ENNIS, INC.
Form 10-Q
October 05, 2012
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# UNITED STATES <br> SECURITIES AND EXCHANGE COMMISSION 

Washington, D.C. 20549

## FORM 10-Q

(Mark One)
x Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the Quarterly Period Ended August 31, 2012

OR

Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 For the Transition Period from to

## ENNIS, INC.

(Exact Name of Registrant as Specified in Its Charter)

| Texas |  |
| :---: | :---: |
| (State or Other Jurisdiction of |  |
| Incorporation or Organization) |  |
| 2441 Presidential Pkwy., Midlothian, Texas |  |
| (Address of Principal Executive Offices) | 75-0256410 <br> (I.R.S. Employer |
| Identification No.) |  |
|  | $(972) 775-9801$ |

(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 x No ${ }^{.}$

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate web site, if any, every Interactive Date File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ..

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule $12 b-2$ of the Exchange Act. (Check one).

Large accelerated Filer ..
Accelerated filer
X
Non-accelerated filer $\quad \cdot$ (Do not check if a smaller reporting company) Smaller reporting company
Indicate by check mark whether the Registrant is a shell company (as defined in Rule $12 \mathrm{~b}-2$ of the Exchange Act). Yes .. No x

As of September 28, 2012, there were $26,155,418$ shares of the Registrant s common stock outstanding.

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ENNIS, INC. AND SUBSIDIARIES

FORM 10-Q

FOR THE PERIOD ENDED AUGUST 31, 2012

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## PART I. FINANCIAL INFORMATION

## Item 1. FINANCIAL STATEMENTS

## ENNIS, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

## (Dollars in thousands)

|  | $\begin{aligned} & \text { August 31, } \\ & \mathbf{2 0 1 2} \\ & \text { (unaudited) } \end{aligned}$ | $\begin{gathered} \text { February } 29, \\ 2012 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: |
| Assets |  |  |  |
| Current assets |  |  |  |
| Cash | \$ 13,205 | \$ | 10,410 |
| Accounts receivable, net of allowance for doubtful receivables of \$4,410 at August 31, 2012 and \$4,403 at |  |  |  |
| February 29, 2012 | 63,591 |  | 58,790 |
| Prepaid expenses | 6,206 |  | 8,091 |
| Prepaid income taxes | 2,996 |  | 3,854 |
| Inventories | 108,247 |  | 132,572 |
| Deferred income taxes | 5,493 |  | 5,493 |
| Total current assets | 199,738 |  | 219,210 |
| Property, plant and equipment, at cost |  |  |  |
| Plant, machinery and equipment | 154,131 |  | 153,818 |
| Land and buildings | 79,097 |  | 80,020 |
| Other | 23,068 |  | 22,997 |
| Total property, plant and equipment | 256,296 |  | 256,835 |
| Less accumulated depreciation | 162,055 |  | 157,319 |
| Net property, plant and equipment | 94,241 |  | 99,516 |
| Goodwill | 121,731 |  | 121,634 |
| Trademarks and tradenames, net | 63,407 |  | 63,473 |
| Customer lists, net | 21,659 |  | 23,188 |
| Deferred finance charges, net | 596 |  | 671 |
| Other assets | 4,165 |  | 4,270 |
| Total assets | \$ 505,537 | \$ | 531,962 |

See accompanying notes to consolidated financial statements.

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## ENNIS, INC. AND SUBSIDIARIES

## CONSOLIDATED BALANCE SHEETS

## (Dollars in thousands, except for share amounts)

|  | August 31, 2012 (unaudited) | $\begin{gathered} \text { February } 29, \\ 2012 \end{gathered}$ |  |
| :---: | :---: | :---: | :---: |
| Liabilities and Shareholders Equity |  |  |  |
| Current liabilities |  |  |  |
| Accounts payable | \$ 21,679 | \$ | 27,924 |
| Accrued expenses |  |  |  |
| Employee compensation and benefits | 14,909 |  | 16,087 |
| Taxes other than income | 1,153 |  | 547 |
| Income taxes payable | 782 |  | 1,183 |
| Other | 3,002 |  | 4,500 |
| Total current liabilities | 41,525 |  | 50,241 |
| Long-term debt | 70,000 |  | 90,000 |
| Liability for pension benefits | 8,572 |  | 7,494 |
| Deferred income taxes | 22,664 |  | 23,029 |
| Other liabilities | 694 |  | 1,323 |
| Total liabilities | 143,455 |  | 172,087 |
| Commitments and contingencies |  |  |  |
| Shareholders equity |  |  |  |
| Preferred stock \$10 par value, authorized 1,000,000 shares; none issued |  |  |  |
| Common stock \$2.50 par value, authorized 40,000,000 shares; issued 30,053,443 shares at August 31 and |  |  |  |
| February 29, 2012 | 75,134 |  | 75,134 |
| Additional paid in capital | 121,407 |  | 121,390 |
| Retained earnings | 252,198 |  | 249,862 |
| Accumulated other comprehensive income (loss): |  |  |  |
| Foreign currency translation, net of taxes | 172 |  | 1,022 |
| Minimum pension liability, net of taxes | $(13,807)$ |  | $(13,807)$ |
| Total accumulated other comprehensive income (loss) | $(13,635)$ |  | $(12,785)$ |
| Treasury stock |  |  |  |
| Cost of 4,090,265 shares at August 31, 2012 and 4,129,668 shares at February 29, 2012 | $(73,022)$ |  | $(73,726)$ |
| Total shareholders equity | 362,082 |  | 359,875 |
| Total liabilities and shareholders equity | \$ 505,537 | \$ | 531,962 |

See accompanying notes to consolidated financial statements.

