companies to estimate the fair value of share-based payment awards and recognize compensation expense over the requisite service period for the portion of the award that is ultimately expected to vest. Prior to the adoption of SFAS 123(R), the Company accounted for share-based awards to employees and directors using the intrinsic value method in accordance with APB 25 as allowed under SFAS 123. Under the intrinsic value method, no stock-based compensation expense related to stock options was required to be recognized if the exercise price of the Company's stock options granted to employees and directors was equal to or greater than the fair market value of the underlying stock on the measurement date.

The Company adopted SFAS 123(R) using the modified prospective transition method which requires compensation cost to be recognized for all share-based payments granted after the date of adoption and for all unvested awards existing on the date of adoption. In accordance with the modified prospective transition method, the Company's Consolidated Financial Statements for prior periods have not been retroactively adjusted to reflect, and do not include, the impact of SFAS 123(R). However, the modified prospective transition method does require the Company to provide pro-forma disclosure of specific income statement line items for periods prior to the adoption of SFAS 123(R) as if the fair-value-based method had been applied to all awards. *See* Note 14 of the Notes to the Consolidated Financial Statements.

SFAS 123(R) requires companies to estimate the fair value of share-based payment awards on the grant-date using an option-pricing model. Upon adoption of SFAS 123(R), the Company began using the Black-Scholes option pricing model as the method of valuation for the Company's stock options. The model requires the use of various assumptions. The key assumptions are summarized as follows:

*Expected Volatility:* The Company estimates the volatility of the common stock at the date of grant based on the historical volatility of its common stock.

*Dividend Yield:* The Company estimates the dividend yield assumption based on the Company's historical and projected dividend payouts.

*Risk-free interest rate:* The Company bases risk-free interest rate on the observed interest rates appropriate for the term of the Company's employee stock options.

*Annual forfeiture rate and expected holding period:* The Company estimates the annual forfeiture rate and expected holding period based on historical experience.

*Amortization period:* The Company recognizes the fair value of awards into expense over the requisite service periods associated with the award.

**Impact of Recently Issued Accounting Pronouncements***Fair Value Option for Financial Assets and Financial Liabilities*

In February 2007, the Financial Accounting Standards Board ( FASB ) issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* ( SFAS 159 ). SFAS 159 permits an entity to elect to measure eligible items at fair value ( fair value option ) including many financial instruments. The provisions of SFAS 159 are



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effective for the Company as of April 1, 2008. If the fair value option is elected, the Company will report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Upfront costs and fees related to items for which the fair value option is elected shall be recognized in earnings as incurred and not deferred. The fair value option may be applied for a single eligible item without electing it for other identical items, with certain exceptions, and must be applied to the entire eligible item and not to a portion of the eligible item. The Company is currently evaluating the irrevocable election of the fair value option pursuant to SFAS 159.

*Prior Year Misstatements on Current Year Financial Statements*

In September 2006, the SEC issued Staff Accounting Bulletin No. 108 ( SAB 108 ), *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* . SAB 108 provides interpretive guidance on how the effects of prior year uncorrected misstatements should be considered when quantifying misstatements in current year financial statements for the purpose of a materiality assessment. SAB 108 is effective as of the Company's fiscal year end March 31, 2007. The Company adopted SAB 108 as of March 31, 2007. The adoption of SAB 108 did not have a material impact on its consolidated financial statements.

*Fair Value Measurements*

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* ( SFAS 157 ), which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 is effective for the Company beginning on April 1, 2008. The Company is evaluating the impact of the adoption of SFAS 157 on the Company's consolidated financial statements.

*Defined Benefit Pension and Other Postretirement Plans*

In September 2006, the FASB issued SFAS No 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans* ( SFAS 158 ). This standard requires, among other things, companies to recognize on the balance sheet the funded or unfunded status of pension and other postretirement benefit plans and to recognize the change in funded status in the period the change occurs through comprehensive income. The provisions of SFAS 158 are effective as of the Company's fiscal year end March 31, 2007. The Company adopted SFAS 158 as of March 31, 2007. The adoption of SFAS 158 had no impact on the Company's Statement of Operations on the date of adoption. However, the Company did record a gain into other comprehensive income of approximately \$2.7 million (1.7 million, net of tax.)

