

Veri-Tek International, Corp.  
Form 10-Q  
August 14, 2006  
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## SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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### FORM 10-Q

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

For the quarterly period ended June 30, 2006

OR

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

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

Commission File Number: 001-32401

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## VERI-TEK INTERNATIONAL, CORP.

(Exact name of registrant as specified in its charter)

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Michigan  
(State or other jurisdiction of  
incorporation or organization)

50120 Pontiac Trail, Wixom, MI 48393

(Address of principal executive offices)

(Zip Code)

42-1628978  
(I.R.S. Employer

Identification Number)

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(248) 560-1000

(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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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 an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). Yes  No

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

The number of shares of the registrant's common stock, no par value, outstanding as of July 31, 2006 was 5,109,875.

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**Table of Contents****VERI-TEK INTERNATIONAL, CORP.****FORM 10-Q INDEX**

This report contains statements (including certain projections and business trends) accompanied by such phrases as assumes, anticipates, believes, expects, estimates, projects, will and other similar expressions, that are forward looking statements as defined in the Private Securities Litigation Reform Act of 1995. Statements regarding future operating performance, new programs expected to be launched and other future prospects and developments are based upon current expectations and involve certain risks and uncertainties that could cause actual results and developments to differ materially. Potential risks and uncertainties include such factors as demand for the Company's products, pricing, the Company's growth strategy, including its ability to consummate and successfully integrate future acquisitions, industry cyclicality and seasonality, the Company's ability to continuously improve production technologies, activities of competitors and other risks detailed in the Company's filings with the Securities and Exchange Commission (SEC). These forward looking statements are made only as of the date hereof.

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**Table of Contents****PART I: FINANCIAL INFORMATION****Item 1: Financial Statements****VERI-TEK INTERNATIONAL, CORP.****BALANCE SHEETS**

(in thousands)

	June 30,	December 31,
	2006	2005
	(Unaudited)	2005
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and Cash Equivalents	\$ 566	\$ 2,025
Accounts Receivable - Trade, net	2,721	1,837
Accounts Receivable - Other		2
Costs and Estimated Earnings in Excess of Billings, net	1,584	2,461
Inventory at Cost	1,050	1,162
Prepaid Expenses	200	136
<b>Total Current Assets</b>	<b>6,121</b>	<b>7,623</b>
<b>Property, Plant and Equipment, net</b>	<b>2,276</b>	<b>2,085</b>
<b>Other Assets</b>		
Security Deposits	48	48
Loan Costs, net	11	23
Patents, net	4,064	4,212
Software, net	119	130
Deferred Tax Asset	3,518	3,106
<b>Total Other Assets</b>	<b>7,760</b>	<b>7,519</b>
<b>Total Assets</b>	<b>\$ 16,157</b>	<b>\$ 17,227</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>Current Liabilities</b>		
Accounts Payable - Trade	\$ 303	\$ 767
Accrued Expenses	280	269
Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts	160	
<b>Total Current Liabilities</b>	<b>743</b>	<b>1,036</b>
<b>Long-Term Liabilities</b>		
Deferred Tax Liability	27	20
<b>Total Long-Term Liabilities</b>	<b>27</b>	<b>20</b>
<b>Total Liabilities</b>	<b>770</b>	<b>1,056</b>
<b>Shareholders Equity</b>		

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Common Stock - No Par Value, Authorized 20,000,000 shares, Issued and Outstanding 4,875,000 shares	22,332	22,332
Retained Earnings (Accumulated Deficit)	(6,945)	(6,161)
Shareholders' Equity	15,387	16,171
Total Liabilities and Shareholders' Equity	\$ 16,157	\$ 17,227

The accompanying notes are an integral part of these financial statements

**Table of Contents****VERI-TEK INTERNATIONAL, CORP.****STATEMENTS OF INCOME**

(Unaudited, in thousands, except for per share amounts)

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2006	2005	2006	2005
Sales	\$ 1,675	\$ 1,142	\$ 3,912	\$ 2,201
Cost of Sales	1,717	984	3,944	2,339
Gross Profit (Loss)	(42)	158	(32)	(138)
Research and Development Costs		171	1	364
Selling, General and Administrative Expenses	610	736	1,187	1,427
Income (Loss) from Operations	(652)	(749)	(1,220)	(1,929)
Other Income (Expense)				
Interest Income	12	58	31	64
Interest Expense				(54)
Total Other Income (Expense)	12	58	31	10
Income (Loss) Before Income Taxes	(640)	(691)	(1,189)	(1,919)
Income Tax Benefit	226	218	405	634
<b>Net Income (Loss)</b>	<b>(414)</b>	<b>(473)</b>	<b>(784)</b>	<b>(1,285)</b>
<b>Earnings Per Share</b>				
Basic	\$ (0.08)	\$ (0.10)	\$ (0.16)	\$ (0.34)
Diluted	\$ (0.08)	\$ (0.10)	\$ (0.16)	\$ (0.31)
<b>Weighted Average Common Shares</b>				
Basic	4,875,000	4,875,000	4,875,000	3,809,329
Diluted	4,875,000	4,875,000	4,875,000	4,113,260