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## ENNIS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF EARNINGS

## (Dollars in thousands except share and per share amounts)

## (Unaudited)

|  | Three months ended |  |  |  | Six months ended |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | August 31, |  |  |  | August 31, |  |  |  |
|  |  | 2012 |  | 2011 |  | 2012 |  | 2011 |
| Net sales | \$ | 138,344 | \$ | 130,384 | \$ | 280,872 | \$ | 273,642 |
| Cost of goods sold |  | 104,395 |  | 96,290 |  | 218,674 |  | 199,847 |
| Gross profit margin |  | 33,949 |  | 34,094 |  | 62,198 |  | 73,795 |
| Selling, general and administrative |  | 21,331 |  | 18,447 |  | 43,357 |  | 39,304 |
| Gain from disposal of assets |  | (5) |  | (125) |  | (9) |  | (125) |
| Income from operations |  | 12,623 |  | 15,772 |  | 18,850 |  | 34,616 |
| Other income (expense) |  |  |  |  |  |  |  |  |
| Interest expense |  | (402) |  | (664) |  | (871) |  | $(1,482)$ |
| Other, net |  | (265) |  | 171 |  | 85 |  | (5) |
|  |  | (667) |  | (493) |  | (786) |  | $(1,487)$ |
| Earnings before income taxes |  | 11,956 |  | 15,279 |  | 18,064 |  | 33,129 |
| Provision for income taxes |  | 4,364 |  | 5,567 |  | 6,593 |  | 11,993 |
| Net earnings | \$ | 7,592 | \$ | 9,712 | \$ | 11,471 | \$ | 21,136 |
| Weighted average common shares outstanding |  |  |  |  |  |  |  |  |
| Basic |  | 25,992,505 |  | 25,933,902 |  | 25,984,188 |  | 25,914,986 |
| Diluted |  | 26,011,143 |  | 25,961,171 |  | 26,003,583 |  | 25,943,361 |
| Per share amounts |  |  |  |  |  |  |  |  |
| Net earnings - basic | \$ | 0.29 | \$ | 0.37 | \$ | 0.44 | \$ | 0.82 |
| Net earnings - diluted | \$ | 0.29 | \$ | 0.37 | \$ | 0.44 | \$ | 0.81 |
| Cash dividends per share | \$ | 0.175 | \$ | 0.155 | \$ | 0.350 | \$ | 0.310 |

See accompanying notes to consolidated financial statements.

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# ENNIS, INC. AND SUBSIDIARIES CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME 

## (Dollars in thousands)

(Unaudited)

|  | Three months ended August 31, |  | Six months ended August 31, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2012 | 2011 | 2012 | 2011 |
| Net earnings | \$ 7,592 | \$ 9,712 | \$ 11,471 | \$ 21,136 |
| Foreign currency translation adjustment, net of deferred taxes | 1,257 | (827) | (850) | 131 |
| Unrealized gain on derivative instruments, net of deferred taxes |  | 154 |  | 372 |
| Comprehensive income | \$ 8,849 | \$ 9,039 | \$ 10,621 | \$ 21,639 |

See accompanying notes to consolidated financial statements.

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## ENNIS, INC. AND SUBSIDIARIES

## CONSOLIDATED STATEMENTS OF CASH FLOWS

## (Dollars in thousands)

## (Unaudited)

|  | Six months ended August 31, |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2012 |  | 2011 |  |
| Cash flows from operating activities: |  |  |  |  |
| Net earnings |  | \$ 11,471 | \$ | 21,136 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |  |  |  |  |
| Depreciation |  | 5,048 |  | 4,846 |
| Amortization of deferred finance charges |  | 75 |  | 216 |
| Amortization of tradenames and customer lists |  | 1,660 |  | 1,198 |
| Gain from disposal of assets |  | (9) |  | (125) |
| Bad debt expense |  | 287 |  | 542 |
| Stock based compensation |  | 697 |  | 499 |
| Deferred income taxes |  | 2 |  | (12) |
| Changes in operating assets and liabilities, net of the effects of acquisition |  |  |  |  |
| Accounts receivable |  | $(4,378)$ |  | 5,290 |
| Prepaid expenses |  | 2,584 |  | (554) |
| Inventories |  | 20,053 |  | $(20,546)$ |
| Other assets |  | (30) |  | (100) |
| Accounts payable and accrued expenses |  | $(8,549)$ |  | 135 |
| Other liabilities |  | (629) |  | (601) |
| Prepaid pension asset |  | 1,078 |  | 820 |
| Net cash provided by operating activities |  | 29,360 |  | 12,744 |
| Cash flows from investing activities: |  |  |  |  |
| Capital expenditures |  | (862) |  | $(4,169)$ |
| Adjustment to purchase price of businesses acquired |  | 3,737 |  |  |
| Proceeds from disposal of plant and property |  | 14 |  | 204 |
| Net cash provided by (used in) investing activities |  | $(2,889)$ |  | $(3,965)$ |
| Cash flows from financing activities: |  |  |  |  |
| Repayment of debt |  | $(20,000)$ |  |  |
| Dividends |  | $(9,135)$ |  | $(8,058)$ |
| Purchase of treasury stock |  | (2) |  | (2) |
| Proceeds from exercise of stock options |  | 26 |  | 200 |
| Net cash used in financing activities |  | $(29,111)$ |  | $(7,860)$ |
| Effect of exchange rate changes on cash |  | (343) |  | 1,083 |
| Net change in cash |  | 2,795 |  | 2,002 |
| Cash at beginning of period |  | 10,410 |  | 12,305 |
| Cash at end of period |  | 13,205 |  | 14,307 |

