

DAKTRONICS INC /SD/  
Form 10-Q  
November 20, 2006

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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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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 October 28, 2006**

**OR**

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

**For the Transition Period From \_\_\_\_\_ to \_\_\_\_\_**

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**Commission File Number: 0-23246**

**DAKTRONICS, INC.**

(Exact name of Registrant as specified in its charter)

**South Dakota**  
(State or other jurisdiction of  
incorporation or organization)

**46-0306862**  
(I.R.S. Employer  
Identification Number)

**331 32nd Avenue**  
**Brookings, SD** **57006**  
(Address of principal executive offices) (zip code)

**(605) 697-4000**  
(Registrant's telephone number, including area code)

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 or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large Accelerated Filer ☐ Accelerated Filer ☒ Non-Accelerated Filer ☐

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

The number of shares of the registrant's common stock outstanding as of November 14, 2006 was 39,230,470.

## DAKTRONICS, INC. AND SUBSIDIARIES FORM 10-Q

For the Quarter Ended October 28, 2006

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### Special Note Regarding Forward-Looking Statements

*This Quarterly Report on Form 10-Q (including exhibits and information incorporated by reference herein) contains both historical and forward-looking statements that involve risks, uncertainties and assumptions. The statements contained in this report that are not purely historical are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21B of the Securities Exchange Act of 1934, as amended, including statements regarding our expectations, beliefs, intentions and strategies for the future. These statements appear in a number of places in this Report and include all statements that are not historical statements of fact regarding our intent, belief or current expectations with respect to, among other things: (i) our financing plans; (ii) trends affecting our financial condition or results of operations; (iii) our growth strategy and operating strategy; and (iv) the declaration and payment of dividends. The words may, would, could, will, expect, estimate, anticipate, believe, intend, plan and similar expressions and variations thereof are intended forward-looking statements. Investors are cautioned that any such forward-looking statements are not guarantees of future performance and involve risk and uncertainties, many of which are beyond our ability to control, and that actual results may differ materially from those projected in the forward-looking statements as a result of various factors discussed herein and those factors discussed in detail in our filings with the Securities and Exchange Commission, including in our Annual Report on Form 10-K for the fiscal year ended April 29, 2006 in the section entitled Item 1A. Risk Factors.*

**PART I. FINANCIAL INFORMATION****Item 1. FINANCIAL STATEMENTS****DAKTRONICS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS**

(in thousands, except share data)

	<b>October 28, 2006 (unaudited)</b>	<b>April 29, 2006 (note 1)</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 5,589	\$ 26,921
Restricted cash	5,123	
Marketable securities		8,310
Accounts receivable, less allowance for doubtful accounts	52,677	46,019
Inventories	50,602	31,045
Costs and estimated earnings in excess of billings	22,298	17,375
Current maturities of long-term receivables	4,182	4,476
Prepaid expenses and other	3,750	2,522
Deferred income taxes	7,204	6,213
Income taxes receivable	219	97
Rental equipment available for sale	23	286
	<hr/>	<hr/>
Total current assets	151,667	143,264
	<hr/>	<hr/>
Advertising rights, net	4,012	3,112
Long-term receivables, less current maturities	9,253	8,756
Investments in affiliates	10,000	582
Goodwill	4,344	2,706
Intangible and other assets	3,858	636
Deferred income taxes	114	232
	<hr/>	<hr/>
	31,581	16,024
	<hr/>	<hr/>
<b>PROPERTY AND EQUIPMENT:</b>		
Land	2,985	1,223
Buildings	27,576	20,470
Machinery and equipment	34,881	22,332
Office furniture and equipment	29,172	22,926
Equipment held for rental	2,700	2,182
Demonstration equipment	4,154	4,899
Transportation equipment	5,889	4,863
	<hr/>	<hr/>
	107,357	78,895
Less accumulated depreciation	41,023	38,336
	<hr/>	<hr/>
	66,334	40,559
	<hr/>	<hr/>
<b>TOTAL ASSETS</b>	<b>\$ 249,582</b>	<b>\$ 199,847</b>
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See notes to consolidated financial statements.

**DAKTRONICS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED BALANCE SHEETS (continued)**

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(in thousands, except share data)

	October 28, 2006 (unaudited)	April 29, 2006 (note 1)
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Notes payable, bank	\$ 2,363	\$
Accounts payable	40,720	20,506
Accrued expenses and warranty obligations	18,888	15,396
Current maturities of long-term debt and marketing obligations	1,002	491
Billings in excess of costs and estimated earnings	23,306	19,760
Customer deposits	8,521	7,777
Deferred revenue	4,736	3,849
Income taxes payable	1,699	555
	<hr/>	<hr/>
Total current liabilities	101,235	68,334
	<hr/>	<hr/>
Long-term debt, less current maturities	635	131
Long-term marketing obligations, less current maturities	539	574
Long-term warranty obligations and other payables	6,196	3,864
Deferred income taxes	1,779	1,599
	<hr/>	<hr/>
	9,149	6,168
	<hr/>	<hr/>
<b>TOTAL LIABILITIES</b>	<b>110,384</b>	<b>74,502</b>
	<hr/>	<hr/>
<b>SHAREHOLDERS' EQUITY:</b>		
Common stock, no par value, authorized 120,000,000 shares: 39,208,379 and 38,931,676 shares issued at October 28, 2006 and April 29, 2006, respectively	20,546	19,551
Additional paid-in capital	4,587	3,480
Retained earnings	113,921	102,381
Treasury stock, at cost, 19,680 shares	(9)	(9)
Accumulated other comprehensive income (loss)	153	(58)
	<hr/>	<hr/>
<b>TOTAL SHAREHOLDERS' EQUITY</b>	<b>139,198</b>	<b>125,345</b>
	<hr/>	<hr/>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 249,582</b>	<b>\$ 199,847</b>
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See notes to consolidated financial statements.

## DAKTRONICS, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF INCOME

(in thousands, except per share data)

(unaudited)

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	October 28, 2006	October 29, 2005	October 28, 2006	October 29, 2005
Net sales	\$ 123,530	\$ 75,802	\$ 215,683	\$ 148,147
Cost of goods sold	88,044	53,485	153,821	103,636

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	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
<b>Gross profit</b>	35,486	22,317	61,862	44,511
Operating expenses:				
Selling	12,528	9,178	24,974	18,988
General and administrative	4,628	2,683	8,356	5,305
Product design and development	3,936	2,749	7,555	5,233
	21,092	14,610	40,885	29,526
<b>Operating income</b>	14,394	7,707	20,977	14,985
Nonoperating income (expense):				
Interest income (expense), net	455	462	1,074	788
Other income (expense), net	(648)	(5)	(541)	(77)
<b>Income before income taxes</b>	14,201	8,164	21,510	15,696
Income tax expense	5,310	2,979	7,631	5,880
<b>Net income</b>	\$ 8,891	\$ 5,185	\$ 13,879	\$ 9,816
Weighted average number of fully diluted shares and common equivalent shares	41,129	40,267	41,072	40,249
Earnings per share:				
Basic	\$ 0.23	\$ 0.13	\$ 0.36	\$ 0.25
Diluted	\$ 0.22	\$ 0.13	\$ 0.34	\$ 0.25
Cash dividend paid per share	\$	\$	\$ 0.06	\$ 0.05

**DAKTRONICS, INC. AND SUBSIDIARIES**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

(in thousands)  
(unaudited)

	<u>Six Months Ended</u>	
	<u>October 28, 2006</u>	<u>October 29, 2005</u>
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income	\$ 13,879	\$ 9,816
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
Depreciation	5,660	4,203
Amortization	23	26
Gain on sale of property and equipment	68	(14)
Stock-based compensation	856	
Equity in earnings of investments in affiliates	781	
Provision for doubtful accounts	263	(255)
Deferred income taxes, net	(693)	(930)

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	<b>Six Months Ended</b>	
	(10,168)	(6,591)
Change in operating assets and liabilities		
<b>Net cash provided by operating activities</b>	<b>10,669</b>	<b>6,255</b>
<b>CASH FLOWS USED IN INVESTING ACTIVITIES:</b>		
Purchase of property and equipment	(27,753)	(7,946)
Cash consideration paid for investment at equity	(13,771)	(130)
Sales (purchases) of marketable securities, net	8,310	348
Proceeds from sale of property and equipment	44	33
<b>Net cash used in investing activities</b>	<b>(33,170)</b>	<b>(7,695)</b>
<b>CASH FLOWS USED IN FINANCING ACTIVITIES:</b>		
Dividend paid	(2,339)	(1,917)
Excess tax benefits from stock-based compensation	251	
Principal payments on long-term debt	25	(525)
Net borrowing (payments) on notes payable	2,363	(84)
Proceeds from exercise of stock options and warrants	639	335
<b>Net cash used in financing activities</b>	<b>939</b>	<b>(2,191)</b>
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH</b>	<b>230</b>	<b>(190)</b>
<b>DECREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(21,332)</b>	<b>(3,821)</b>
<b>CASH AND CASH EQUIVALENTS BEGINNING OF PERIOD</b>	<b>26,921</b>	<b>15,961</b>
<b>CASH AND CASH EQUIVALENTS END OF PERIOD</b>	<b>\$ 5,589</b>	<b>\$ 12,140</b>
<b>Supplemental disclosures of cash flow information:</b>		
Cash payments for:		
Interest	\$ 61	\$ 96
Income taxes, net of refunds	7,065	4,886
<b>Supplemental schedule of non-cash investing and financing activities:</b>		
Tax benefits related to exercise of stock options	\$ 251	\$ 160
Demonstration equipment transferred to inventory	1,625	
Purchase of plant and equipment included in accounts payable and notes payable	5,221	694
Transfers of equipment to affiliates	226	
See notes to consolidated financial statements		

**DAKTRONICS, INC. AND SUBSIDIARIES**  
**NOTES TO THE CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands, except share and per share data)  
(unaudited)

**Note 1. Basis of Presentation**

In the opinion of management, the accompanying unaudited consolidated financial statements contain all adjustments necessary to fairly present our financial position, results of operations and cash flows for the periods presented. 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 therein. Due to the inherent uncertainty involved in making estimates, actual results in future periods may differ from those estimates.