The accompanying notes are an integral part of these financial statements

**Table of Contents****VERI-TEK INTERNATIONAL, CORP.****STATEMENTS OF CASH FLOWS****(Unaudited, in thousands)**

	Six Months Ended	
	2006	June 30, 2005
<b>Cash Flows From Operating Activities:</b>		
Net Income (Loss)	\$ (784)	\$ (1,285)
Adjustments to Reconcile Net Income to Cash		
Provided by Operating Activities:		
Depreciation and Amortization	292	204
Bad Debt Expense	(13)	
Changes in Operating Assets and Liabilities:		
(Increase) Decrease in Accounts Receivable	(869)	103
(Increase) Decrease in Costs and Estimated Earnings in Excess of Billings	877	1,560
(Increase) Decrease in Inventory	112	(317)
(Increase) Decrease in Prepaid Expenses	(64)	439
(Increase) Decrease in Deferred Tax Asset	(412)	(639)
Increase (Decrease) in Accounts Payable	(464)	(714)
Increase (Decrease) in Accrued Expenses	11	(340)
Increase (Decrease) in Billings in Excess of Costs and Estimated Earnings on Uncompleted Contracts	160	398
Increase (Decrease) in Deferred Tax Liability	7	5
Net Cash Used For Operating Activities	(1,147)	(586)
<b>Cash Flows From Investing Activities</b>		
Purchase of Property and Equipment	(310)	(373)
Investment in Patents		(37)
Investment in Software	(2)	
Net Cash Used For Investing Activities	(312)	(410)
<b>Cash Flows From Financing Activities</b>		
Proceeds from Revolving Credit Facility		1,021
Payments on Revolving Credit Facility		(7,981)
Payment for Loan Fees		(46)
Proceeds from Issuance of Stock		16,042
Payment for Expenses Relating to Initial Public Offering		(979)
Net Cash Provided By Financing Activities		8,057
Net Increase (Decrease) in Cash	(1,459)	7,061
Cash and Cash Equivalents - Beginning of Period	2,025	6
Cash and Cash Equivalents - End of Period	\$ 566	\$ 7,067

The accompanying notes are an integral part of these financial statements

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**VERI-TEK INTERNATIONAL, CORP. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**

**Note A - Nature of Operations and Summary of Significant Accounting Policies**

This summary of significant accounting policies of Veri-Tek International Corp. is presented to assist in understanding the Company's financial statements. The financial statements and notes are representations of the Company's management who is responsible for their integrity and objectivity. These accounting policies conform to generally accepted accounting principles and have been consistently applied in the preparation of the financial statements. All figures are in thousands unless otherwise stated.

**Nature of Operations**

Veri-Tek International Corp. designs and manufactures testing and assembly equipment used primarily in the manufacture of driveline components in the automotive and heavy equipment industries. In addition, the Company has utilized this technology to provide testing services to original equipment manufacturers and tier 1 suppliers in order to verify the manufacturing process. The Company is in the process of entering the drive-train manufacturing industry utilizing its proprietary technology and processes.

**Cash and Cash Equivalents**

For purposes of the statement of cash flows, the Company considers all short-term securities purchased with maturity dates of three months or less to be cash equivalents.

**Marketable Securities**

The Company has investments in corporate debt instruments that are available for sale to meet working capital needs. Cost represents estimated fair value at the balance sheet date and there are no gross unrealized gains or losses. Interest earned is included in interest income.

**Revenue Recognition**

The Company has two main businesses—the design and manufacture of assembly and testing equipment (A & T) and the testing and manufacturing of drive-line products (T & M). The A & T business recognizes revenue under a proportionate performance method. The T & M business recognizes revenue when products are shipped or services are rendered. The testing business has not generated material revenue to date.

**Accounts Receivable Trade**

The Company has adopted a policy consistent with U.S. GAAP for the periodic review of its accounts receivable to determine whether the establishment of an allowance for doubtful accounts is warranted based on the Company's assessment of the collectibility of the accounts. The Company established an allowance for bad debts of \$11 and \$24 at June 30, 2006 and December 31, 2005, respectively.

**Costs and Earnings in Excess of Billings**

Costs and earnings in excess of billings are the result of earned revenue on projects that are not immediately billable to customers due to agreed upon billing arrangements. As of June 30, 2006 and December 31, 2005, the Company has established a reserve of \$1,734 against costs in excess of billings. See Note M.