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## ENNIS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## FOR THE PERIOD ENDED AUGUST 31, 2012

1. Significant Accounting Policies and General Matters

## Basis of Presentation

These unaudited consolidated financial statements of Ennis, Inc. and its subsidiaries (collectively the Company or Ennis ) for the quarter ended August 31, 2012 have been prepared in accordance with generally accepted accounting principles for interim financial reporting. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements and should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended February 29, 2012, from which the accompanying consolidated balance sheet at February 29, 2012 was derived. All significant intercompany balances and transactions have been eliminated in consolidation. In the opinion of management, all adjustments considered necessary for a fair presentation of the interim financial information have been included and are of a normal recurring nature. In preparing the financial statements, the Company is required to make estimates and assumptions that affect the disclosure and reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. The Company evaluates these estimates and judgments on an ongoing basis, including those related to bad debts, inventory valuations, property, plant and equipment, intangible assets, pension plan, accrued liabilities, and income taxes. The Company bases estimates and judgments on historical experience and on various other factors that are believed to be reasonable under the circumstances. The results of operations for any interim period are not necessarily indicative of the results of operations for a full year.

## Recent Accounting Pronouncements

In June 2011, the FASB issued an accounting standards update regarding the presentation of comprehensive income in financial statements. The provisions of this standard provide an option to present the components of net income and other comprehensive income either as one continuous statement of comprehensive income or as two separate but consecutive statements. The Company adopted this standard for the interim period ending May 31, 2012 which is the period for which it became effective. The Company has elected to utilize two separate but consecutive statements for its presentation.

In July 2012, the FASB issued amended standards to simplify how entities test indefinite-lived intangible assets for impairment which improves consistency in impairment testing requirements among long-lived asset categories. These amended standards permit an assessment of qualitative factors to determine whether it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying value. For assets in which this assessment concludes it is more likely than not that the fair value is more than its carrying value, these amended standards eliminate the requirement to perform quantitative impairment testing as outlined in the previously issued standards. These amended standards are effective for annual goodwill impairment tests performed for fiscal years beginning after December 15, 2011. The adoption of this standard has no impact on the Company s interim financial statements, but may change the way the Company performs its annual goodwill impairment test in the fourth quarter of 2013.

## 2. Accounts Receivable and Allowance for Doubtful Receivables

Accounts receivable are reduced by an allowance for an estimate of amounts that are uncollectible. Substantially all of the Company s receivables are due from customers in North America. The Company extends credit to its customers based upon its evaluation of the following factors: (i) the customer s financial condition, (ii) the amount of credit the customer requests, and (iii) the customer s actual payment history

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(which includes disputed invoice resolution). The Company does not typically require its customers to post a deposit or supply collateral. The Company s allowance for doubtful receivables is based on an analysis that estimates the amount of its total customer receivable balance that is not collectible. This analysis includes assessing a default probability to customers receivable balances, which is influenced by several factors including (i) current market conditions, (ii) periodic review of customer credit worthiness, and (iii) review of customer receivable aging and payment trends.

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## ENNIS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## FOR THE PERIOD ENDED AUGUST 31, 2012

## 2. Accounts Receivable and Allowance for Doubtful Receivables-continued

The Company writes off accounts receivable when they become uncollectible, and payments subsequently received on such receivables are credited to the allowance in the period the payment is received. Credit losses from continuing operations have consistently been within management s expectations.

The following table represents the activity in the Company s allowance for doubtful receivables for the three and six months ended August 31, 2012 and 2011 (in thousands):

|  | Three months ended August 31, |  | Six months ended August 31, |  |
| :---: | :---: | :---: | :---: | :---: |
|  | 2012 | 2011 | 2012 | 2011 |
| Balance at beginning of period | \$ 4,479 | \$ 4,882 | \$ 4,403 | \$4,814 |
| Bad debt expense |  | 21 | 287 | 542 |
| Recoveries | 13 | 6 | 19 | 172 |
| Accounts written off | (82) | (76) | (299) | (695) |
| Balance at end of period | \$4,410 | \$ 4,833 | \$ 4,410 | \$4,833 |

## 3. Inventories

The Company uses the lower of last-in, first-out (LIFO) cost or market to value certain of its business forms inventories and the lower of first-in, first-out (FIFO) cost or market to value its remaining forms and apparel inventories. The Company regularly reviews inventories on hand, using specific aging categories, and writes down the carrying value of its inventories for excess and potentially obsolete inventories based on historical usage and estimated future usage. In assessing the ultimate realization of its inventories, the Company is required to make judgments as to future demand requirements. As actual future demand or market conditions may vary from those projected by the Company, adjustments to inventories may be required.