**Note 1. Basis of Presentation**

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Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America have been condensed or omitted. The balance sheet at April 29, 2006 has been derived from the audited financial statements at that date but does not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. These financial statements should be read in conjunction with our financial statements and notes thereto for the year ended April 29, 2006, which are contained in our Annual Report on Form 10-K previously filed with the Securities and Exchange Commission. The results of operations for the interim periods presented are not necessarily indicative of results that may be expected for any other interim period or for the full fiscal year.

The consolidated financial statements include the accounts of our wholly-owned subsidiaries: Daktronics France SARL; Daktronics Shanghai, Ltd.; Daktronics GmbH; Star Circuits, Inc.; Daktronics Media Holdings, Inc. (formerly Sports Link, Ltd.); MSC Technologies, Inc.; Daktronics UK, Ltd.; Daktronics Hong Kong, Ltd.; Daktronics Canada, Inc., Daktronics Hoist, Inc. (dba Vortek) and Daktronics FZE. Investments in affiliates owned 50% or less are accounted for by the equity method. Intercompany balances 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 requires us 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. Actual results could differ significantly from those estimates. Material estimates that are particularly susceptible to significant change in the near-term relate to the determination of the estimated total costs on long-term contracts, estimated costs to be incurred for product warranty, inventory valuation reserves for doubtful accounts and estimated effective annual tax rates. Changes in estimates are reflected in the periods in which they become known.

Reclassifications: Certain reclassifications have been made to the fiscal year 2006 financial statements to conform to the presentation used in the fiscal year 2007 financial statements. These reclassifications had no effect on shareholders' equity or net income as previously reported. We reclassified certain prepayments from accounts payable to prepaid expenses, certain deferred revenue amounts to accrued expenses and warranty obligations, reclassified equity investments on the balance sheet from intangibles and other assets, and netted current maturities of long-term debt and marketing obligations.

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### Note 2. Significant Accounting Policies

Prior to April 30, 2006, we accounted for share-based employee compensation plans under the measurement and recognition provisions of Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees, and related Interpretations, as permitted by Statement of Financial Accounting Standard (SFAS) No. 123, Accounting for Stock-Based Compensation. Accordingly, we recorded no share-based employee compensation expense for options granted under our current stock option plans during the three and six months ended October 29, 2005, as all options granted under those plans had exercise prices equal to the fair market value of our common stock on the date of grant. We also recorded no compensation expense in those periods in connection with our Employee Stock Purchase Plan, as the purchase price of the stock was not less than 85% of the lower of the fair market value of our common stock at the beginning and end of each offering period. In accordance with SFAS No. 123 and SFAS No. 148, Accounting for Stock-Based Compensation Transition and Disclosure, we provided pro forma net income and net income per share disclosures for each period prior to the adoption of SFAS No. 123(R), Share-Based Payment, as if we had applied the fair value-based method in measuring compensation expense for our share-based compensation plans.

Effective April 30, 2006, we adopted the fair value recognition provisions of SFAS No. 123(R), using the modified prospective transition method. Under that transition method, we recognized compensation expense for share-based payments that vested during the three and six months ended October 28, 2006 using the following valuation methods: (a) for share-based payments granted prior to but not yet vested as of April 30, 2006, the grant date fair value was estimated in accordance with the original provisions of SFAS No. 123, and (b) for share-based payments granted on or after April 30, 2006, the grant date fair value was estimated in accordance with the provisions of SFAS No. 123(R). Because we elected to use the modified prospective transition method, results for prior periods have not been restated. In March 2005, the Securities and Exchange Commission issued Staff Accounting Bulletin (SAB) No. 107, Share-Based Payment, which provides supplemental implementation guidance for SFAS No. 123(R). We have applied the provisions of SAB No. 107 in our adoption of SFAS No. 123(R). See Note 11 for information on the impact of our adoption of SFAS No. 123(R) and the assumptions we use to calculate the fair value of share-based employee compensation.

As a result of adopting SFAS No. 123(R) on April 30, 2006, our income before income taxes and net income for the year ended April 29, 2006 are \$1,495 and \$1,405 lower, respectively, than if we had continued to account for share-based compensation under APB Opinion 25. Basic and diluted earnings per share for the year ended April 29, 2006 would have been \$0.04 and \$0.03 lower, respectively, if we had not adopted SFAS No. 123(R).

Commitments and Contingencies. We are involved in various claims and legal actions arising in the ordinary course of business. In our opinion, based upon consultation with legal counsel, the ultimate disposition of these matters will not have a material adverse effect on our consolidated financial position.

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In connection with the sale of equipment to a financial institution, we entered into a contractual arrangement whereby we agreed to repurchase equipment at the end of the lease term at a fixed price of approximately \$1,100. We have recognized a guarantee in the amount of \$200 under the provisions of FASB Interpretation No. 45, Guarantors Accounting and Disclosure Requirements for Guarantees, Including Indirect Guarantees of Indebtedness of Others. Revenue related to this transaction of \$3,476 was recognized during the quarter.

**Product Warranties.** We offer standard warranty coverages on many of our products, which include parts and in some cases labor, maintenance and support, for periods varying from one to 10 years. The specific terms and conditions of these warranties vary depending on the product sold and other factors. We estimate the costs that may be incurred under the warranty and record a liability in the amount of such costs at the time the product is shipped in the case of standard orders and prorated over the construction period in the case of custom projects. Factors that affect our warranty liability include historical and anticipated costs. We periodically assess the adequacy of our recorded warranty costs and adjust the amounts as necessary.

Changes in our product warranties for the six months ended October 28, 2006 consisted of the following:

	<u>Amount</u>
Beginning accrued warranty costs	\$ 8,319
Warranties issued during the period	5,138
Settlements made during the period	(3,179)
Changes in accrued warranty costs for pre-existing warranties during the period, including expirations	(4)
Ending accrued warranty costs	\$ 10,274

**Lease Commitments.** We lease office space for various sales and service locations and various equipment, primarily office equipment. Rental expense for operating leases was \$841 and \$697 for the six months ended October 28, 2006 and October 29, 2005, respectively. Future minimum payments under noncancelable operating leases, excluding executory costs such as management and maintenance fees, with initial or remaining terms of one year or more, consisted of the following at October 28, 2006:

<u>Fiscal Year</u>	<u>Amount</u>
2007	\$ 1,775
2008	1,532
2009	1,358
2010	1,058
2011	799
Thereafter	517
Total	\$ 7,039

**Purchase Commitments.** From time to time, we commit to purchase inventory and advertising rights over periods that extend over a year. As of October 28, 2006, we were obligated to purchase inventory and advertising rights through fiscal year 2010 as follows:

<u>Fiscal Year</u>	<u>Amount</u>
2007	\$ 4
2008	74
2009	74
2010	74
Total	\$ 226

### Note 3. Recently Issued Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN No. 48), which clarifies the accounting for uncertainty in income taxes recognized in accordance with SFAS No. 109, Accounting for Income Taxes (SFAS No. 109). FIN No. 48 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN No. 48 also provides guidance on derecognition,



classification, interest and penalties, accounting in interim periods and disclosure. FIN No. 48 is effective for fiscal years beginning after December 15, 2006 and is required to be adopted by us effective April 29, 2007. We are currently evaluating the impact of FIN No. 48 on our financial statements.

In September 2006, the FASB issued SFAS 157, *Fair Value Measurement*. The standard provides guidance for using fair value to measure assets and liabilities. SFAS 157 clarifies the principle that fair value should be based on the assumptions market participants would use when pricing an asset or liability and establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. Under the standard, fair value measurements would be separately disclosed by level within the fair value hierarchy. The statement is effective for us beginning in 2008; however, early adoption is permitted. We have not yet determined the impact, if any, that the implementation of SFAS 157 will have on our results of operations and financial condition.

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 the carryover or reversal of prior year misstatements should be considered in quantifying a current year misstatement. 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 for fiscal years ending on or after November 15, 2006, with early application encouraged. We do not expect the adoption of this standard to have any impact on our consolidated financial statements.

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#### Note 4. Revenue Recognition

*Long-term contracts:* Earnings on long-term contracts are recognized on the percentage-of-completion method, measured by the percentage of costs incurred to date to estimated total costs for each contract. Operating expenses are charged to operations as incurred and are not allocated to contract costs. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are estimable.

*Equipment other than long-term contracts:* We recognize revenue on equipment sales, other than long-term contracts, when title passes, which is usually upon shipment and then only if the revenue is fixed and determinable.

*Long-term receivables and advertising rights:* We occasionally sell and install our products at facilities in exchange for the rights to sell or to retain future advertising revenues. For these transactions, we recognize revenue for the amount of the present value of the future advertising payments if enough advertising is sold to obtain normal margins on the contract, and we record the related receivable in long-term receivables. On those transactions where we have not sold the advertising for the full value of the equipment at normal margins, we record the related cost of equipment as advertising rights. Revenue to the extent of the present value of the advertising payments is recognized in long-term receivables when it becomes fixed and determinable under the provisions of the applicable advertising contracts. At the time the revenue is recognized, costs of the equipment are recognized based on an estimate of overall margin expected.