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**Note A - Nature of Operations and Summary of Significant Accounting Policies (Continued)**

**Financial Instruments and Credit Risk Concentrations**

Financial instruments which potentially subject the Company to concentrations of credit risk consist primarily of trade receivables and payables. As of June 30, 2006, three customers accounted for 88% of accounts receivable. One of these customers individually accounted for 63% of accounts receivable as of June 30, 2006. Two customers accounted for 94% of unbilled revenue at June 30, 2006. One of these customers individually accounted for 54% of unbilled revenue as of June 30, 2006. Three customers accounted for 77% of the revenue for the six months ended June 30, 2006. One of these customers accounted for 50% of the revenue individually during this period.

As of December 31, 2005, three customers accounted for 80% of accounts receivable. One customer accounted for 76% of unbilled revenue at June 30, 2005. A different customer accounted for 51% of the revenue for the six months ended June 30, 2005.

Two suppliers accounted for 23% of accounts payable as of June 30, 2006.

During the period ended June 30, 2005, the Company purchased 24% of materials from two suppliers. Three suppliers accounted for 48% of accounts payable as of June 30, 2005.

**Inventory**

Inventory consists of stock materials and various machines developed for demonstration purposes and are stated at the lower of cost (first in, first out) or market.

**Property, Equipment and Depreciation**

Property and equipment are stated at cost. Depreciation of property and equipment is provided using accelerated methods used for tax purposes over the following useful lives:

Machinery and Equipment	3 - 7 years
Furniture and Fixtures	7 years
Leasehold Improvements	39 years

Expenditures for major renewals and betterments that extend the useful lives of property and equipment are capitalized. Expenditures for maintenance and repairs are charged to expense as incurred. Depreciation expense for the six months ended June 30, 2006 and 2005 was \$119 and \$44, respectively.

**Patents**

The Company capitalizes certain costs related to patent technology as well as allocating a substantial portion of the purchase price related to the acquisition of substantially all of the assets of JCJ International, Inc. These costs are amortized on a straight-line basis over the estimated useful lives of the assets. Amortization expense for the six months ended June 30, 2006 and 2005 was \$148 and \$148, respectively.

**Research and Development Expenses**

The Company expenses research and development expenses as incurred. Amounts payable to third parties under product development agreements are recorded at the earlier of the milestone achievement or when payments become contractually due. For the six months ended June 30, 2006 and 2005, \$1 and \$364, respectively, of research and development costs were expensed.

## **Table of Contents**

### **Note A - Nature of Operations and Summary of Significant Accounting Policies (Continued)**

#### **Impairment of Long-Lived Assets**

In accordance with SFAS No. 121, the Company reviews its long-lived assets, including property and equipment, goodwill and other identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of the assets may not be fully recoverable. To determine recoverability of its long-lived assets, the Company evaluates the probability that future undiscounted net cash flows, without interest charges, will be less than the carrying amount of the assets. Impairment is measured at fair value. The Company had no loss on impairment of long-lived assets during the six months ended June 30, 2006 and 2005.

#### **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 certain reported amounts and disclosures. Accordingly, actual results could differ from those estimates.

#### **Fair Value of Financial Instruments**

The Company's financial instruments include cash, accounts receivable, accounts payable, accrued liabilities, line of credit and long-term debt. The carrying value of these instruments approximates their estimated fair value.

#### **Income Taxes**

The Company accounts for income taxes under the provisions of SFAS No. 109, *Accounting for Income Taxes*, which requires recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the Company's financial statements or tax returns. Under this method, deferred tax assets and liabilities are determined based on the differences between the financial accounting and tax basis of assets and liabilities using enacted tax rates in effect for the year in which the differences are expected to reverse.

#### **Computation of Earnings Per Share**

Basic earnings per share were computed by dividing net loss by the weighted average number of common shares outstanding during the period. Diluted earnings per share reflect the potential dilution that could occur from the conversion of the subordinated debt at \$6 per share.

#### **New Accounting Pronouncements**

In March 2005, the SEC released Staff Accounting Bulletin No 107, *Share Based Payment* ( *SAB 107* ), which provides interpretive guidance related to the interaction between SFAS 123(R) and certain SEC rules and regulations. In April 2005, the SEC amended the compliance dates for SFAS 123(R), to allow companies to implement the standard at the beginning of the next fiscal year, instead of the next reporting period beginning after June 15, 2005. Management is currently evaluating the impact SAB 107 will have on our financial statements.