The following table summarizes the components of inventories at the different stages of production as of the dates indicated (in thousands):

|  | August 31, <br> 2012 | February 29, <br> $\mathbf{2 0 1 2}$ |  |
| :--- | :---: | ---: | ---: |
| Raw material | $\$ 14,820$ | $\$$ | 22,217 |
| Work-in-process | 8,144 | 11,194 |  |
| Finished goods | 85,283 | 99,161 |  |
|  |  |  |  |
|  | $\$ 108,247$ | $\$$ | 132,572 |

## 4. Acquisitions

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On February 10, 2012, the Company acquired from Cenveo Corporation ( Cenveo ), and its subsidiaries, Cenveo Resale Ohio, LLC, and Printegra Corporation, certain assets of Cenveo s document business, including the manufacturing facilities branded under the names PrintXcel and Printegra for a cash payment of $\$ 40.0$ million plus the assumption of certain trade liabilities. The cash portion of the purchase price was funded by borrowing under the Company $s$ line of credit facility. As the result of an adjustment made during the quarter ended August 31,2012 to the acquisition date inventory balances and pursuant to the terms of the purchase agreement, the net purchase price was subsequently reduced to $\$ 36.2$ million. The combined sales of the purchased operations were $\$ 74.4$ million during the twelve month period ended December 31, 2011. The acquired assets will continue to be operated under their respective trade names of PrintXcel and Printegra.

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## ENNIS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE PERIOD ENDED AUGUST 31, 2012

## 4. Acquisitions-continued

The following is a summary of the preliminary purchase price allocations for PrintXcel and Printegra (in thousands):

| Accounts receivable | 7,389 |
| :--- | ---: |
| Inventories | 4,897 |
| Other assets | 631 |
| Property, plant \& equipment | 8,255 |
| Customer lists | 7,930 |
| Trademarks | 4,840 |
| Patent | 773 |
| Goodwill | 4,390 |
| Other long-term assets | 1 |
| Accounts payable and accrued liabilities | $(2,873)$ |

## \$ 36,233

On September 30, 2011, the Company purchased all of the outstanding equity of PrintGraphics, LLC ( PrintGraphics ), a privately held company, as well as the associated land and buildings for an aggregate of $\$ 6.0$ million in cash. PrintGraphics has locations in Vandalia, Ohio and Nevada, Iowa, The sales of the purchased operations were $\$ 15.1$ million during the twelve month period ended December 31, 2010.

The following is a summary of the purchase price allocation for PrintGraphics (in thousands):

| Accounts receivable | $\$ 1,867$ |
| :--- | :---: |
| Inventories | 1,356 |
| Other assets | 94 |
| Property, plant \& equipment | 3,572 |
| Accounts payable and accrued liabilities | $(903)$ |

The results of operations for PrintXcel, Printegra, and PrintGraphics are included in the Company s consolidated financial statements from the dates of acquisition. The following table represents certain operating information on a pro forma basis as though all operations had been acquired as of March 1, 2011, after the estimated impact of adjustments such as amortization of intangible assets, interest expense, interest income and related tax effects (in thousands except per share amounts):

## Three months ended

August 31,

|  | $\mathbf{2 0 1 1}$ |  | $\mathbf{2 0 1 1}$ |  |
| :--- | ---: | ---: | ---: | :---: |
| Pro forma net sales | $\$$ | 154,528 | $\$$ |  |
| Pro forma net earnings | 10,475 | 322,328 |  |  |
| Pro forma earnings per share - diluted | 0.40 | 22,667 |  |  |

The pro forma results are not necessarily indicative of what would have occurred if the acquisitions had been in effect for the periods presented.

## 5. Goodwill and Other Intangible Assets

Goodwill represents the excess of the purchase price over the fair value of net assets of acquired businesses and is not amortized. Goodwill and indefinite-lived intangibles are evaluated for impairment on an annual basis, or more frequently if impairment indicators arise, using a fair-value-based test that compares the fair value of the asset to its carrying value. Fair values of reporting units are typically calculated using a factor of expected earnings before

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## ENNIS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## FOR THE PERIOD ENDED AUGUST 31, 2012

## 5. Goodwill and Other Intangible Assets-continued

interest, taxes, depreciation, and amortization. The Company must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets in assessing the recoverability of its goodwill and other intangibles. If these estimates or the related assumptions change, the Company may be required to record impairment charges for these assets in the future.

The cost of intangible assets is based on fair values at the date of acquisition. Intangible assets with determinable lives are amortized on a straight-line basis over their estimated useful life (between 1 and 10 years). Trademarks with indefinite lives and a net book value of $\$ 63.4$ million at August 31, 2012 are evaluated for impairment on an annual basis, or more frequently if impairment indicators arise. The Company assesses the recoverability of its definite-lived intangible assets primarily based on its current and anticipated future undiscounted cash flows.