*Uncertainty in Income Taxes*

In July 2006, the FASB issued FASB Interpretation No. 48 ( FIN 48 ), *Accounting for Uncertainty in Income Taxes* which clarifies the accounting for uncertainty in tax positions. The Company plans to adopt the Interpretation as of April 1, 2007. The Interpretation is currently being evaluated by the Company for its full impact and, at this time, the Company believes it has properly and adequately provided for all income tax positions and therefore expects minimal impact from adopting the Interpretation.

*Definition of Settlement in FIN 48*

In May 2007, the FASB issued staff position No. FIN 48-1 ( FSP FIN 48-1 ), *Definition of Settlement in FASB Interpretation No. 48* which amended FIN 48 to provide guidance about how an enterprise should determine whether a tax position is effectively settled for the purpose of recognizing previously unrecognized tax benefits. The Company plans to adopt FSP FIN 48-1 in conjunction with adoption of FIN 48 as of April 1, 2007. This staff position is currently being evaluated by the Company for its full impact and, at this time, the Company believes it has properly and adequately provided for all income tax positions and therefore expects minimal impact from adoption.

*Stock-Based Compensation*

On April 1, 2006, the Company adopted the provisions of SFAS 123(R). For the three and nine month periods ended December 31, 2006, the Company recognized compensation expense of \$1,840 (\$1,196 net of tax) or \$0.07 per diluted share and \$7,476 (\$4,860 net of tax) or \$0.27 per diluted share, respectively on the Company's Consolidated Statements of Income. See Note 2 and Note 14 of the Notes to the Consolidated Financial Statements for reference.

*Tax Effects of Share-Based Payment Awards*

On November 10, 2005, the FASB issued Staff Position No. SFAS 123(R)-3, *Transition Election Related to Accounting for Tax Effects of Share-Based Payment Awards* ( SFAS 123(R)-3 ). The alternative transition method

includes simplified methods to establish the beginning balance of the additional paid-in capital pool ( APIC pool ) related to the tax effects of employee share-based compensation, and to determine the subsequent impact on the APIC pool and Consolidated Statements of Cash Flows of the tax effects of employee share-based compensation awards that are outstanding upon adoption of SFAS 123(R). The company has elected this transition method for calculating tax effects of share-based payment awards.



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**Inflation**

The overall effects of inflation on the Company have been nominal. Although long-term inflation rates are difficult to predict, the Company continues to strive to minimize the effects of inflation through improved productivity and cost reduction programs as well as price adjustments within the constraints of market competition.

**Cautionary Forward Looking Statements**

When included in this Quarterly Report on Form 10-Q or in documents incorporated herein by reference, the words expects, intends, anticipates, believes, estimates and analogous expressions are intended to identify forward-looking statements. Such statements are inherently subject to a variety of risks and uncertainties that could cause actual results to differ materially from those projected. Such risks and uncertainties include, among others, the timing and final outcome of the ongoing review of the Company's stock option practices, including the related SEC investigation, shareholder derivative lawsuit, NASDAQ process regarding listing of the common stock and tax matters, and the impact of any actions that may be required or taken as a result of such review, SEC investigation, shareholder derivative lawsuit, NASDAQ process or tax matters, levels of business activity and operating expenses, expenses relating to corporate compliance requirements, cash flows, global economic and business conditions, successful integration of acquisitions, including the NextiraOne business, the timing and costs of restructuring programs, successful marketing of DVH (Data, Voice, and Hotline) Services, successful implementation of our M&A program, including identifying appropriate targets, consummating transactions and successfully integrating the businesses, competition, changes in foreign, political and economic conditions, fluctuating foreign currencies compared to the U.S. dollar, rapid changes in technologies, client preferences, the ability of the Company to identify, acquire and operate additional technical services companies and various other matters, many of which are beyond the Company's control. These forward-looking statements are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995 and speak only as of the date of this Quarterly Report on Form 10-Q. The Company expressly disclaims any obligation or undertaking to release publicly any updates or any changes in the Company's expectations with regard thereto or any change in events, conditions or circumstances on which any statement is based.