In cases where we receive advertising rights, as opposed to only cash payments, in exchange for the equipment, revenue is recognized as it becomes earned, and the related costs of the equipment are amortized over the term of the advertising rights, which were owned by us. On these transactions, advance collections of advertising revenues are recorded as deferred income.

The cost of advertising rights, net of amortization, was \$4,012 as of October 28, 2006 and \$3,112 as of April 29, 2006.

*Product maintenance:* In connection with the sale of our products, we also occasionally sell separately priced extended warranties and product maintenance contracts. The revenue related to such contracts are deferred and recognized ratably as net sales over the term of the contracts, which varies from one month to 10 years.

*Software:* We sell our proprietary software bundled with displays and certain other products. Pursuant to American Institute of Certified Public Accountants (AICPA) Statement of Position (SOP) 97-2, *Software Revenue Recognition*, as amended by SOP 98-4, *Deferral of the Effective Date of a Provision of SOP 97-2*, and SOP 98-9, *Modification of SOP 97-2, Software Revenue Recognition with Respect to Certain Transactions*, revenues from software license fees on sales, other than long-term contracts, are recognized when persuasive evidence of an agreement exists, delivery of the product has occurred, the fee is fixed and determinable and collection is probable. For sales of software included in long-term contracts, the revenue is recognized under the percentage-of-completion method for long-term contracts starting when all of the above-mentioned criteria have been met.

*Services:* Revenues generated by us for services such as event support, control room design, on-site training, equipment service and continuing technical support for operators of our equipment are recognized as net sales as the services are performed.

*Derivatives:* We utilize derivative financial instruments to manage the economic impact of fluctuations in currency exchange rates on those transactions that are denominated in currency other than our functional currency, which is the U.S. Dollar. We enter into currency forward

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contracts to manage these economic risks. SFAS No. 133, Accounting for Derivative Instruments and Hedging Activities, as amended by SFAS No. 137 and No.138, requires us to recognize all of our derivative instruments on the balance sheet at fair value. Derivatives that are not hedges must be adjusted to fair value through earnings. If a derivative is a hedge, depending on the nature of the hedge, changes in the fair value of derivatives are either offset against the change in the fair value of the hedged assets, liabilities or firm commitments through earnings or recognized in accumulated other comprehensive gain (loss) until the hedged item is recognized in earnings.

To protect against the reduction in value of forecasted foreign currency cash flows resulting from export sales over the next year, we have instituted a foreign currency cash flow hedging program. We hedge portions of our forecasted revenue denominated in foreign currencies with forward contracts. When the dollar strengthens significantly against the foreign currencies, the decline in value of future foreign currency revenue is offset by gains in the value of the forward contracts designated as hedges. Conversely, when the dollar weakens, the increase in the value of future foreign currency cash flows is offset by losses in the value of the forward contracts.

During six months ended October 28, 2006, we assessed all hedges to be effective and recorded changes of value in other comprehensive income. Cash flow hedges were discontinued, causing the recognition of a gain or loss in other income (expense), net of \$14. The fair value of all derivatives is included in prepaid expenses and other in the statement of financial condition.

As of October 28, 2006, we expect to reclassify \$25 of net gains (losses) on derivative instruments from accumulated other comprehensive income to earnings during the next 12 months due to actual sales.

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### Note 5. Earnings Per Share

Basic earnings per share (EPS) is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding for the period. Diluted EPS reflects the potential dilution that would occur if securities or other obligations to issue common stock were exercised or converted into common stock or resulted in the issuance of common stock that then shared in our earnings.

A reconciliation of the income and common share amounts used in the calculation of basic and diluted EPS for the three months ended October 28, 2006 and October 29, 2005 follows:

	<u>Net Income</u>	<u>Shares</u>	<u>Per Share Amount</u>
For the three months ended October 28, 2006:			
Basic earnings per share	\$ 8,891	39,127,835	\$ 0.23
Effect of dilutive securities:			
Exercise of stock options and warrants		2,001,688	(0.01)
	<u>\$ 8,891</u>	<u>41,129,523</u>	<u>\$ 0.22</u>
Diluted earnings per share			
For the three months ended October 29, 2005:			
Basic earnings per share	\$ 5,185	38,586,359	\$ 0.13
Effect of dilutive securities:			
Exercise of stock options and warrants		1,680,708	(0.00)
	<u>\$ 5,185</u>	<u>40,267,067</u>	<u>\$ 0.13</u>
Diluted earnings per share			
For the six months ended October 28, 2006:			
Basic earnings per share	\$ 13,879	39,053,193	\$ 0.36
Effect of dilutive securities:			
Exercise of stock options and warrants		2,018,422	(0.02)
	<u>\$ 13,879</u>	<u>41,071,615</u>	<u>\$ 0.34</u>
Diluted earnings per share			
For the six months ended October 29, 2005:			
Basic earnings per share	\$ 9,816	38,494,629	\$ 0.25
Effect of dilutive securities:			
Exercise of stock options and warrants		1,754,178	(0.00)
	<u>\$ 9,816</u>	<u>40,248,807</u>	<u>\$ 0.25</u>
Diluted earnings per share			

On May 25, 2006, our Board of Directors declared a two-for-one stock split in the form of a stock dividend payable to stockholders of record on June 8, 2006. All data related to common shares has been retroactively adjusted based on the new shares outstanding after the effect of the split for all periods presented.

On August 16, 2006, the shareholders of Daktronics approved an amendment to the articles of incorporation to increase the authorized number of shares of common stock from 60,000,000 shares to 120,000,000 shares.

#### Note 6. Goodwill and Other Intangible Assets

We account for goodwill and other intangible assets in accordance with SFAS No. 142, Goodwill and Other Intangible Assets, and we complete an impairment analysis on at least an annual basis and more frequently if circumstances warrant.

Goodwill, net of accumulated amortization, was \$4,344 at October 28, 2006 and \$2,706 at April 29, 2006. Accumulated amortization was \$157 at October 28, 2006 and at April 29, 2006. We performed our annual impairment analysis of goodwill as of October 28, 2006. The result of this analysis indicated that no goodwill impairment existed as of that date.

As required by SFAS No. 142, intangibles with finite lives continue to be amortized. Included in intangible assets are non-compete agreements and a patent license. Intangible assets before accumulated amortization were \$3,969 at October 28, 2006 and April 29, 2006. Accumulated amortization was \$602 and \$579 at October 28, 2006 and April 29, 2006, respectively. The net value of intangible assets is included as a component of intangible and other assets in the accompanying consolidated balance sheets. Estimated amortization expense based on intangibles as of October 28, 2006 was \$503 for the fiscal years ending 2007, \$314 for fiscal years 2008 to 2010, \$287 for 2011 and \$1,253 thereafter.

#### Note 7. Inventories

Inventories consist of the following:

	October 28, 2006	April 29, 2006
Raw Materials	\$ 30,810	\$ 15,841
Work-in-progress	10,247	6,025
Finished goods	9,545	9,179
	<u>\$ 50,602</u>	<u>\$ 31,045</u>

#### Note 8. Segment Disclosure

Our chief operating decision maker reviews financial information presented on a consolidated basis, accompanied by disaggregated information about revenue and certain expenses, by market and geographic region, for purposes of assessing financial performance and making operating decisions. Accordingly, we consider ourselves to be operating in a single industry segment. We do not manage our business by solution or focus area.

We do not maintain information on sales by products and, therefore, disclosure of such information is not practical.

The following table presents information about us by geographic area:

	United States	Other	Total
Net sales for the six months ended:			
October 28, 2006	\$ 191,940	\$ 23,743	\$ 215,683
October 29, 2005	129,977	18,170	148,147
Long-lived assets at:			
October 28, 2006	65,349	985	66,334
October 29, 2005	34,251	1,211	35,462

#### Note 8. Segment Disclosure

**Note 9. Equipment Held for Sale**

In accordance with SFAS No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets, we review long-lived assets to be held and used and long-lived assets to be disposed of, including intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. Recoverability of assets to be held and used is measured by comparing the carrying amount of the asset to the future undiscounted net cash flows expected to be generated by the asset. Recoverability of assets held for sale is measured by comparing the carrying amount of the assets to their estimated fair market value. If any assets are considered to be impaired, the impairment is measured by the amount by which the carrying amount of the assets exceeds the estimated fair value.

*Impairment of Long-Lived Assets:* We recorded a pre-tax asset impairment charge of \$340 for the six months ended October 28, 2006. The impairment charges related to technology changes in our demonstration equipment and tooling equipment. Impairment charges are included in selling expenses and cost of goods sold. We recorded the impairment in the first quarter of 2007.

**Note 10. Acquisitions**

During the first quarter of fiscal year 2007, we acquired a 50% equity interest in Arena Media Networks LLC, a company that owns and operates the nation's largest network of digital flat-panel displays in stadiums and arenas across the U.S. We paid approximately \$6,008 for the investment and we account for this transaction under the equity method of accounting.

During the second quarter of fiscal year 2007, we acquired a 50% interest in FuelCast Media International, the largest pump-top display network in the nation. We paid approximately \$4,000 for the investment and we account for this transaction under the equity method of accounting.