**Table of Contents****Note A - Nature of Operations and Summary of Significant Accounting Policies (Continued)**

In March 2005, the FASB issued FASB Interpretation No. 47, Accounting for Conditional Asset Retirement Obligations (FIN 47). FIN 47 provides guidance relating to the identification of and financial reporting for legal obligations to perform an asset retirement activity. The Interpretation requires recognition of a liability for the fair value of a conditional asset retirement obligation when incurred if the liability's fair value can be reasonably estimated. FIN 47 also defines when an entity would have sufficient information to reasonably estimate the fair value of an asset retirement obligation. The provision is effective no later than the end of fiscal years ending after December 15, 2005. The Company adopted FIN 47 during the first quarter of fiscal year 2006 and does not believe the adoption will have a material impact on its financial position of results of operations or cash flows.

In May 2005, the FASB issued FASB Statement No. 154, Accounting Changes and Error Corrections. This new standard replaces APB Opinion No. 20, Accounting Changes, and FASB Statement No. 3, Reporting Accounting Changes in Interim Financial Statements, and represents another step in the FASB's goal to converge its standards with those issued by the IASB. Among other changes, Statement 154 requires that a voluntary change in accounting principle be applied retrospectively with all prior period financial statements presented on the new accounting principle, unless it is impracticable to do so. Statement 154 also provides that (1) a change in method of depreciating or amortizing a long-lived non-financial asset be accounted for as a change in estimate (prospectively) that was effected by a change in accounting principle, and (2) correction of errors in previously issued financial statements should be termed a restatement. The new standard is effective for accounting changes and correction of errors made in fiscal years beginning after December 5, 2005. Early adoption of this standard is permitted for accounting changes and correction of errors made in fiscal years beginning after June 1, 2005. The Company has evaluated the impact of the adoption of Statement 154 and does not believe the impact will be significant to the Company's overall results of operations or financial position.

In February of 2006, the FASB issued SFAS No. 155, Accounting for Certain Hybrid Financial Instruments, which is intended to simplify the accounting and improve the financial reporting of certain hybrid financial instruments (i.e. derivatives embedded in other financial instruments). The statement amends SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, and SFAS No. 140, Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities a replacement of FASB Statement No. 125. SFAS No. 155 is effective for all financial instruments issued or acquired after the beginning of an entity's first fiscal year that begins after September 15, 2006. The Company is currently evaluating the impact SFAS No. 155 will have on its financial statements, if any.

**Note B - Inventory**

The components of inventory at June 30, 2006 and December 31, 2005 are as follows:

	2006	2005
Raw Materials and Purchased Parts	\$ 97	\$ 119
Finished Goods and Replacement Parts	953	1,043
	\$ 1,050	\$ 1,162

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**Note C Property, Plant and Equipment**

Property, plant and equipment consisted of the following at June 30, 2006 and December 31, 2005:

	2006	2005
Machinery and Equipment	\$ 683	\$ 680
Furniture and Fixtures	22	22
Leasehold Improvements	43	43
Assets Under Development	1,608	1,305
Computer Software and Equipment	227	223
	2,583	2,273
Less: Accumulated Depreciation	307	188
Net Property and Equipment	\$ 2,276	\$ 2,085

**Note D Revolving Credit Facility**

As a result of our successful initial public offering in February 2005, our outstanding balance on our revolving credit facility was reduced to zero and the credit facility was terminated. We negotiated a new credit facility with our lender under what we believe to be more favorable terms as compared to our previous facility. The new facility is a two year, \$8.0 million revolving credit facility secured by substantially all of the Company's assets. The facility expires on February 28, 2007. The facility contains customary limitations including, but not limited to, acquisitions, dividends and capital expenditures. The interest rate is variable and advances can bear interest at the Eurodollar based rate or the prime based rate. As of June 30, 2006 the facility had a zero balance. The unused facility was merged into the existing \$16.5 million revolving credit facility as part of the acquisition of Manitex. See Note N.

**Note E Subordinated Debt**

The note payable to a shareholder with interest at 20% per annum required quarterly interest only payments of 8% with the remaining 12% added to principal when due. The principal balance and all outstanding interest was originally due in full August 1, 2008. The note was subordinate to the line of credit. In April 2004, the agreement was modified to accrue all interest and add it to principal. In October 2004, the rate was modified to include a conversion option to convert the total amount due, including interest, upon the Company's completion of its initial public offering. In February 2005, the Company issued 1,195,900 shares of common stock as settlement of \$7.2 million of debt, including interest of \$1.3 million.