The carrying amount and accumulated amortization of the Company s intangible assets at each balance sheet date are as follows (in thousands):

| As of August 31, 2012 | Weighted Average Remaining Life (in years) | Gross Carrying Amount |  | mulated <br> rtization | Net |
| :---: | :---: | :---: | :---: | :---: | :---: |
| Amortized intangible assets |  |  |  |  |  |
| Tradenames | 0.2 | \$ 1,234 | \$ | 1,205 | \$ 29 |
| Customer lists | 6.8 | 37,887 |  | 16,228 | 21,659 |
| Noncompete |  | 500 |  | 500 |  |
| Patent | 5.5 | 773 |  | 70 | 703 |
| Total | 6.6 | \$ 40,394 | \$ | 18,003 | \$ 22,391 |
| As of February 29, 2012 |  |  |  |  |  |
| Amortized intangible assets |  |  |  |  |  |
| Tradenames | 0.8 | \$ 1,234 | \$ | 1,139 | \$ 95 |
| Customer lists | 7.2 | 37,887 |  | 14,699 | 23,188 |
| Noncompete |  | 500 |  | 500 |  |
| Patent | 6.0 | 773 |  | 5 | 768 |
| Total | 7.0 | \$ 40,394 | \$ | 16,343 | \$ 24,051 |


|  | August 31, <br> 2012 | February 29, <br> $\mathbf{2 0 1 2}$ |  |
| :--- | :---: | :---: | :---: |
| Non-amortizing intangible assets | $\$ 63,378$ | $\$$ | 63,378 |

Aggregate amortization expense for the six months ended August 31, 2012 and 2011 was $\$ 1.7$ million and $\$ 1.2$ million, respectively.
The Company s estimated amortization expense for the current and next five fiscal years ending in February of the stated year is as follows (in thousands):

| 2013 | $\$ 3,278$ |
| :--- | ---: |
| 2014 | 3,180 |
| 2015 | 3,063 |
| 2016 | 3,004 |
| 2017 | 3,004 |
| 2018 | 2,765 |

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## ENNIS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## FOR THE PERIOD ENDED AUGUST 31, 2012

## 5. Goodwill and Other Intangible Assets-continued

The following table represents changes in the carrying amount of goodwill as of the dates indicated (in thousands):

|  | Print <br> Segment <br> Total | Apparel <br> Segment <br> Total | Total |
| :--- | :---: | :---: | ---: |
| Balance as of February 28, 2011 | $\$ 42,792$ | $\$ 74,549$ | $\$ 117,341$ |
| Goodwill acquired | 4,293 |  | 4,293 |
| Goodwill impairment |  |  |  |
| Balance as of February 29, 2012 | 47,085 | 74,549 | 121,634 |
| Goodwill acquired adjustment   <br> Goodwill impairment 97  |  |  | 97 |
| Balance as of August 31, 2012 | $\$ 47,182$ | $\$ 74,549$ | $\$ 121,731$ |

During the fiscal year ended February 29, 2012, $\$ 4.3$ million was added to goodwill related to the acquisition of PrintXcel and Printegra assets. During the six months ended August 31, 2012, an adjustment of $\$ 0.1$ million reflects a revised estimate in accounts receivable, inventories, accrued expenses, and property, plant and equipment, net of adjustment to the purchase price, related to the acquisition of PrintXcel and Printegra assets during fiscal year 2012.

## 6. Other Accrued Expenses

The following table summarizes the components of other accrued expenses as of the dates indicated (in thousands):

|  | August 31, 2012 | February 29, 2012 |  |  |
| :--- | :---: | ---: | ---: | ---: |
| Accrued taxes | $\$$ | 388 | $\$$ | 293 |
| Accrued legal and professional fees |  | 1,082 | 852 |  |
| Accrued interest | 101 | 48 |  |  |
| Accrued utilities | 76 | 93 |  |  |
| Accrued repairs and maintenance | 775 | 775 |  |  |
| Accrued construction retainage |  | 1,759 |  |  |
| Accrued phantom stock obligation | 438 | 475 |  |  |
| Accrued acquisition related obligations | 142 |  | 205 |  |
|  |  |  |  |  |

## 7. Derivative Instruments and Hedging Activities

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The Company uses, at times, derivative financial instruments to manage its exposure to interest rate fluctuations on its floating rate debt. On July 7, 2008, the Company entered into a three-year Interest Rate Swap Agreement ( Swap ) for a notional amount of $\$ 40.0$ million which expired on July 22, 2011. The Swap effectively fixed the LIBOR rate for the Company s floating rate debt at $3.79 \%$.

The Swap was designated as a cash flow hedge, and the fair value at February 28, 2011 was ( $\$ 0.6$ ) million, ( $\$ 0.4$ ) million, net of deferred taxes. The Swap was reported on the Consolidated Balance Sheet as of February 28, 2011 as current installments of long-term debt with a related deferred charge recorded as a component of other comprehensive income (loss). During the three and six months ended August 31, 2011, the Company incurred an additional $\$ 0.2$ million and $\$ 0.6$ million, respectively, in interest expense related to the Swap.

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## ENNIS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## FOR THE PERIOD ENDED AUGUST 31, 2012

## 8. Fair Value of Financial Instruments

The carrying amounts of cash, accounts receivable, accounts payable and long-term debt approximate fair value because of the short maturity and/or variable rates associated with these instruments. Derivative financial instruments are recorded at fair value.