**Table of Contents****Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

The Company is exposed to market risks in the ordinary course of business that include interest rate volatility and foreign currency exchange rates volatility. Market risk is measured as the potential negative impact on earnings, cash flows or fair values resulting from a hypothetical change in interest rates or foreign currency exchange rates over the next year.

**Interest Rate Risk**

The Company's primary interest rate risk relates to its long-term debt obligations. As of December 31, 2006, the Company had total long-term obligations of \$254,525, including the current portion of those obligations of \$587. Of the outstanding debt, \$1,810 was in fixed rate obligations, \$100,000 was in variable rate debt that was effectively converted to a fixed rate through an interest rate swap agreement and \$151,410 was in variable rate obligations. As of December 31, 2006, an instantaneous 100 basis point increase in the interest rate of the variable rate debt would reduce the Company's net income in the subsequent quarter by \$384 assuming the Company employed no intervention strategies.

To mitigate the risk of interest-rate fluctuations associated with the Company's variable rate long-term debt, the Company has implemented an interest-rate risk management strategy that incorporates the use of derivative instruments to minimize significant unplanned fluctuations in earnings caused by interest-rate volatility. The Company's goal is to manage interest-rate sensitivity by modifying the re-pricing characteristics of certain balance sheet liabilities so that the net-interest margin is not, on a material basis, adversely affected by the movements in interest rates.

On July 26, 2006, the Company entered into an interest rate swap which has been used to effectively convert a portion of the Company's variable rate debt to fixed rate. The interest rate swap has a notional value of \$100,000 reducing to \$50,000 after three years and does not qualify for hedge accounting. Changes in the fair market value of the interest rate swap are recorded as an asset or liability in the Company's Consolidated Balance Sheet and Interest Expense (Income) in the Company's Consolidated Statements of Income.

**Foreign Exchange Rate Risk**

The Company has operations, clients and suppliers worldwide, thereby exposing the Company's financial results to foreign currency fluctuations. In an effort to reduce this risk of foreign currency fluctuations, the Company generally sells and purchases inventory based on prices denominated in U.S. dollars. Intercompany sales to subsidiaries are generally denominated in the subsidiaries' local currency. The Company has entered and will continue in the future, on a selective basis, to enter into foreign currency forward contracts to reduce the foreign currency exposure related to certain intercompany transactions, primarily trade receivables and loans. All of the foreign currency forward contracts have been designated and qualify as cash flow hedges. The effective portion of any changes in the fair value of the derivative instruments is recorded in OCI until the hedged forecasted transaction occurs or the recognized currency transaction affects earnings. Once the forecasted transaction occurs or the recognized currency transaction affects earnings, the effective portion of any related gains or losses on the cash flow hedge is reclassified from OCI to other expense (income) in the Company's Consolidated Statement of Income. In the event it becomes probable that the hedged forecasted transaction will not occur, the ineffective portion of any gain or loss on the related cash flow hedge would be reclassified from OCI to other expense (income).

As of December 31, 2006, the Company had open foreign exchange contracts in Australian and Canadian dollars, Danish krone, Euro, Japanese yen, Norwegian kroner, Pound sterling, Swedish krona and Swiss franc. The open contracts have contract rates ranging from 1.2658 to 1.3407 Australian dollar, 1.1141 to 1.1472 Canadian dollar, 5.6222 to 5.8136 Danish krone, 0.7482 to 0.8185 Euro, 105.47 to 110.10 Japanese yen, 6.0294 to 6.4315 Norwegian kroner, 0.5069 to 0.5435 Pound sterling, 6.7675 to 7.1925 Swedish krona and 1.1827 to 1.2133 Swiss franc, all per U.S. dollar. The total open contracts had a notional amount of approximately \$63,994, have a fair value of \$63,692 and will expire within twenty-seven months. The Company does not hold or issue any other financial derivative instruments nor does it engage in speculative trading of financial derivatives.