**Note F Income Taxes**

The Company has incurred a net operating loss for federal tax purposes of \$1,196 and \$1,891 for the six months ended June 30, 2006 and 2005, respectively, which it has elected to carryforward, therefore the Company has not recorded any current tax accrual. The Company has total net operating losses that expire as follows:

December 31, 2023	\$ 689
December 31, 2024	3,597
December 31, 2025	3,151
June 30, 2026	1,196
	\$ 8,633

**Table of Contents****Note F Income Taxes (Continued)**

The provision for income taxes consists of the following components:

	2006	2005
Current	\$	\$
Deferred	(405)	(634)
	\$ (405)	\$ (634)

Differences between income taxes calculated using the federal statutory income tax rate of 34% and the provision for income taxes were as follows:

	2006	2005
Income (Loss) Before Income Taxes	\$ (1,189)	\$ (1,919)
Statutory Federal Income Tax	\$ (404)	\$ (652)
Non-Deductible Meals and Entertainment	10	4
Miscellaneous Book/Tax Differences	(11)	14
	\$ (405)	\$ (634)

Deferred taxes are detailed as follows:

	2006	2005
Deferred Income Tax Liability		
Depreciation and Amortization	\$ 27	\$ 20
Net Deferred Income Tax Liability	27	20
Deferred Income Tax Assets		
Inventory Capitalization	(6)	(12)
Allowance on Cost in Excess of Billings	589	589
Net Operating Loss	2,935	2,529
Net Deferred Income Tax Asset	3,518	3,106
Net Deferred Income Tax Benefit	\$ 3,491	\$ 3,086

Deferred income tax assets and liabilities are computed annually for differences between the financial statements and tax basis of assets and liabilities that will result in taxable or deductible amounts in the future based on enacted tax laws and rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce deferred tax assets to the amount expected to be realized.

Realization of the Company's deferred tax assets is dependent on generating sufficient taxable income. Although realization is not assured, management believes it is more likely than not that all of the deferred tax assets will be realized.

**Table of Contents****Note G Supplemental Cash Flow Disclosures**

Interest received and paid, income taxes paid and non-cash transactions incurred during the six months ended June 30, 2006 and 2005 was as follows:

	2006	2005
Interest Received	\$ 31	\$ 64
Interest Paid	\$	\$ 59
Income Taxes	\$	\$
Non-Cash Transactions:		
Conversion of Debt to Stock	\$	\$ 7,175

**Note H Operating Leases**

The Company leases its facility under an operating lease with an entity owned by a shareholder. Monthly payments under the lease are \$22. The lease expires September 1, 2007. Total rent expense related to this lease was \$131 for each of the six month periods ended June 30, 2006 and 2005.

The Company leased certain equipment under an operating lease with an entity under common ownership. Monthly payments under the lease are \$5. The lease expired May 1, 2005. Total rent expense related to this lease was \$0 and \$28, respectively, for the six months ended June 30, 2006 and 2005.

The Company leases other equipment under an operating lease with monthly payments of \$1. The lease expires December 21, 2008. Total rent expense related to this lease was \$6 and \$0, respectively, for the six months ended June 30, 2006 and 2005.

The Company leases various vehicles with monthly payments ranging from \$0.4 - \$0.7 per month, expiring at various times through 2006. Total rent expense related to these leases was \$2 and \$7 for the six months ended June 30, 2006 and 2005, respectively.

Future Minimum Lease Payments are:

June 30, 2007	\$ 274
June 30, 2008	77
June 30, 2009	5
June 30, 2010	
June 30, 2011	
	\$ 356

**Note I Related Party Transactions**

As mentioned in Note H, the Company leases its facility and certain equipment from an entity owned by a shareholder. Rent paid under these leases totaled \$131 and \$159 for the six months ended June 30, 2006 and 2005, respectively.

As mentioned in Note E, the Company had a note payable to shareholder. This note was converted to stock in February 2005. No interest was paid for the six months ended June 30, 2006 and 2005.



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### **Note J - 401K Profit Sharing Plan**

The Company sponsors a 401K profit sharing plan that covers all employees of the Company. The plan allows eligible employees to withhold amounts from their pay on a pre-tax basis and invest in self directed investment accounts. The Company has no obligation to make any contributions to the plan, however, they currently match employee contributions up to a maximum of \$2 per employee. Contributions to the plan for the six months ended June 30, 2006 and 2005 were \$53 and \$61, respectively.

### **Note K - Stock Split**

On February 7, 2005, the Board of Directors authorized a 1 for 3.730879244 reverse stock split to shareholders of record on February 7, 2005 effective on February 7, 2005. The share and per share information have been restated as of January 1, 2005 to reflect the reverse stock split in accordance with GAAP.

### **Note L - Initial Public Offering**

On February 14, 2005, the Company offered 2,500,000 shares of common stock at \$6.00 per share in its initial public offering. All shares were purchased and the Company received \$14.0 million, net of fees of \$1.1 million, on February 18, 2005.

On March 2, 2005, the underwriter exercised its option to purchase an additional 375,000 shares at \$6.00 per share. The Company received \$2.1 million, net of fees of \$158, on March 2, 2005.