On October 16, 2006, we acquired certain operating assets and liabilities of Hoffend & Sons, Inc. through our wholly-owned subsidiary. The business operates under the name Vortek, a division of Daktronics Hoist, Inc. Results of the operations of Vortek have been included in the consolidated financial statements since the date of acquisition. Hoffend was the world's leading supplier of patented hoist systems for theater and sporting systems and has been a supplier of ours in connection with center hung arena video systems. The aggregate purchase price, excluding contingent consideration, was approximately \$4,245 and includes \$500 due one year from the closing date. Contingent consideration of \$1,500 is due over the three calendar years following the closing date to the extent the gross profit on net sales of hoist products exceed predefined thresholds. In addition, contingent payments are due at the end of the fifth calendar year following closing to the extent gross profit on net sales of hoist products exceeds \$50,000. We are in the process of obtaining third-party valuations of certain intangible assets; thus, the allocation of the purchase price and related amounts assigned to intangibles and goodwill is preliminary. The following table summarizes the allocation of the purchase price along with the related amortization periods, if any:

	Amount Allocated	Amortization Period
Intangible assets subject amortization:		
Patents	\$ 2,282	10 years
Order backlog	300	Based on order ship dates
Non-compete agreements	200	5 years
Intangible assets not subject amortization:		
Registered trademarks	401	
Goodwill	1,617	
Net assets/(liabilities)	(555)	
Total purchase price	\$ 4,245	

The goodwill is expected to be deductible for tax purposes

**Note 11. Share-Based Compensation**

*Description of Plans.* We have two plans under which we are permitted to grant incentive and non-qualified stock options (the 1993 Incentive Stock Option Plan and the 2001 Incentive Stock Option Plan) and two plans under which we are permitted to grant non-qualified stock options (the 1993 Outside Directors Stock Option Plan and the 2001 Outside Directors Stock Option Plan). These plans authorize the awards of incentive stock options to our employees and nonqualified stock options to non-employees and outside directors as compensation for services rendered. Under these plans, options have a maximum term of 10 years in the case of the 1993 Incentive Stock Option Plan and the 2001 Incentive Stock Option Plan and seven years in the case of the 1993 Outside Directors Stock Option Plan and the 2001 Outside Directors Stock Option Plan. In addition, such options must have exercise prices equal to the market value of our common stock at the date of grant or 110% of the market value at the date of grant in the case of an employee who owns more than 10% of all voting power of all classes of our stock then outstanding. The options generally vest ratably over a five-year period in the case of options granted under the 1993 Incentive Stock Option Plan and the 2001 Incentive Stock Option Plan and three years in the case of options granted under the 1993 Outside Directors Stock Option Plan and the 2001 Outside Directors Stock Option Plan. The actual vesting period is determined at the time of grant.

*Impact of the Adoption of SFAS No. 123(R).* See Note 2 for a description of our adoption of SFAS No. 123(R) on April 30, 2006. A summary of the share-based compensation expense for stock options and our employee stock purchase plan that we recorded in accordance with SFAS No. 123(R) for the three and six months ended October 28, 2006 is as follows:

	Three-months ended October 28, 2006	Six Months Ended October 28, 2006
Cost of Sales	\$ 26	\$ 61
Selling	221	354
General and administrative	132	300
Product development and design	70	140
	<hr/> \$ 449	<hr/> \$ 855
Decrease of net income per share to common stockholders	<hr/> \$ 0.01	<hr/> \$ 0.02

Prior to the adoption of SFAS No. 123(R), we presented all tax benefits for deductions resulting from the exercise of stock options as operating cash flows on our statement of cash flows. SFAS No. 123(R) requires the cash flows resulting from the tax benefits for tax deductions in excess of the compensation expense recorded for those options (excess tax benefits) to be classified as financing cash flows. Accordingly, we classified the \$251 in excess tax benefits as financing cash inflows rather than as operating cash inflows on our statements of cash flows for the six months ended October 28, 2006.

**Determining Fair Value**

*Valuation and Amortization Method.* We estimate the fair value of stock options granted using the Black-Scholes option valuation model. We amortize the fair value of the stock options on a straight-line basis. All options are amortized over the requisite service periods of the awards, which are generally the vesting periods.

*Expected Term.* The expected term of options granted represents the period of time that they are expected to be outstanding. We estimate the expected term of options granted based on historical exercise patterns, which we believe are representative of future behavior. Our estimate of the expected life of new options granted to our employees is five years, consistent with prior periods. We have examined our historical pattern of option exercises in an effort to determine if there were any discernable patterns of activity based on certain demographic characteristics. Demographic characteristics tested included age, salary level, job level and geographic location. We have determined that there were no meaningful differences in option exercise activity based on the demographic characteristics tested.

*Expected Volatility.* Also in light of implementing SFAS No. 123(R), we reevaluated our expected volatility assumption used in estimating the fair value of employee options. We estimate the volatility of our common stock at the date of grant based on historical volatility, consistent with SFAS No. 123(R) and SAB No. 107. Our decision to use historical volatility instead of implied volatility was based upon analyzing historical data along with the lack of availability of history of actively traded options on our common stock.

*Risk-Free Interest Rate.* We base the risk-free interest rate that we use in the Black-Scholes option valuation model on the implied yield in effect at the time of option grant on U.S. Treasury zero-coupon issues with equivalent remaining terms.

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**Dividends.** We use an expected dividend yield consistent with our dividend yield over the period of time we have paid dividends in the Black-Scholes option valuation model.

**Forfeitures.** SFAS No. 123(R) requires us to estimate forfeitures at the time of grant and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. We use historical data to estimate pre-vesting option forfeitures and record share-based compensation expense only for those awards that are expected to vest. For purposes of calculating pro forma information under SFAS No. 123 for periods prior to fiscal 2006, we estimated forfeitures.

The Black-Scholes option-pricing model was developed for use in estimating the fair value of traded options that have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions, including the expected stock price volatility. Because changes in the subjective input assumptions can materially affect the fair value estimate, in our opinion, the existing models do not necessarily provide a reliable single value of our options and may not be representative of the future effects on reported net income or the future stock price of our company.

**Share-Based Compensation Expense and Stock Option Activity.** We recorded \$855 in share-based compensation expense, which consists of \$705 for stock options and \$150 for our employee stock purchase plan, for the six months ended October 28, 2006. As of October 28, 2006, there was \$3,551 of total unrecognized compensation cost related to non-vested share-based compensation arrangements granted under all equity compensation plans. Total unrecognized compensation cost will be adjusted for future changes in estimated forfeitures. We expect to recognize that cost over a weighted average period of five years.

During the six months ended October 28, 2006, we granted options to purchase 45 shares of our common stock under the 2001 Directors Stock Option Plan, which had a fair value of \$400.

A summary of stock option activity under all stock option plans during the six months ended October 28, 2006 is as follows:

	Stock Options	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding at April 29, 2006	3,292	\$ 6.31	4.91	\$ 33,370
Granted	48	22.75		
Cancelled or Forfeited	(9)	10.22		(100)
Exercised	(270)	2.36		(5,227)
Outstanding at October 28, 2006	3,061	6.89	5.3	50,745
Exercisable at October 28, 2006	1,915	\$ 4.24		\$ 36,839

We define in-the-money options at October 28, 2006 as options that had exercise prices that were lower than the \$23.47 per share market price of our common stock at that date. The aggregate intrinsic value of options outstanding at October 28, 2006 is calculated as the difference between the exercise price of the underlying options and the market price of our common stock for the shares that were in-the-money at that date. There were 3,200 in-the-money options exercisable at October 28, 2006.

We received \$639 in cash from option exercises under all share-based payment arrangements for the six months ended October 28, 2006. The actual tax benefits that we realized related to tax deductions for non-qualified option exercises and disqualifying dispositions under all share-based payment arrangements totaled \$300 for the same period.

**Comparable Disclosure.** Prior to April 30, 2006, we accounted for our share-based compensation plans under the recognition and measurement provisions of APB Opinion No. 25 and related Interpretations. No share-based employee compensation cost is reflected in the condensed consolidated statements of operations for the six months ended October 29, 2005, as all options granted under those plans had an exercise price equal to the market value of the underlying common stock on the date of grant. The following table illustrates the effect on net income and net income per share if we had applied the fair value recognition provisions of SFAS No. 123 to share-based employee compensation prior to April 30, 2006:

Three Months Ended October 29, 2005	Six Months Ended October 29, 2005
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Net income, as reported	\$ 5,185	\$ 9,816
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(171)	(339)
Pro forma net income	\$ 5,014	\$ 9,477
Net income per share:		
Basic as reported	\$ 0.13	\$ 0.25
Basic - pro forma	\$ 0.13	\$ 0.25
Diluted as reported	\$ 0.13	\$ 0.25
Diluted - pro forma	\$ 0.13	\$ 0.25

**Note 12. Comprehensive Income**

We follow the provisions of SFAS No. 130, Reporting Comprehensive Income, which establishes standards for reporting and display of comprehensive income and its components. Comprehensive income reflects the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. For us, comprehensive income represents net income adjusted for foreign currency translation adjustments and net gains and losses on derivative instruments. The foreign currency translation adjustment included in comprehensive income has not been tax effected, as the investment in the foreign affiliate is deemed to be permanent. In accordance with SFAS No. 130, we have chosen to disclose comprehensive income in the consolidated statement of shareholders' equity.

	<u>Six Months Ended</u>	
	<u>October 28, 2006</u>	<u>October 29, 2005</u>
Net income	\$ 13,879	\$ 5,185
Net foreign currency translation adjustment	(250)	175
Net gain on derivatives	39	(11)
Total comprehensive income	\$ 13,668	\$ 5,349

**Item 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion highlights the principal factors affecting changes in financial condition and results of operations. This discussion should be read in conjunction with the accompanying consolidated financial statements and notes to the consolidated financial statements.