**Table of Contents****Item 4. Controls and Procedures****Evaluation of Disclosure Controls and Procedures**

As disclosed in the Explanatory Note and in Note 3 of the Notes to Consolidated Financial Statements in this Form 10-Q, and as previously disclosed, the Audit Committee, with the assistance of outside legal counsel, commenced an independent review of the Company's historical stock option grant practices and related accounting for stock option grants for the Review Period. On March 19, 2007, the Audit Committee concluded that the exercise price of certain stock option grants differed from the fair market value of the underlying shares on the appropriate measurement date. At that time, the Company and the Audit Committee announced that it was currently expected that the Company's additional non-cash, pre-tax charges for stock-based compensation expense relating to certain stock option grants would approximate \$63 million (subsequently adjusted as set forth elsewhere in this Form 10-Q) for the Review Period. In addition, the Company and the Audit Committee concluded that the Company would need to restate its previously-issued financial statements contained in reports previously filed by the Company with the SEC. Accordingly, on March 19, 2007, the Company and the Audit Committee concluded that the Company's previously-issued financial statements and other historical financial information and related disclosures for the Review Period, including applicable reports of its current or former independent registered public accounting firms and related press releases, should not be relied upon.

In connection with the preparation of this Form 10-Q, an evaluation was performed, under the supervision and with the participation of Company management, including the CEO and the CFO, of the effectiveness of the design and operation of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e)) under the Securities Exchange Act of 1934, as amended (the Exchange Act), as of December 30, 2006. Based on that evaluation and the foregoing, management, including the CEO and the CFO, has concluded that, as of December 30, 2006, the Company had a material weakness in internal control over financial reporting with respect to the Company's stock option grant practices and related accounting for stock option grants and that, as a result of this material weakness in internal control over financial reporting, its disclosure controls and procedures were not effective as of December 30, 2006.

There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including cost limitations, judgments used in decision making, assumptions regarding the likelihood of future events, soundness of internal controls, fraud, the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can provide only reasonable, and not absolute, assurance of achieving their control objectives.

**Changes in Internal Control Over Financial Reporting**

During the three (3) and nine (9) month periods ended December 30, 2006, there had been no change in the Company's internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting.

As of the date of filing of this Form 10-Q, management has made significant revisions to the Company's internal control structure surrounding the Company's stock option grant practices, including the formalization of documentation with respect to appropriate approvals for stock option grants and additional levels of review with respect to stock option grant terms, which management believes should facilitate the prevention and/or detection of material errors in future periods. Also, as of the date of filing of this Form 10-Q, the Audit Committee has completed its review of the Company's stock option grant practices and continues to analyze the facts discovered in its review in order to make additional recommendations for appropriate remedial actions regarding the Company's stock option grant practices and related accounting for stock option grants. It is anticipated that the Company will adopt and implement any such additional recommendations. Pending the Audit Committee's consideration of and the Company's implementation of these recommendations, the Company has not made and does not intend to make any stock option grants. The Company also took action to suspend the exercise of outstanding stock options. It is anticipated that the Company will permit stock option exercises following the filing of this Form 10-Q and the FY07 Form 10-K.

The scope of management's assessment of the effectiveness of internal controls over financial reporting includes all of the Company's material businesses except for NextiraOne, a material business acquired on April 30, 2006. The NextiraOne portion of the business will be included in the current year assessment to be completed as of March 31, 2007.