### **Note M - Unrealized Loss on Cost in Excess of Billing**

During the year ended December 31, 2005, the Company recorded reserves totaling \$169 against cost in excess of billings related to two contracts for two different customers. The customers have raised questions regarding the capabilities of the specialty equipment being constructed for them. The reserves reduce the carrying value of the contract to the estimated net realizable value of the contracts.

### **Note N Subsequent Event Regarding the Purchase of Manitek, Inc.**

Effective July 3, 2006, the Company has closed on the purchase of Manitek, Inc. ( Manitek ) through the acquisition of all of the membership interests of Quantum Value Management, LLC (an entity owned by certain stockholders). Manitek is a leading provider of engineered lift solutions in North America. Manitek, based in Georgetown, Texas, is a leading designer, manufacturer, and marketer of a comprehensive line of boom trucks, sign cranes and trolley boom unloaders. Manitek s boom trucks and crane products are primarily used for industrial projects and infrastructure development, including roads, bridges and commercial construction, and most recently, energy exploration. For the year ended December 31, 2005, Manitek had revenues of approximately \$62 million.

Consideration, which may be subject to post-closing working capital adjustments, aggregated approximately \$35 million, and was paid by delivering 234,875 shares of Veri-Tek s common stock and a promissory note for approximately \$1.1 million. The remaining portion of the consideration is composed of Veri-Tek s assumption of approximately \$33 million of Manitek indebtedness. Pursuant to the terms of the purchase agreement, Veri-Tek also entered into an employment agreement with David Langevin, Chief Executive Officer of Manitek, Inc., pursuant to which Mr. Langevin will serve as the Chief Executive Officer of Veri-Tek. Mr. Langevin was also elected as a Director and as Chairman of the Board of Veri-Tek, effective as of the closing of the acquisition.



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

**General**

We derive most of our revenue under purchase orders from OEMs and Tier 1 Suppliers. The volume and timing of orders placed by our customers vary due to several factors, including variation in demand for our customers' products, changes in our customers' manufacturing strategies and general economic conditions. We recognize revenue from our specialty equipment using the percentage of completion method. We recognize revenue in our testing business when services are rendered. The testing business has not generated material revenue to date. The driveshaft manufacturing portion of our business will recognize revenue when products are shipped. To date, we have generated no revenue from selling our driveshaft manufacturing services.

Our operating profit for our specialty equipment depends on the mix between the cost of materials in the equipment and the cost of labor and manufacturing overhead allocated to the equipment. Our driveshaft assembly products contain less sophisticated technology than our axle testing products, and therefore, have a lower cost of production. In addition, as we gain experience in manufacturing a certain kind of equipment, we usually achieve increased efficiencies, which result in lower labor costs and manufacturing overhead for that equipment. While we may achieve some level of increased efficiency with respect to manufacturing specialty equipment, our gross margins related thereto will likely continue to vary, as we must produce different kinds of equipment and each piece of equipment must meet certain specifications of our customers. As we implement our growth strategy of providing testing services and manufacturing precision driveshafts, we believe that our gross margins will stabilize, as the equipment that we produce will be less varied.

On February 15, 2005 we completed an initial public offering of 2,500,000 shares of our common stock at a price of \$6.00 per share and on March 2, 2005 we completed the sale of the underwriters' over-allotment option of 375,000 shares of our common stock. Net proceeds after underwriters' discount and other expenses relating to the offering are estimated to be \$15.2 million.

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**Three Months Ended June 30, 2006 Compared to Three Months Ended June 30, 2005**

*Revenue.* Our revenue increased by \$0.6 million, or 46.7%, to \$1.7 million for the three months ended June 30, 2006 from \$1.1 million for the same period in 2005. This increase was primarily the result of increased orders for our specialty equipment as well as the timing of revenue recognition. We recognize revenue based on the percentage of completion method for our specialty equipment, therefore, revenue is not recognized on an even basis. Our main sources of revenue for the period ended June 30, 2006 were driveshaft equipment, diesel engine test equipment, and NVH equipment.

*Cost of Sales.* Our cost of sales increased by \$0.7 million, or 74.5%, to \$1.7 million for the period ended June 30, 2006 from \$1.0 million for the comparable period in 2005. This increase in cost of sales was primarily attributable to higher production of our specialty equipment. As a percentage of revenue, cost of sales increased to 102.5% in 2006 from 86.2% in 2005. This increase in cost of sales as a percentage of revenue was primarily the result of higher materials costs experienced during the three months ended June 30, 2006 versus the same period in 2005.

*Gross Margin(loss).* Our gross margin decreased \$0.2 million to a loss of \$0.04 million for the 2006 period from a gain of \$0.2 million for 2005. As a percentage of sales, gross margin decreased to -2.5% in 2006 from 13.8% in 2005. The dollar and percentage decrease in gross margin was primarily the result of the impact of higher fixed costs, partially offset by higher revenue volume.