**OVERVIEW**

We design, manufacture and sell a wide range of display systems to customers in a variety of markets throughout the world. We focus our sales and marketing efforts on geographical regions, markets and products. The primary categories of markets include sport, commercial and transportation.

Our net sales and profitability historically have fluctuated due to the impact of large product orders, such as display systems for professional sport facilities and colleges and universities, as well as the seasonality of the sports market. Net sales and gross profit percentages also have fluctuated due to other seasonality factors, including the impact of holidays, which primarily impact our third quarter. Our gross margins on large product orders tend to fluctuate more than those for smaller standard orders. Large product orders that involve competitive bidding and substantial subcontract work for product installation generally have lower gross margins. Although we follow the percentage of completion method of recognizing revenues for large custom orders, we nevertheless have experienced fluctuations in operating results and expect that our future results of operations may be subject to similar fluctuations.

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Orders are booked only upon receipt of a firm contract and, depending on terms, only after receipt of any required deposits related to the order. As a result, certain orders for which we have received binding letters of intent or contracts will not be booked until all required contractual documents and deposits are received. In addition, order bookings can vary significantly as a result of the timing of large orders.

We operate on a 52-53 week fiscal year, with fiscal years ending on the Saturday closest to April 30 of each year. Fiscal years 2007 and 2006 each contains 52 weeks.

For a summary of recently issued accounting pronouncements and the effects of those pronouncements on our financial results, refer to Note 3 of the notes to our consolidated financial statements, which are included elsewhere in this report.

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### CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The following discussion and analysis of financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements require us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. On a regular basis, we evaluate our estimates, including those related to estimated total costs on long-term contracts, estimated costs to be incurred for product warranties and extended maintenance contracts, bad debts, excess and obsolete inventory and contingencies. Our estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

We believe the following critical accounting policies require significant judgments and estimates in the preparation of our consolidated financial statements:

*Revenue recognition on long-term contracts.* Earnings on long-term contracts are recognized on the percentage-of-completion method, measured by the percentage of costs incurred to date to estimated total costs for each contract. Provisions for estimated losses on uncompleted contracts are made in the period in which such losses are estimatable. Generally, contracts we enter into have fixed prices established and, to the extent the actual costs to complete contracts are higher than the amounts estimated as of the date of the financial statements, the resulting gross margin would be negatively affected in future quarters when we revise our estimates. Our practice is to revise estimates as soon as such changes in estimates are known. We do not believe there is a reasonable likelihood that there will be a material change in future estimates or assumptions we use to determine these estimates.

*Allowance for doubtful accounts.* We maintain an allowance for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. If the financial condition of our customers were to deteriorate, resulting in an impairment of their ability to make payments, additional allowances may be required. To identify impairment in the customer's ability to pay, we review aging reports, contact customers in connection with collection efforts and review other available information. Although we consider our allowance for doubtful accounts adequate, if the financial condition of our customers were to deteriorate and impair their ability to make payments to us, additional allowances may be required in future periods. We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to determine the allowance for doubtful accounts. As of October 28, 2006 and April 29, 2006, we had an allowance for doubtful accounts balance of approximately \$1.5 million and \$1.4 million, respectively.

*Warranties.* We have created a reserve for warranties on our products equal to our estimate of the actual costs to be incurred in connection with our performance under the warranties. Generally, estimates are based on historical experience taking into account known or expected changes. If we would become aware of an increase in our warranty reserves, additional reserves may become necessary, resulting in an increase in costs of goods sold. We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to determine our reserve for warranties. As of October 28, 2006 and April 29, 2006, we had approximately \$10.3 million and \$8.1 million reserved for these costs, respectively.

*Extended warranty and product maintenance.* We have deferred revenue related to separately priced extended warranty and product maintenance agreements. The deferred revenue is recognized ratably over the contractual term. If we would become aware of an increase in our estimated costs under these agreements in excess of our deferred revenue, additional reserves may be necessary, resulting in an increase in costs of goods sold. In determining if additional reserves are necessary, we examine cost trends and other information on the contracts and compare that to the deferred revenue. We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to determine estimated costs under these agreements. As of October 28, 2006 and April 29, 2006, we had \$4.7 million and \$4.1 million of deferred revenue related to extended warranty and product maintenance, respectively.

*Inventory.* Inventories are stated at the lower of cost or market. Market refers to the current replacement cost, except that market may not exceed the net realizable value (that is, estimated selling price in the ordinary course of business less reasonable predictable costs of completion and disposal); and market is not less than the net realizable value reduced by an allowance for normal profit margins. In valuing inventory, we estimate market value where it is believed to be the lower of cost or market, and any necessary charges are charged to costs of goods sold in the



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period in which it occurs. In determining market value, we review various factors such as current inventory levels, forecasted demand and technological obsolescence. We do not believe there is a reasonable likelihood that there will be a material change in the future estimates or assumptions we use to calculate the estimated market value of inventory. However, if market conditions change, including changes in technology, product components used in our products or in expected sales, we may be exposed to losses or gains that could be material.

**Income Taxes.** As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each of the jurisdictions in which we operate. This process involves estimating the actual current tax expense as well as assessing temporary differences in the treatment of items for tax and accounting purposes. These timing differences result in deferred tax assets and liabilities, which are included in our consolidated balance sheets. We must then assess the likelihood that our deferred tax assets will be recovered from future taxable income in each jurisdiction, and to the extent we believe that recovery is not likely, a valuation allowance must be established. We review deferred tax assets, including net operating losses, and for those not expecting to be realized, we have created a valuation allowance. If our estimates of future taxable income are not met, a valuation allowance for some of these deferred tax assets would be required.

We operate within multiple taxing jurisdictions, both domestic and international, and are subject to audits in these jurisdictions. These audits can involve complex issues, including challenges regarding the timing and amount of deductions and the allocation of income amounts to various tax jurisdictions. At any one time, multiple tax years are subject to audit by various tax authorities. The United States Internal Revenue Service (IRS) is currently in the process of examining our U.S. federal tax returns for fiscal years 2002, 2003 and 2004.

We record our income tax provision based on our knowledge of all relevant facts and circumstances, including the existing tax laws, the status of current IRS examinations and our understanding of how the tax authorities view certain relevant industry and commercial matters. In evaluating the exposures associated with our various tax filing positions, we record reserves for probable exposures. A number of years may elapse before a particular matter for which we have established a reserve is audited and fully resolved or clarified. We adjust our tax contingencies reserve and income tax provision in the period in which actual results of a settlement with tax authorities differs from our established reserve, when the statute of limitations expires for the relevant taxing authority to examine the tax position, or when more information becomes available. Our tax contingencies reserve contains uncertainties because management is required to make assumptions and to apply judgment to estimate the exposure associated with our various filing positions. We believe that any potential tax assessments from various tax authorities that are not covered by our income tax provision will not have a material adverse impact on our consolidated financial position or cash flow.

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### RESULTS OF OPERATIONS

The following table sets forth the percentage of net sales represented by items included in our consolidated statements of income for the periods indicated:

	<u>Three Months Ended</u>		<u>Six Months Ended</u>	
	<u>October 28,</u> <u>2006</u>	<u>October 29,</u> <u>2005</u>	<u>October 28,</u> <u>2006</u>	<u>October 29,</u> <u>2005</u>
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of goods sold	71.3%	70.6%	71.3%	70.0%
Gross profit	28.7%	29.4%	28.7%	30.0%
Operating expenses	17.1%	19.3%	19.0%	19.9%
Operating income	11.6%	10.1%	9.7%	10.1%
Interest income (expense)	0.4%	0.6%	0.5%	0.5%
Other income (expense), net	(0.5%)	0.0%	(0.3%)	(0.0%)
Income before income taxes	11.5%	10.7%	9.9%	10.6%
Other tax expense	4.3%	3.9%	3.5%	4.0%
Net income	7.2%	6.8%	6.4%	6.6%

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**NET SALES**

Net sales increased 45.6% to \$215.7 million for the six months ended October 28, 2006 as compared to \$148.1 million for the same period in fiscal year 2006. Net sales increased 63.0% to \$123.5 million for the three months ended October 28, 2006 as compared to \$75.8 million for the same period in fiscal year 2006. For the six months and three months ended October 28, 2006, net sales increased in all our markets, with the commercial market experiencing growth rates in excess of 55% for the six-month period, sports market growing more than 35% year-to-date and the transportation market up more than 65%. For the three months ended October 28, 2006, commercial, sports and transportation market's sales increased 75%, 50% and 90%, respectively. Net sales for the three months ended October 28, 2006 increased domestically and on an international basis. On an international basis, net sales increased over 20% for the quarter and year-to-date. As a percent of overall net sales, small product orders as opposed to large custom orders were approximately 20% of net sales for the second quarter and 22% year-to-date.

Overall, the level of net sales generated during the second quarter of fiscal year 2007 and year-to-date in all markets was limited as a result of capacity constraints within our manufacturing facilities, both in terms of space and personnel. This limitation began to diminish in the second quarter as a result of the ramping up of facilities in Brookings and Sioux Falls, South Dakota. We will continue to develop increased manufacturing capabilities, including in Asia (which is not expected to be significant in the near term). As we progress through the rest of the calendar year 2007, we expect that the constraints should become less of a factor based on our current estimates of orders through the end of the calendar year. In addition, we are evaluating various other opportunities to more efficiently manufacture and keep pace with the evolving marketplace for video displays, including additional facilities.