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**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings.**

*Regulatory Matters*

As previously disclosed, on November 13, 2006, the Company received a letter of informal inquiry from the Enforcement Division of the SEC relating to the Company's stock option practices from January 1, 1997 to present. On May 24, 2007, the SEC issued a formal order of investigation in connection with this matter, and, on May 29, 2007, the Company received a document subpoena from the SEC acting pursuant to such order. The Company has cooperated with the SEC in this matter and intends to continue to do so.

As previously announced, the Audit Committee of the Board of Directors of the Company, with the assistance of outside legal counsel, is conducting an independent review of the Company's historical stock option grant practices and related accounting for stock option grants. See the Explanatory Note preceding Part I, Item 1 of this Form 10-Q for more information regarding this and related matters.

On September 20, 2006, the Company received formal notice from the Internal Revenue Service ( IRS ) regarding its intent to begin an audit of the Company's tax years 2004 and 2005. In connection with this normal recurring audit, the IRS has requested certain documentation with respect to stock options for the Company's 2004 and 2005 tax years. The Company has produced various documents requested by the IRS and is currently in the process of responding to additional documentation requests.

At the conclusion of these regulatory matters, the Company could be subject to additional taxes, fines or penalties which could be material.

*Litigation Matters*

In November 2006, two stockholder derivative lawsuits were filed against the Company itself, as a nominal defendant, and several of the Company's current and former officers and directors in the United States District Court for the Western District of Pennsylvania. The two substantially identical stockholder derivative complaints allege that the individual defendants improperly backdated grants of stock options to several officers and directors in violation of the Company's stockholder-approved stock option plans during the period 1996-2002, improperly recorded and accounted for backdated stock options in violation of generally accepted accounting principles, improperly took tax deductions based on backdated stock options in violation of the Code produced and disseminated false financial statements and SEC filings to the Company's stockholders and to the market that improperly recorded and accounted for the backdated option grants, concealed the alleged improper backdating of stock options and obtained substantial benefits from sales of Company stock while in the possession of material inside information. The complaints seek damages on behalf of the Company against certain current and former officers and directors and allege breach of fiduciary duty, unjust enrichment, securities law violations and other claims. The two lawsuits have been consolidated into a single action as *In re Black Box Corporation Derivative Litigation*, Master File No. 2:06-CV-1531-TMH, and plaintiffs filed a consolidated amended complaint on January 29, 2007. The parties have stipulated that responses by the defendants, including the Company, are due on or before August 1, 2007. The Company may have indemnification obligations arising out of this matter to its current and former directors and officers named in this litigation. The Company has made a claim for such costs under an insurance policy.

The Company is involved in, or has pending, various legal proceedings, claims, suits and complaints arising out of the normal course of business.

As previously disclosed, the Company received a subpoena, dated December 8, 2004, from the United States General Services Administration ( GSA ), Office of Inspector General. The subpoena requires production of documents and information. The Company understands that the materials are being sought in connection with an investigation regarding potential violations of the terms of a GSA Multiple Award Schedule contract. The Company has not received any communication on this matter from the GSA since June 2005.

Based on the facts currently available to the Company, management believes the matters described under this caption

Litigation Matters are adequately provided for, covered by insurance, without merit or not probable that an unfavorable outcome will result.

**Item 1A. Risk Factors.**

In addition to the Risk Factors set forth in the Company's Form 10-K for the fiscal year ended March 31, 2006, you should carefully consider the following risk factor, as well as the other information contained in this document, when evaluating your investment in our securities.

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**Stock options matters** As previously disclosed, on November 13, 2006, we received a letter of informal inquiry from the Enforcement Division of the SEC relating to the Company's stock option practices from January 1, 1997 to present. Our Audit Committee, with the assistance of outside legal counsel, is conducting an independent review of the Company's historical stock option grant practices and related accounting for stock option grants. On May 24, 2007, the SEC issued a formal order of investigation in connection with this matter, and, on May 29, 2007, we received a document subpoena from the SEC acting pursuant to such order. We have cooperated with the SEC in this matter and intend to continue to do so. See the Explanatory Note preceding Part I, Item 1 of this Form 10-Q for more information regarding this and related matters.