*Research and Development Expenses.* Our research and development expenses declined \$0.2 million to \$0 for the period ended June 30, 2006 as compared to \$0.2 million in the comparable 2005 period. As a percentage of sales, our research and development expenses decreased to 0% of sales in 2006 from 15.0% in 2005.

*Selling, General and Administrative Expenses.* Our selling, general and administrative expenses decreased \$0.1 million, or 17.1%, to \$0.6 million for the period ended June 30, 2006 from \$0.7 million for the 2005 period. This decrease was primarily the result of continued cost cutting initiatives.

*Operating Profit (Loss).* As a result of the foregoing factors, operating profit increased \$0.1 million to a loss of \$0.65 million for the 2006 period from a loss of \$0.75 million for 2005.

*Interest Income.* Interest income decreased \$0.05 million to \$0.01 million for the 2006 period from \$0.06 million for the same period in 2005. This decrease was primarily due lower cash reserves in the 2006 period compared to the same period in 2005.

*Income Tax Expense (Benefit).* Our income tax benefit was \$0.2 million for the period ended June 30, 2006 as compared to a benefit of \$0.2 million in the 2005 period.

*Net Earnings (Loss).* As a result of the foregoing factors, net loss from operations was \$0.4 million in the 2006 period as compared to a net loss of \$0.5 million in 2005.

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**Six Months Ended June 30, 2006 Compared to Six Months Ended June 30, 2005**

*Revenue.* Our revenue increased by \$1.7 million, or 77.7%, to \$3.9 million for the period ended June 30, 2006 from \$2.2 million for the same period in 2005. This increase was primarily the result of increased orders for our specialty equipment as well as the timing of revenue recognition. We recognize revenue based on the percentage of completion method for our specialty equipment, therefore, revenue is not recognized on an even basis. Our main sources of revenue for the period ended June 30, 2006 were driveshaft equipment, diesel engine test equipment, and NVH equipment.

*Cost of Sales.* Our cost of sales increased by \$1.6 million, or 68.6%, to \$3.9 million for the period ended June 30, 2006 from \$2.3 million for the comparable period in 2005. This increase in cost of sales was primarily attributable to higher production of our specialty equipment. As a percentage of revenue, cost of sales decreased to 100.8% in 2006 from 106.3% in 2005. The reduction in cost of sales as a percent of revenue was a result of improved engineering, partially offset by higher materials costs.

*Gross Margin(loss).* Our gross margin increased \$0.1 million to a loss of \$0.03 million for the 2006 period from a loss of \$0.1 million for 2005. As a percentage of sales, gross margin increased to -0.8% in 2006 from -6.3% in 2005. The dollar and percentage increase in gross margin was primarily the result of the impact of higher revenues and improved engineering.

*Research and Development Expenses.* Our research and development expenses declined \$0.4 million to \$0 for the period ended June 30, 2006 as compared to \$0.4 million in the comparable 2005 period. As a percentage of sales our research and development expenses decreased to 0% of sales in 2006 from 16.5% in 2005.

*Selling, General and Administrative Expenses.* Our selling, general and administrative expenses decreased \$0.2 million, or 16.8%, to \$1.2 million for the period ended June 30, 2006 from \$1.4 million for the 2005 period. This decrease was primarily the result of continued cost cutting initiatives.

*Operating Profit (Loss).* As a result of the foregoing factors, operating profit increased \$0.7 million to a loss of \$1.2 million for the 2006 period from a loss of \$1.9 million for 2005.

*Interest Income.* Interest income decreased \$0.03 million to \$0.03 million for the 2006 period from \$0.06 million for the same period in 2005. This decrease was primarily due lower cash reserves in the 2006 period compared to the same period in 2005.

*Interest Expense.* Interest expense decreased \$0.05 million to \$0 for the 2006 period from \$0.05 million for the same period in 2005. The decrease in interest expense was primarily due the paydown of our credit facility to zero and the conversion of our subordinated debt. These actions were the result of our successful initial public offering in the first quarter of 2005.

*Income Tax Expense (Benefit).* Our income tax benefit was \$0.4 million for the period ended June 30, 2006 as compared to a benefit of \$0.6 million in the 2005 period.

*Net Earnings (Loss).* As a result of the foregoing factors, net loss from operations was \$0.8 million in the 2006 period as compared to loss of \$1.3 million in 2005.

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### **Liquidity and Capital Resources**

Our cash requirements have historically been satisfied through a combination of cash flow from operations and debt financings. Working capital needs and capital expenditures are expected to continue to increase as we implement our growth strategy. Anticipated increases in required working capital and capital expenditures are expected to be met from our cash flow from operations, revolving credit borrowings, equipment financing and the net proceeds of our initial public offering completed in February and March 2005.