Fair value is the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. The hierarchy below lists three levels of fair value based on the extent to which inputs used in measuring fair value are observable in the market. The Company categorizes each of its fair value measurements in one of these three levels based on the lowest level input that is significant to the fair value measurement in its entirety. These levels are:

Level 1 - Inputs utilize quoted prices (unadjusted) in active markets for identical assets or liabilities that the Company has the ability to access.

Level 2 - Inputs utilize data points that are observable such as quoted prices, interest rates and yield curves
Level 3 - Inputs are unobservable data points for the asset or liability, and include situations where there is little, if any, market activity for the asset or liability.
There were no financial assets or liabilities measured at fair value as of August 31, 2012 and February 29, 2012.

## 9. Long-Term Debt

Long-term debt consisted of the following as of the dates indicated (in thousands):

|  | August 31, <br> $\mathbf{2 0 1 2}$ | February 29, <br> $\mathbf{2 0 1 2}$ |  |
| :--- | :---: | :---: | :---: |
| Revolving credit facility | $\$ 70,000$ | $\$$90,000 <br> Total long-term debt | $\$ 70,000$ |

On February 22, 2012, the Company entered into the Second Amendment to Second Amended and Restated Credit Agreement (the Facility ) with a group of lenders led by Bank of America, N.A. (the Lenders ). The Facility provides the Company access to $\$ 150.0$ million in revolving credit, which the Company may increase to $\$ 200.0$ million in certain circumstances, and matures on August 18, 2016. The Facility bears interest at the London Interbank Offered Rate ( LIBOR ) plus a spread ranging from $1.0 \%$ to $2.25 \%$ (LIBOR $+1.75 \%$ or $1.98 \%$ at August 31,2012 and $2.47 \%$ at August 31, 2011), depending on the Company s ratio of total funded debt to the sum of net earnings plus interest, tax, depreciation, and amortization ( EBITDA ). As of August 31, 2012, the Company had $\$ 70.0$ million of borrowings under the revolving credit line and $\$ 3.5$ million outstanding under standby letters of credit arrangements, leaving the Company availability of approximately $\$ 76.5$ million. The Facility contains financial covenants, restrictions on capital expenditures, acquisitions, asset dispositions, and additional debt, as well as other customary covenants, such as the total funded debt to EBITDA ratio. The Company was in compliance with these covenants as of August 31, 2012. The Facility is secured by substantially all of the Company s domestic assets as well as all capital securities of each of the Company s U.S. subsidiaries and $65 \%$ of all capital securities of each of the Company s direct foreign subsidiaries.

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## ENNIS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## FOR THE PERIOD ENDED AUGUST 31, 2012

## 10. Shareholders Equity

Changes in shareholders equity accounts for the six months ended August 31, 2012 are as follows (in thousands), except share and per share amounts:

|  | Common Stock |  | Additional Paid-in Capital | Retained <br> Earnings | Accumulated Other Comprehensive Income (Loss) |  | Treasury Stock |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
|  | Shares | Amount |  |  |  |  | Shares | Amount | Total |
| Balance February 29, 2012 | 30,053,443 | \$ 75,134 | \$ 121,390 | \$ 249,862 | \$ | $(12,785)$ | $(4,129,668)$ | \$ $(73,726)$ | \$ 359,875 |
| Net earnings |  |  |  | 11,471 |  |  |  |  | 11,471 |
| Foreign currency translation, net of deferred tax of \$526 |  |  |  |  |  | (850) |  |  | (850) |
| Dividends declared ( $\$ .35$ per share) |  |  |  | $(9,135)$ |  |  |  |  | $(9,135)$ |
| Stock based compensation |  |  | 697 |  |  |  |  |  | 697 |
| Exercise of stock options and restricted stock grants |  |  | (680) |  |  |  | 39,578 | 706 | 26 |
| Stock repurchases |  |  |  |  |  |  | (175) | (2) | (2) |
| Balance August 31, 2012 | 30,053,443 | \$ 75,134 | \$ 121,407 | \$ 252,198 | \$ | $(13,635)$ | (4,090,265) | \$ $(73,022)$ | \$ 362,082 |

On October 20, 2008, the Board of Directors authorized the repurchase of up to $\$ 5.0$ million of the common stock through a stock repurchase program. Under the board-approved repurchase program, share purchases may be made from time to time in the open market or through privately negotiated transactions depending on market conditions, share price, trading volume and other factors, and such purchases, if any, will be made in accordance with applicable insider trading and other securities laws and regulations. These repurchases may be commenced or suspended at any time or from time to time without prior notice. While no shares have been repurchased during the last two fiscal years or during the current fiscal year under the program, there have been a total of 96,000 shares of common stock that have been purchased under the repurchase program since its inception at an average price per share of $\$ 10.45$. On April 20, 2012, the Board increased the authorized amount available to repurchase our shares by an additional $\$ 5.0$ million, bringing the total available to repurchase our common stock to approximately $\$ 9.0$ million. Unrelated to the stock repurchase program, the Company purchased 175 shares of common stock during the six months ended August 31, 2012.