As we have reported in prior filings, we have made two investments in two media companies, one that owns and controls the nation's largest network of digital LCD and plasma screens in professional sports facilities and the other company that owns and controls the nation's largest gas pump digital display network. Both of these transactions are expected to help us generate more recurring revenue opportunities and expand our services businesses. Also, these companies are non-consolidated entities, and therefore their sales are not included in our net sales. Also, during the second quarter of fiscal year 2007, we acquired certain operating assets of Hoffend & Sons, Inc., a leader in the automated hoist business for sporting and theater applications. We expect that for the remainder of fiscal year 2007 and ongoing, net sales from this business will increase at rates in excess of 20%; however, the impact on our net sales in fiscal year 2007 will be less than \$5 million.

*Commercial Market.* Net sales in the commercial market grew during the second quarter and first six months of fiscal year 2007 as compared to the same periods of fiscal year 2006. For the first six months of fiscal year 2007, net sales increased more than 55%, and for the quarter, they increased more than 75% as compared to the same periods of last fiscal year. This increase is attributable to both standard and custom orders. The increase in custom projects for both the quarter and year-to-date is due primarily to an increase in orders from outdoor advertising companies, while the increase in standard products is due to the growth in our Galaxy display business within the national account portion of our business and through resellers. On an international basis, net sales increased over 35% for the quarter and almost 50% year-to-date as compared to the same periods of last fiscal year. We continue to believe that we are gaining traction in our efforts to build our international business and are seeing a greater potential for higher sales overseas. However, as a result of the significant growth rates domestically, we would not expect international business in the commercial market to outpace domestic growth.

Overall, the commercial market continues to benefit from increasing product acceptance, lower cost of displays, our expanding distribution network and a better understanding by our customers of the product as a revenue generation tool. The most significant factor for increasing sales has been the order volume of video displays for outdoor advertising companies. This industry continues to increase its demand for video displays in place of traditional billboards due to the enhanced margins and cash flow that they achieve. Our rate of growth could increase depending on our success in capturing and retaining the business of the major billboard companies.

We expect that the growth in the commercial market will continue throughout fiscal year 2007 due to increased order volume in the billboard market, our expanded distribution network, greater product acceptance, our international expansion, the development of our resellers and our integrated product offerings. Net sales in the commercial market should also expand at rates faster than our other markets, and our national account business and billboard business within the commercial market could grow faster depending on our success in booking major accounts in this niche. We also expect to see growth generated through sales of our new ProTour line of mobile and modular displays, which we believe will drive improvements in profitability internationally.

Our growth in the commercial market depends to some degree on the state of the economy, which we do not believe had any adverse effects in the first six months of fiscal year 2007 as opposed to the same period in fiscal year 2006.

Order bookings in the commercial market were up more than 80% for the second quarter of fiscal year 2007 and more than 75% year-to-date as compared to the same periods of fiscal year 2006. The increases were the result of the same factors as mentioned above in connection with net sales. During the quarter ended October 28, 2006, we received a significant amount in orders from large outdoor advertising companies.

*Sports Market.* Within the sports markets, the increase in net sales in the second quarter of fiscal year 2007 as compared to the second quarter of fiscal year 2006 was the result of increases in large and small sports facilities with the majority of the growth occurring in the larger

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venues. In addition, most of the growth in net sales both for the quarter and on a year-to-date basis as compared to the prior fiscal year was in custom orders as opposed to standard orders. Our sports market is subject to volatility based on the timing of large orders, especially orders for professional facilities, which can cause net sales to fluctuate year-to-year. The mid-sized and small facilities experience more consistency in growth rates due to the greater number of facilities. The increase in net sales to large sports venues for the year was attributable to increases at both college and professional sports facilities and included the benefit of the unusually large amount of orders booked in the first quarter of fiscal year 2007.

The growth in net sales for large and small sports venues was due to a number of factors, including the expanding market, with facilities spending more on larger display systems; our product and services offering, which remains the most integrated and comprehensive offering in the industry; and our network of sales and service offices, which is important to support our customers. We believe that the effects of the economy have a lesser impact on our sports market as compared to our other markets, since our products are generally revenue generation tools (through advertising) for facilities and the sports business in general is more resistant to negative factors in the economy as a whole.

An important trend that continues to gain momentum in large professional and college facilities is the demand for high definition video displays as well as more square footage of video equipment overall at facilities, both of which should have the effect of increasing order sizes on large projects. We believe that this could be an important factor in our growth for the future, along with the development of video systems for larger high school facilities.

The dollar amount of orders (as opposed to net sales) in the sports market also increased in the second quarter of fiscal year 2007 as compared to the second quarter of fiscal year 2006. Orders were up approximately 35% for the quarter and 45% year-to-date. This improved performance is due to the same reasons indicated for the increase in net sales in sports market. The growth in orders was in the same niches as net sales. Orders on an international basis within the sports market were not significant.

For the rest of fiscal year 2007, we expect that net sales and orders in the sports market will continue to outpace the prior periods of fiscal year 2006; however, we expect that orders will grow at less than the 35% rate experienced during the second quarter of fiscal year 2007. We believe that the growth in the sports market over the long-term is driven by new product development, new uses for existing products, an expanding market as our products become more affordable to more institutions, growth internationally, and our overall product offerings, which we believe are the most complete systems in the marketplace.

*Transportation Market.* The increase in net sales in the transportation market for the second quarter of fiscal year 2007, as compared to the second quarter of fiscal 2006, was more than 90%, and net sales in the transportation market are up more than 65% year-to-date as compared to fiscal year 2006, fueled by orders bookings in the second quarter of fiscal 2006. For the rest of fiscal year 2007, we believe that we will benefit from legislation passed during calendar year 2005 by Congress that provided for increased spending on transportation projects, including large increases associated with intelligent transportation systems. For the rest of fiscal year 2007, we expect that sales and orders will outpace fiscal year 2006 as a result of the expected increased order volume.

*Other Markets.* We occasionally sell products in exchange for the advertising revenues generated from use of products. These sales represented less than 2% and 1% of net sales for the second quarter and six months ended October 28, 2006. The gross profit percents on these transactions should typically be higher than the gross profit percents on other transactions of similar size, although the selling expenses associated with these transactions are typically higher.

Historically our sales have declined in our third quarter on a sequential basis, primarily as a result of the time between the start of major sports seasons and the effects of the holidays. As our commercial market has developed, we have seen this decline on sales on a sequential basis diminish. As a result of the significant efforts during the second quarter, which included numerous extra shifts and various other tactics to decrease backlog which we believe are not sustainable, net sales could decline sequentially as a percentage in the third quarter more than in fiscal year 2006. Offsetting this, our ability to execute on continued ramp up capacity in the third quarter compared to the second quarter.

The order backlog as of October 28, 2006 was approximately \$121 million as compared to \$81 million as of October 29, 2005 and \$123 million at the beginning of the second quarter of fiscal year 2007. Historically, our backlog varies due to the timing of large orders. Our order backlog as of October 28, 2006 was higher in all three markets when compared to the backlog as of October 29, 2005 and October 28, 2006. The changes in the backlog were the result of the combination of the changes in orders and net sales discussed above as well as the constraints in capacity as mentioned above.

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### GROSS PROFIT

Gross profit increased 59.0% to \$35.5 million for the second quarter of fiscal 2007 as compared to \$22.3 million for the second quarter of fiscal year 2006. For the six months ended October 28, 2006, gross profit increased 39.0% to \$61.9 million compared to \$44.5 million for the six months ended October 29, 2005. As a percent of net sales, gross profit was 28.7% for three and six months ended October 28, 2006 as compared to 29.4% and 30.0% for the three and six months ended October 29, 2005. The gross profit percentage decrease for both the quarter and six months ended October 28, 2006 as compared to the same periods in fiscal year 2006 relate to a number of factors, including the lower margins

on a couple of larger projects mentioned in the previous quarter, the increased costs of expanding facilities, higher warranty costs, the mix between small orders versus large custom product orders and various other factors.

We strive towards higher gross margins as a percent of net sales, although depending on the actual mix, performance on larger projects, our ability to execute on the business and level of future sales, margin percentages may not increase and are likely to remain below the levels of the last fiscal year in the upcoming quarter due to the continuation of efforts to expand facilities.

We expect that margins in the third quarter of fiscal 2007 will increase over the margin levels of the second quarter of fiscal year 2007. There are a number of factors that could affect this expectation, including our actual mix of sales and performance on the orders, the level at which we book orders during the quarter and our ability to execute the rollout of the new facilities. Finally, our ability to estimate gross profit margin is subject at all times to the inherent volatility that comes with long-term contracts like our custom orders.

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## OPERATING EXPENSES

*Operating expenses.* Operating expenses, which are comprised of selling, general and administrative expenses and product design and development costs, increased by approximately 44.4% from \$14.6 million in the second quarter of fiscal year 2006 to \$21.1 million in the second quarter of fiscal year 2007. As a percent of net sales, operating expenses decreased from 19.3% of net sales to 17.1% of net sales. For the six months ended October 28, 2006, operating expenses increased 38.5% from \$29.5 million for the six months ended October 29, 2005 to \$40.9 million for the six months ended October 28, 2006.

*Selling Expenses.* Selling expenses consist primarily of salaries, other employee related costs, travel and entertainment expense, facilities-related costs for sales and service offices, and expenditures for marketing efforts, including collateral materials, conventions and trade shows, product demos and supplies.