We used cash in operations of \$1.1 million for the six months ended June 30, 2006. Net cash used by operations was primarily the result of increases in accounts receivable and deferred tax assets, decreases in accounts payable, and losses from operations. This was partially offset by decreases in cost and estimated earnings in excess of billings and inventory as well as increases in billings in excess of costs and estimated earnings.

We used cash in investing activities of \$0.3 million for the six months ended June 30, 2006. For the 2006 period, we used cash in investing activities for the purchase of capital equipment.

No cash was used in nor provided by financing activities for the six months ended June 30, 2006.

Effective March 1, 2005, we entered into a new credit agreement with our lender, Comerica Bank. With the proceeds of our initial public offering we reduced the balance of our agreement at the time of the offering to zero and terminated the agreement. The new agreement is a two year, \$8.0 million revolving credit facility. Our credit facility is secured by substantially all of our assets and provides for the issuance of up to \$5.0 million in standby or documentary letters of credit. Our credit facility may be utilized for general corporate purposes, including working capital, and provides us with borrowing options for multi-currency loans. Borrowing options include a Eurocurrency rate, or a base rate. As of the date of this report there are no borrowings on this facility.

In conjunction with our initial public offering, our subordinated debt totaling approximately \$7.2 million was converted into 1,195,900 shares of our common stock at \$6.00 per share.

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

We are exposed to various market risks as a part of our operations, and we anticipate that this exposure will increase as a result of our planned growth. In an effort to mitigate losses associated with these risks, we may at times enter into derivative financial instruments, although we have not historically done so. These may take the form of forward sales contracts, option contracts, foreign currency exchange contracts and interest rate swaps. We do not, and do not intend to, engage in the practice of trading derivative securities for profit.

*Interest Rates* . We are exposed to market risks relating to changes in interest rates. Some of the proceeds of this offering are invested in short-term, interest-bearing, investment grade securities. The value of these securities will be subject to interest rate risk and could fall in value if interest rates rise. Our credit facility allows for borrowings based on the Eurodollar rate or a base rate. The interest rate incurred by us is based on these rates plus a premium. If these rates rise, our interest expense will increase accordingly. As of the date of this report, we have no borrowings under our credit facility.

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**Item 4: Controls and Procedures**

Disclosure Controls and Procedures. The Company maintains disclosure controls and procedures designed to ensure that information that is required to be disclosed in its filings with the Securities and Exchange Commission is recorded, processed, summarized and reported on a timely basis. The Company's management, with the participation of the President and the Chief Financial Officer, has reviewed and evaluated the effectiveness of the Company's disclosure controls and procedures, as defined in the Securities Exchange Act Rules 13a-15(e) and 15d-15(e) as of June 30, 2006 and have concluded that as of June 30, 2006, the Company's disclosure controls and procedures were adequate and effective to ensure that material information relating to the Company required to be disclosed by the Company in the reports it files with the SEC under the Securities Exchange Act of 1934 would be made known to them by others within the Company, particularly during the period in which this Quarterly Report on Form 10-Q was being prepared.

Changes in Internal Controls over Financial Reporting. There have been no changes in the Company's internal control over financial reporting during the quarter ended June 30, 2006 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

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**PART II - OTHER INFORMATION**

**Item 1: Legal Proceedings**

Not applicable.

**Item 2: Changes in Securities, Use of Proceeds and Issuer Purchases of Equity Securities**

Not applicable.

**Item 3: Defaults Upon Senior Securities**

Not applicable.

**Item 4: Submission of Matters to a Vote of Security Holders**

Not applicable.

**Item 5: Other Information**

Not applicable.

**Item 6: Exhibits and Reports on Form 8-K**

(a) Exhibits:

31.1 Section 302 Certification by Principal Executive Officer

31.2 Section 302 Certification by Chief Financial Officer

32.1 Section 906 Certification by Principal Executive Officer and the Chief Financial Officer

(b) The following reports on Form 8-K were filed during the three month period ended June 30, 2006.

- (i) Report on Form 8-K filed on May 12, 2006 concerning the results of operations and financial statements for the quarter ended March 31, 2006.

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- (i) Report on Form 8-K filed on May 19, 2006 concerning the entry into a material definitive agreement to purchase all of the outstanding membership interests of the Company's Parent, Quantum Value Management, LLC.

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**SIGNATURES**

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.

VERI-TEK INTERNATIONAL, CORP.

Dated: August 14, 2006

By: /s/ Kyle R. Stallman  
Kyle R. Stallman,  
Principal Financial Officer  
Veri-Tek International, Corp.