## 11. Stock Option Plan and Stock Based Compensation

The Company grants stock options and restricted stock to key executives and managerial employees and non-employee directors. At August 31, 2012, the Company had one stock option plan, the 2004 Long-Term Incentive Plan of Ennis, Inc., as amended and restated as of June 30, 2011, formerly the 1998 Option and Restricted Stock Plan amended and restated as of May 14, 2008 ( Plan ). The Company has 937,854 shares of unissued common stock reserved under the Plan for issuance. The exercise price of each stock option granted equals a referenced price of the Company s common stock as reported on the New York Stock Exchange on the date of grant, and an option s maximum term is ten years. Stock options and restricted stock may be granted at different times during the year and vest ratably over various periods, from grant date up to five years. The Company uses treasury stock to satisfy option exercises and restricted stock awards.

The Company recognizes compensation expense for stock options and restricted stock grants on a straight-line basis over the requisite service period. For the three months ended August 31, 2012 and 2011, the Company included in selling, general and administrative expenses,
compensation expense related to share based compensation of $\$ 0.4$ million ( $\$ 0.2$ million net of tax), and $\$ 0.3$ million ( $\$ 0.2$ million net of tax), respectively. For the six months ended August 31, 2012 and 2011, the Company included in selling, general and administrative expenses, compensation expense related to share based compensation of $\$ 0.7$ million ( $\$ 0.4$ million net of tax), and $\$ 0.5$ million ( $\$ 0.3$ million net of tax), respectively.

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## ENNIS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## FOR THE PERIOD ENDED AUGUST 31, 2012

## 11. Stock Option Plan and Stock Based Compensation-continued

## Stock Options

The Company had the following stock option activity for the six months ended August 31, 2012:

|  | Number <br> of Shares (exact quantity) |  | eighted <br> verage <br> xercise <br> Price | Weighted Average Remaining Contractual Life (in years) |  | gate <br> nsic <br> (a) <br> sands) |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Outstanding at February 29, 2012 | 310,193 | \$ | 15.60 | 6.6 | \$ | 626 |
| Granted | 72,707 |  | 15.48 |  |  |  |
| Terminated | $(2,500)$ |  | 13.28 |  |  |  |
| Exercised | $(3,000)$ |  | 8.94 |  |  |  |
| Outstanding at August 31, 2012 | 377,400 | \$ | 15.64 | 6.8 | \$ | 398 |
| Exercisable at August 31,2012 | 206,196 | \$ | 15.63 | 5.3 | \$ | 271 |

(a) Intrinsic value is measured as the excess fair market value of the Company s common stock as reported on the New York Stock Exchange over the applicable exercise price.
The following is a summary of the assumptions used and the weighted average grant-date fair value of the stock options granted during the six months ended August 31, 2012 and 2011:

|  | August 31, |  |
| :--- | :---: | :---: |
| Expected volatility | $\mathbf{2 0 1 2}$ | $\mathbf{2 0 1 1}$ |
| Expected term (years) | $37.02 \%$ | $43.76 \%$ |
| Risk free interest rate | 3 | 3 |
| Dividend yield | $0.43 \%$ | $1.16 \%$ |
| Weighted average grant-date fair value | $4.42 \%$ | $3.66 \%$ |

A summary of the stock options exercised and tax benefits realized from stock based compensation is presented below (in thousands):


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## ENNIS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## FOR THE PERIOD ENDED AUGUST 31, 2012

## 11. Stock Option Plan and Stock Based Compensation-continued

A summary of the status of the Company s unvested stock options at February 29, 2012, and changes during the six months ended August 31, 2012 is presented below:

|  | Number of Options | Weighted Average Grant Date Fair Value |  |
| :---: | :---: | :---: | :---: |
| Unvested at February 29, 2012 | 169,411 | \$ | 3.31 |
| New grants | 72,707 |  | 2.83 |
| Vested | $(70,914)$ |  | 3.13 |
| Forfeited |  |  |  |
| Unvested at August 31, 2012 | 171,204 | \$ | 3.18 |

As of August 31, 2012, there was $\$ 425,000$ of unrecognized compensation cost related to unvested stock options granted under the Plan. The weighted average remaining requisite service period of the unvested stock options was 1.8 years. The total fair value of shares underlying the options vested during the six months ended August 31, 2012 was $\$ 1.0$ million.

## Restricted Stock

The Company had the following restricted stock grant activity for the six months ended August 31, 2012:

|  | Number of Shares | Weighted Average Grant Date Fair Value |  |
| :---: | :---: | :---: | :---: |
| Outstanding at February 29, 2012 | 131,333 | \$ | 17.09 |
| Granted | 92,293 |  | 15.46 |
| Terminated |  |  |  |
| Vested | $(36,578)$ |  | 16.05 |
| Outstanding at August 31, 2012 | 187,048 | \$ | 16.49 |

As of August 31, 2012, the total remaining unrecognized compensation cost related to unvested restricted stock granted under the Plan was approximately $\$ 2.3$ million. The weighted average remaining requisite service period of the unvested restricted stock awards was 2.1 years.

## 12. Pension Plan

The Company and certain subsidiaries have a noncontributory defined benefit retirement plan (the Pension Plan ) covering approximately $9 \%$ of their aggregate employees. Benefits are based on years of service and the employee $s$ average compensation for the highest five compensation years preceding retirement or termination. The Company s funding policy is to contribute annually an amount in accordance with the requirements of the Employee Retirement Income Security Act of 1974 ( ERISA ).