On September 20, 2006, we received formal notice from the IRS regarding its intent to begin an audit of our tax years 2004 and 2005. In connection with this normal recurring audit, the IRS has requested certain documentation with respect to stock options for our 2004 and 2005 tax years. We have produced various documents requested by the IRS and are currently in the process of responding to additional documentation requests.

In addition, in November 2006, two stockholder derivative lawsuits were filed against the Company, as a nominal defendant, and several of our current and former officers and directors in the United States District Court for the Western District of Pennsylvania. The two substantially identical stockholder derivative complaints allege that the individual defendants improperly backdated grants of stock options to several officers and directors in violation of our stockholder-approved stock option plans during the period 1996-2002, improperly recorded and accounted for backdated stock options in violation of generally accepted accounting principles, improperly took tax deductions based on backdated stock options in violation of the Code, produced and disseminated false financial statements and SEC filings to our stockholders and to the market that improperly recorded and accounted for the backdated option grants, concealed the alleged improper backdating of stock options and obtained substantial benefits from sales of Company stock while in the possession of material inside information. The complaints seek damages on behalf of the Company against certain current and former officers and directors and allege breach of fiduciary duty, unjust enrichment, securities law violations and other claims. The two lawsuits have been consolidated into a single action as *In re Black Box Corporation Derivative Litigation*, Master File No. 2:06-CV-1531-TMH, and plaintiffs filed a consolidated amended complaint on January 29, 2007. The parties have stipulated that responses by the defendants, including the Company, are due on or before August 1, 2007.

The stock options investigations and related litigation have imposed, and are likely to continue to impose, significant costs on us, both monetarily and in requiring attention by our management team. While we are unable to estimate the costs that we may incur in the future, these are likely to include:

- professional fees in connection with the conduct of the investigations, the restatement of our financial statements and the defense of the litigation;

- potential damages, fines, penalties or settlement costs; and

- payments to, or on behalf of, our current and former officers and directors subject to the investigation or named in the litigation pursuant to our indemnification obligations (in certain circumstances these indemnification payments are recoverable if it is determined that the officer or director at issue acted improperly, but there is no assurance that we will be able to recover such payments).

While we expect that certain of such costs will be reimbursed pursuant to an insurance policy, at this point such costs have not been reimbursed.

In the course of our investigation, we have determined that a number of executives may have exercised options for which the application of Section 162(m) may apply. It is possible that these options will be treated as having been granted at less than fair market value for federal income tax purposes because we incorrectly applied the measurement date as defined in APB 25. If such options are deemed to be granted at less than fair market value, pursuant to Section 162(m), any compensation to our executive officers, including proceeds from options exercised in any given tax year in excess of \$1.0 million, will be disallowed as a deduction for tax purposes. We estimate that the potential tax effected liability for the disallowed Section 162(m) deduction is \$3.6 million. We may also incur interest and penalties if we were to incur any such tax liability, which could be material.

In addition, we are considering the application of Section 409A to those options for which we incorrectly applied the measurement date as defined in APB 25. It is possible that these options will be treated as having been granted at less

than fair market value for federal income tax purposes and thus subject to Section 409A. Accordingly, we may adopt remedial measures to address the application of Section 409A. We do not currently know what impact any remedial measures, if adopted, would have on our results of operations, financial position or cash flows, although such impact could be material.

Adverse developments in the legal proceedings or the investigation arising out of our historical stock option granting practices or any other matter raised as a result thereof could have an adverse impact on our business and our stock price, including increased stock volatility.