Selling expenses increased 36.5% to \$12.5 million for the three months ended October 28, 2006 as compared to \$9.2 million for the same period in fiscal year 2006. Selling expenses increased 31.5% to \$25.0 million for the six months ended October 28, 2006 from \$19.0 million for the same period in fiscal year 2006. Selling expenses decreased to 10.1% of net sales for the second quarter of fiscal year 2007 from 12.1% of net sales for the second quarter of fiscal year 2006. For the six months ended October 28, 2006, selling expenses were 11.6% of net sales as compared to 12.8% of net sales for the six months ended October 29, 2005.

Selling expenses for the quarter and the six months ended October 28, 2006 were higher as a result of an increase in personnel costs, as we continued to build our sales infrastructure in all markets and internationally. This includes increases in initiatives such as support for sales of extended services, geographical expansion, and sales efforts related to new products and market niches. In addition, selling expenses increased due to the increasing investment in demonstration equipment and travel costs associated with the higher level of order bookings. We expect selling expense to increase slightly in the third quarter as compared to the second quarter of fiscal 2007. Because sales expenses relate more to the level of order bookings than to the level of net sales, we believe that during periods where orders outpace sales, the selling expense percentage may not reflect the actual long-term percentage.

*General and Administrative.* General and administrative expenses consist primarily of salaries, other employee-related costs, professional fees, shareholder relations fees, facilities and equipment related costs for administration departments, amortization of intangibles and supplies.

General and administrative expenses increased 72.5% to \$4.6 million for the second quarter of fiscal year 2007 as compared to \$2.7 million for the second quarter of fiscal year 2006. General and administrative expenses increased 57.5% to \$8.4 million for the six months ended October 28, 2006 as compared to \$5.3 million for the six months ended October 29, 2005. General and administrative expenses increased to 3.7% as a percent of net sales for the second quarter of fiscal year 2007 from 3.5% of net sales for the second quarter of fiscal year 2006. For the six months ended October 28, 2006, general and administrative expenses increased to 3.9% of net sales as compared to 3.6% of net sales for the six months ended October 29, 2005.

The increase in general and administrative expenses for the first three and six months of fiscal year 2007 as compared to the first three and six months of fiscal year 2006 was due to the implementation of SFAS No. 123R relating to stock option expense; increases in personnel related costs within general and administration, primarily information systems staff due to our growth and additions in human resources to support the company growth overall; professional fees associated with the completion of the IRS audit, which are partially offset through a lower effective tax rate; information systems maintenance and support costs; international expansion; and higher recruiting and training costs of our expanding work force. We expect that general and administrative costs will increase slightly in the third quarter of fiscal year 2007.

*Product Design and Development.* Product design and development expenses consist primarily of salaries, other employee-related costs, facilities and equipment related costs, and costs of supplies.

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Product design and development expenses increased 43.2% to \$3.9 million for the three months ended October 28, 2006 compared to \$2.7 million for the same period in fiscal year 2006. Product design and development expenses increased 44.3% to \$7.6 million for the six months ended October 28, 2006 as compared to \$5.2 million for the six months ended October 29, 2005. Product design and development expense was 3.2% of net sales for the second quarter of fiscal year 2007 and 3.6% of net sales for second quarter of fiscal 2006. Product design and development expenses were 3.5% of net sales for both the six months ended October 28, 2006 and October 29, 2005.

Generally, product design and development expenses increase when our engineering resources are not dedicated to long-term contracts, as the same personnel who work on research and development also work on long-term contracts. During the second quarter of fiscal 2007, we continued to invest in a number of critical initiatives. We expect that product design and development expenses will be less than 4% of net sales for all of fiscal year 2007.

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### INTEREST INCOME AND EXPENSE

We occasionally generate interest income through product sales on an installment basis, under lease arrangements or in exchange for the rights to sell and retain advertising revenues from displays, which result in long-term receivables. We also invest excess cash in short-term temporary cash investments and marketable securities that generate interest income. Interest expense is comprised primarily of interest costs on our notes payable and long-term debt. Interest income (expense), net resulting from these items decreased 1.5% to \$0.4 million for the three months ended October 28, 2006 as compared to \$0.5 million for the second quarter of fiscal year 2006. For the six months ended October 28, 2006, interest income (expense), net increased 36.1% to \$1.1 million from \$0.8 million for the six months ended October 29, 2005. The change for the six months as a whole was the result of higher average levels of temporary cash investments, marketable securities and long-term receivables outstanding during the respective periods as well as lower levels of debt outstanding. The decline for the second quarter of fiscal 2007 was attributable to the significant investments made in building our facilities and equipment which caused average cash, temporary cash investments and marketable securities to decline so significantly. We expect that during the rest of fiscal year 2007, our cash balances will increase and that we will trend towards higher net interest income.

### OTHER INCOME (EXPENSE), NET

Other income (expense), net decreased to (\$0.6) million for the second quarter of fiscal year 2007 as compared to (\$0.0) million in the second quarter of fiscal year 2006. For the first six months of fiscal year 2007, other income (expense), net decreased to (\$0.5) million from (\$0.1) million for the same period in fiscal year 2006. The change for both the quarter and year-to-date results from the effects of earnings attributable to unconsolidated affiliates and from currency gains and losses.

### INCOME TAX EXPENSE

Income taxes were approximately \$5.3 million in the second quarter of fiscal year 2007 and \$3.0 million for the second quarter of fiscal year 2006. For the first six months of fiscal year 2007, income taxes increased to \$7.6 million as compared to \$5.9 million for the first six months of fiscal year 2006. The effective tax rate for the six months ended October 28, 2006 was 35.5% as compared to 37.5% for the first six months of fiscal year 2006. The effective rate was lower in fiscal year 2007 as a result of utilizations of net operating losses in Europe which had previously been offset by valuation allowances; benefits relating to transfer pricing assumptions, and the conclusion of an IRS audit, which examined tax returns from fiscal years 2002 through 2005.

We recently completed an examination by the IRS primarily rated to research and development credits we utilized in the past, although it did cover many other areas. The net result was a benefit to income tax expense. We also continue to be optimistic that as a result of perceived improvements in our international business, we will begin generating taxable income in foreign jurisdictions, which would allow us to recognize the benefits related to net operating loss carryforwards that have been offset by a valuation reserve. Finally, we expect that our effective tax rate for the rest of the 2007 fiscal year will approximate 38% and could be less to the extent Congress reinstates research and development tax credits from which we are currently not recognizing any benefit from.

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### LIQUIDITY AND CAPITAL RESOURCES

Working capital, consisting of current assets less current liabilities, was \$50.4 million at October 28, 2006 and \$67.5 million at April 30, 2006. We have historically financed working capital needs through a combination of cash flow from operations and borrowings under bank credit agreements.

Cash provided by operations for the six months ended October 28, 2006 was \$10.7 million. Net income of \$13.9 million, plus depreciation and amortization of \$5.6 million, plus an increase in accounts payable, billings in excess of costs and estimated earnings, deferred revenue, and income taxes payable, were offset by an increase in inventory, accounts receivable, restricted cash, costs and estimated earnings in excess of billings, prepaid insurance and other assets, advertising rights and the effects of changes in various other operating assets and liabilities.

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The changes overall in operating assets and liabilities are generally due to the impact of the timing of cash flows on large projects, which can cause significant fluctuations in the short term. We expect that as a result of various initiatives underway, including changes being made in manufacturing, purchasing, collections and payment processes, we expect to continue to improve our cash flow from operations and our balance sheet as a whole, relative to the sales level.

Included in cash was approximately \$5 million of restricted cash. This cash represents a customer's down payment on an order that has been deposited in an escrow account on our behalf to serve as a collateral to protect the customer against certain defaults by us under the contract. We expect that these conditions will be eliminated and that the cash will become unrestricted during the third quarter of fiscal year 2007.

Cash used by investing activities was \$33.2 million for the six months ended October 28, 2006. This included \$27.8 million for purchases of property and equipment. During the first six months of fiscal year 2007, we invested approximately \$3.7 million in facilities additions, primarily related to manufacturing facilities in Brookings, South Dakota and Sioux Falls, South Dakota; \$1.2 million in transportation equipment; \$13.5 million in manufacturing equipment; \$5.1 million in information systems infrastructure, including software; \$1.7 million for rental equipment; \$0.8 in land; and \$0.5 million in product demonstration equipment. These investments were made to support our continued growth and to replace obsolete equipment. During the first six months of fiscal 2007, we made investments in two different entities and purchased assets from another entity, as described previously, which approximated \$13.7 million in cash. These investments are not expected to have significant impact on cash from operations. During the six months ended October 28, 2006, we sold \$8.3 marketable securities.

In early fiscal 2007, we began construction of another significant addition to our facilities in Brookings, South Dakota. The majority of the addition is designed to be used for administrative and manufacturing space and is expected to be complete in early fiscal 2008. The total cost of the building and related equipment is approximately \$14 million. We expect that total capital equipment investments for all of fiscal 2007 may exceed \$43 million.

Cash used by financing activities in the first six months of fiscal year 2007 consisted of \$2.0 million, including the dividend paid to shareholders of \$2.3 million on June 23, 2006 and advances under our line of credit with the bank, which were partially offset by option exercises and excess tax benefits from stock based compensation. We expect that the bank debt will be repaid in the short term, and we have funded the majority of the intended capital investments already through the first half of the fiscal year, it is unlikely that we will need to incur any additional debt to fund the expansion plans over the rest of the fiscal year. During the second quarter of fiscal year 2007, we purchased a land parcel in Sioux Falls, South Dakota for long-term development and financed it through a note from the seller.

Included in receivables as of October 28, 2006 was approximately \$1.3 million of retainage on long-term contracts, all of which is expected to be collected in one year.

We have used and expect to continue to use cash reserves and bank borrowings to meet our short-term working capital requirements. On large product orders, the time between order acceptance and project completion may extend up to and exceed 18 months depending on the amount of custom work and the customer's delivery needs. We often receive a down payment or progress payments on these product orders. To the extent that these payments are not sufficient to fund the costs and other expenses associated with these orders, we use working capital and bank borrowings to finance these cash requirements.

Our product development activities include the enhancement of existing products and the development of new products from existing technologies. Product design and development expenses were \$2.9 million for the quarter ended October 28, 2006 and \$7.6 million for the six months ended October 28, 2006. We intend to continue to incur these expenditures to develop new display products using various display technologies to offer higher resolution and more cost effective and energy efficient displays. We also intend to continue developing software applications for our display controllers to enable these products to continue to meet the needs and expectations of the marketplace.

We have a credit agreement with a bank that provides for a \$20.0 million line of credit, which includes up to \$10.0 million for standby letters of credit. The interest rate on the line of credit is equal to LIBOR plus 0.75% (5.3% at October 28, 2006) and is due on October 1, 2007. As of October 28, 2006, approximately \$2.4 million was outstanding under the line of credit. In addition, standby letters of credit were issued and outstanding for approximately \$3.9 million as of October 28, 2006. The credit agreement is unsecured and requires us to meet certain covenants, including maintaining tangible net worth of at least \$75 million, a minimum liquidity ratio, a limit on dividends and distributions, and a minimum adjusted fixed charge coverage ratio. Daktronics Canada, Inc., our subsidiary, has various credit agreements that provide up to \$0.2 million in borrowings under lines of credit. The interest rate on the lines of credit is equal to 1.0% above the prime rate of interest (6.0% at October 28, 2006). As of October 28, 2006, no advances under the line of credit were outstanding. The lines are secured primarily by accounts receivables, inventory and other assets of the subsidiary. Finally, as mentioned above, we incurred approximately \$1.1 million of debt secured by land purchased in Sioux Falls, South Dakota. The note bears no interest and matures on September 1, 2008.

On May 25, 2006, our Board of Directors approved a two-for-one stock split of our common stock in the form of a stock dividend. Stockholders of record at the close of business on June 8, 2006 received one additional share for each share of common stock held on that date of record. Our stock began trading on the split-adjusted basis on June 23, 2006. On that same date, our Board also declared an annual dividend payment of \$.06 per share (as adjusted for the two-for-one stock split declared by the Board of Directors on May 25, 2006) on our common

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stock for the year ended April 29, 2006. Although we intend to pay regular annual dividends for the foreseeable future, all subsequent dividends will be reviewed annually and declared by our Board of Directors at its discretion.

We are sometimes required to obtain performance bonds for display installations, and we have a bonding line available through a surety company that provides for an aggregate of \$100 million in bonded work outstanding. At October 28, 2006, we had approximately \$22.4 million of bonded work outstanding against this line.

We believe that based on our current growth estimates over the next 12 months, we have sufficient capacity under our lines of credit. Beyond that time, we may need to increase the amount of our credit facilities depending on various factors. We anticipate that we will be able to obtain any needed funds under commercially reasonable terms from our current lender. We believe that cash from operations from our existing or increased credit facility and from our current working capital will be adequate to meet the cash requirements of our operations in the foreseeable future.

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### Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

#### FOREIGN CURRENCY EXCHANGE RATES

Through October 28, 2006, most of our net sales were denominated in United States dollars, and our exposure to foreign currency exchange rate changes was not significant. Net sales originating outside the United States through the second quarter of fiscal year 2007 were 11.0% of total net sales. We operate in various countries in Europe, Asia and the Middle East and in Canada through wholly-owned subsidiaries. Sales of those foreign subsidiaries comprised 8.7% of net sales during the second quarter of fiscal year 2007. If we believed that currency risk in any foreign location was significant, we would utilize foreign exchange hedging contracts to manage our exposure to the currency fluctuations.

We expect net sales to international markets in the future to increase and that a greater portion of this business will be denominated in foreign currencies. As a result, operating results may become subject to fluctuations based upon changes in the exchange rates of certain currencies in relation to the United States dollar. To the extent that we engage in international sales denominated in United States dollars, an increase in the value of the United States dollar relative to foreign currencies could make our products less competitive in international markets. This effect is also impacted by the sources of raw materials from international sources. We will continue to monitor and minimize our exposure to currency fluctuations and, when appropriate, use financial hedging techniques, including foreign currency forward contracts and options, to minimize the effect of these fluctuations. However, exchange rate fluctuations as well as differing economic conditions, changes in political climates, differing tax structures and other rules and regulations could adversely affect our financial results in the future.

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#### INTEREST RATE RISKS

Our exposure to market rate risk for changes in interest rates relates primarily to our debt and long-term accounts receivables. We maintain a blend of both fixed and floating rate debt instruments. As of October 28, 2006, our outstanding debt approximated \$4.5 million, substantially all of which was in fixed rate obligations. Each 100 basis point increase or decrease in interest rates would have an insignificant annual effect on variable rate debt interest based on the balances of such debt as of October 28, 2006. For fixed-rate debt, interest rate changes affect its fair market value but do not affect earnings or cash flows.

In connection with the sale of certain display systems, we have entered into various types of financings with customers. The aggregate amounts due from customers include an interest element. The majority of these financings carry fixed rates of interest. As of October 28, 2006, our outstanding long-term receivables were approximately \$13.4 million. Each 25 basis point increase in interest rates would have an associated annual opportunity cost to us of less than \$0.1 million.

The following table provides information about our financial instruments that are sensitive to changes in interest rates, including debt obligations, for the sixth months ending April 30, 2007 and subsequent fiscal years.

Six Months Ending April 30, 2007	Principal (Notional) Amount by Expected Maturity (in thousands)				
	Fiscal Year				
	2008	2009	2010	2011	There- after

**Principal (Notional) Amount by Expected Maturity**

## Assets:

## Long-term receivables, including current maturities:

Fixed-rate	\$ 2,643	\$ 2,949	\$ 2,227	\$ 1,938	\$ 1,176	\$ 2,502
Average interest rate	7.0%	7.8%	7.6%	7.5%	8.0%	8.1%

## Liabilities:

## Long- and short-term debt:

Fixed-rate	\$ 75	\$ 2,907	\$ 542	\$ 25	\$ 24	\$
Average interest rate	4.8%	6.0%	5.7%			

## Long-term marketing obligations, including current portion:

Fixed-rate	\$ 316	\$ 243	\$ 203	\$ 124	\$ 50	\$ 30
Average interest rate	5.4%	8.2%	8.3%	8.7%	8.9%	8.5%

The carrying amounts reported on the balance sheet for long-term receivables and long- and short-term debt approximates their fair value.

Substantially all of our cash balances are denominated in United States dollars. Cash balances in foreign currencies are operating balances maintained in accounts of our foreign subsidiaries and accounts to settle euro-based payments. These balances are immaterial as a whole.

**Item 4. CONTROLS AND PROCEDURES**

We carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, as that term is defined in Rule 13a-15(e) and Rule 15d-15(e) under the Securities Exchange Act of 1934, as of October 28, 2007, which is the end of the period covered by this report. Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that as of October 28, 2006, our disclosure controls and procedures were effective.

Based on the evaluation described in the foregoing paragraph, our Chief Executive Officer and Chief Financial Officer concluded that during the quarter ended October 28, 2006, there was no change in our internal control over financial reporting that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**PART II. OTHER INFORMATION****Item 1. LEGAL PROCEEDINGS**

Not Applicable

**Item 1A. Risk Factors**

The discussion of our business and operations included in this Quarterly Report on Form 10-Q should be read together with the risk factors described in Item 1A of our Annual Report on Form 10-K for the year ended April 29, 2006. It describes various risks and uncertainties to which we are or may become subject. These risks and uncertainties, together with other factors described elsewhere in this report, have the potential to affect our business, financial condition, results of operations, cash flows, strategies or prospects in a material and adverse manner. New risks may emerge at any time, and we cannot predict those risks or estimate the extent to which they may affect financial performance.

**Item 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

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**

- |         |   |
|---------|---|
| Ex 31.1 | Certification Of The Chief Executive Officer Required By Rule 13a-14(a) OR Rule 15d-14(a) Of The Securities Exchange Act of 1934, As Adopted Pursuant To Section 302 Of The Sarbanes-Oxley Act Of 2002. (9) |
| Ex 31.2 | Certification Of The Chief Financial Officer Required By Rule 13a-14(a) OR Rule 15d-14(a) Of The Securities Exchange Act of 1934, As Adopted Pursuant To Section 302 Of The Sarbanes-Oxley Act Of 2002. (9) |
| Ex 32.1 | Certification Of The Chief Executive Officer Pursuant To Section 906 Of The Sarbanes-Oxley Act of 2002 (18 U.S.C. Section 1350). (9)  |
| Ex 32.2 | Certification Of The Chief Financial Officer Pursuant To Section 906 Of The Sarbanes-Oxley Act Of 2002 (18 U.S.C. Section 1350). (9)  |

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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.

By: /s/ William R. Retterath  
Daktronics, Inc.  
William R. Retterath,  
Chief Financial Officer and Chief Accounting Officer

Date: November 17, 2006