**Table of Contents****Item 2. Unregistered Sales of Equity Securities and Use of Proceeds.**

<b>Period</b>	<b>(a) Total Number of Shares (or Units)  Purchased</b>	<b>(b) Average Price Paid per Share (or Unit)</b>	<b>(c) Total Number of Shares (or Units) Purchased as Part of Publicly Announced Plans or Programs</b>	<b>(d) Maximum Number (or Approximate Dollar Value) of Shares (or Units) that May Yet Be Purchased Under the Plans or Programs</b>
October 1, 2006 to October 29, 2006	--	--	--	123,973 <sup>(1)</sup>
October 30, 2006 to November 26, 2006	60,028	43.64	60,028	1,063,945 <sup>(2)</sup>
November 27, 2006 to December 30, 2006	--	--	--	1,063,945
<b>Total</b>	<b>60,028</b>	<b>43.64</b>	<b>60,028</b>	<b>1,063,945</b>

<sup>(1)</sup> As of October 1, 2006, 123,973 shares were available for repurchase under repurchase programs approved by the Board of Directors and announced on November 20, 2003 and August 12, 2004.

<sup>(2)</sup> Amount includes an increase 1,000,000 shares in the repurchase program

approved by the  
Board of  
Directors on  
November 7,  
2006.

The repurchase programs have no expiration date and no programs were terminated prior to the full repurchase of the authorized amount.

Additional repurchases of stock may occur from time to time depending upon factors such as the Company's cash flows and general market conditions. While the Company expects to continue to repurchase shares of the common stock for the foreseeable future, there can be no assurance as to the timing or amount of such repurchases.

Under the Company's Credit Agreement, the Company is permitted to pay dividends on and repurchase common stock as long as no Event of Default or Potential Default (each as defined in the Credit Agreement) occurs or is continuing.

**Item 6. Exhibits.**

Exhibit

Number Description

- |      |   |
|------|---|
| 10.1 | Waiver Letter dated February 28, 2007 by and among Black Box Corporation of Pennsylvania and Norstan, Inc., as Borrowers, the Company, the Guarantors parties thereto, the Lenders parties thereto and Citizens Bank of Pennsylvania <sup>(1)</sup> |
| 10.2 | Waiver Letter dated May 28, 2007 by and among Black Box Corporation of Pennsylvania and Norstan, Inc., as Borrowers, the Company, the Guarantors parties thereto, the Lenders parties thereto and Citizens Bank of Pennsylvania <sup>(1)</sup>      |
| 10.3 | Waiver Letter dated June 11, 2007 by and among Black Box Corporation of Pennsylvania and Norstan, Inc., as Borrowers, the Company, the Guarantors parties thereto, the Lenders parties thereto and Citizens Bank of Pennsylvania <sup>(1)</sup>     |
| 10.4 | Description of Executive Officer Incentive Bonus Plan for Fiscal 2008 <sup>(1)</sup>  |
| 10.5 | Summary of Director Compensation <sup>(1)</sup>   |
| 21.1 | Subsidiaries of the Registrant <sup>(1)</sup>   |

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- 31.1 Certification of the Chief Executive Officer pursuant to Rule 13a-14(a) of the Securities and Exchange Act of 1934, as amended, and Section 302 of the Sarbanes-Oxley Act of 2002 <sup>(1)</sup>
- 31.2 Certification of the Chief Financial Officer pursuant to Rule 13a-14(a) of the Securities and Exchange Act of 1934, as amended, and Section 302 of the Sarbanes-Oxley Act of 2002 <sup>(1)</sup>
- 32.1 Certification of the Chief Executive Officer and Chief Financial Officer pursuant to Rule 13a-14(b) of the Securities and Exchange Act of 1934, as amended, and 18 U.S.C. Section 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 <sup>(1)</sup>

<sup>(1)</sup> Filed herewith.

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**SIGNATURE**

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

**BLACK BOX CORPORATION**

Dated: July 23, 2007

By: /s/ Michael McAndrew

Michael McAndrew, Vice President,  
Chief Financial Officer, Treasurer, Secretary  
and Principal Accounting Officer

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**EXHIBIT INDEX**

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Number Description

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- 10.4 Description of Executive Officer Incentive Bonus Plan for Fiscal 2008 <sup>(1)</sup>
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<sup>(1)</sup> Filed herewith.