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## ENNIS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## FOR THE PERIOD ENDED AUGUST 31, 2012

## 12. Pension Plan-continued

Pension expense is composed of the following components included in cost of goods sold and selling, general and administrative expenses in the Company s consolidated statements of earnings (in thousands):

|  | Three months ended <br> August 31, |  | Six months ended <br> August 31, |  |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: | :---: |
| Components of net periodic benefit cost | $\mathbf{2 0 1 2}$ | $\mathbf{2 0 1 1}$ | $\mathbf{2 0 1 2}$ | $\mathbf{2 0 1 1}$ |  |  |
| Service cost | $\$ 320$ | $\$ 303$ | $\$$ | 641 | $\$ 6$ | 607 |
| Interest cost | 601 | 630 | 1,201 | 1,261 |  |  |
| Expected return on plan assets | $(802)$ | $(803)$ | $(1,604)$ | $(1,607)$ |  |  |
| Amortization of: | $(36)$ | $(36)$ | $(72)$ | $(72)$ |  |  |
| Prior service cost | 456 | 316 | 912 | 631 |  |  |
| Unrecognized net loss | $\$ 539$ | $\$ 410$ | $\$ 1,078$ | $\$$ | 820 |  |

The Company is required to make contributions to the Pension Plan. These contributions are required under the minimum funding requirements of ERISA. Due to the recent enactment of the Moving Ahead for Progress in the $21^{\text {st }}$ Century (MAP-21) in July 2012, which effectively raises the discount rates mandated for determining the value of a plan $s$ benefit liability and annual cost of accruals, the Company s minimum required contribution to the Pension Plan is zero for the Pension Plan year ending February 28, 2013. However, the Company does expect to make a cash contribution to the Pension Plan of between $\$ 2.0$ million and $\$ 3.0$ million during the fourth quarter of fiscal year 2013. The Company contributed $\$ 3.0$ million to the Pension Plan during fiscal year 2012.

## 13. Earnings per share

Basic earnings per share have been computed by dividing net earnings by the weighted average number of common shares outstanding during the applicable period. Diluted earnings per share reflect the potential dilution that could occur if stock options or other contracts to issue common shares were exercised or converted into common stock.

For the three and six months ended August 31, 2012, shares related to stock options of 305,150 and 301,150 respectively, were not included in the diluted earnings per share computation because their exercise price exceeded the average fair market value of the Company s stock. For the three and six months ended August 31, 2011, 176,443 shares related to stock options were not included in the diluted earnings per share computation because their exercise price exceeded the average fair market value of the Company s stock. The following table sets forth the computation for basic and diluted earnings per share for the periods indicated:

## Three months ended

August 31,

Six months ended

August 31,
2012

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| Basic weighted average common shares outstanding | $\begin{array}{r} 25,992,505 \\ 18,638 \end{array}$ |  | $\begin{array}{r} 25,933,902 \\ 27,269 \end{array}$ |  | $\begin{array}{r} 25,984,188 \\ 19,395 \end{array}$ |  | $\begin{array}{r} 25,914,986 \\ 28,375 \end{array}$ |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Effect of dilutive options |  |  |  |  |  |  |  |  |
| Diluted weighted average common shares outstanding | 26,011,143 |  | 25,961,171 |  | 26,003,583 |  | 25,943,361 |  |
| Per share amounts: |  |  |  |  |  |  |  |  |
| Net earnings basic | \$ | 0.29 | \$ | 0.37 | \$ | 0.44 | \$ | 0.82 |
| Net earnings diluted | \$ | 0.29 | \$ | 0.37 | \$ | 0.44 | \$ | 0.81 |
| Cash dividends | \$ | 0.175 | \$ | 0.155 | \$ | 0.350 | \$ | 0.310 |

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## ENNIS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## FOR THE PERIOD ENDED AUGUST 31, 2012

## 14. Segment Information and Geographic Information

The Company operates in two segments the Print Segment and the Apparel Segment.
The Print Segment, which represented $62 \%$ of the Company s consolidated net sales for the three and six months ended August 31,2012 , is in the business of manufacturing, designing, and selling business forms and other printed business products primarily to distributors located in the United States. The Print Segment operates 50 manufacturing locations throughout the United States in 20 strategically located domestic states. Approximately $94 \%$ of the business products manufactured by the Print Segment are custom and semi-custom, constructed in a wide variety of sizes, colors, number of parts and quantities on an individual job basis depending upon the customers specifications.

The products sold include snap sets, continuous forms, laser cut sheets, tags, labels, envelopes, integrated products, jumbo rolls and pressure sensitive products in short, medium and long runs under the following labels: Ennis ${ }^{\circledR}$, Royal Business Forms ${ }^{\circledR}$, Block Graphics ${ }^{\circledR}$, Specialized Printed Forms ${ }^{\circledR}, 360^{\circ}$ Custom Labels ${ }^{\text {SM }}$, Enfusion ${ }^{\circledR}$, Uncompromised Check Solutions ${ }^{\circledR}$, VersaSea ${ }^{\circledR}$, Witt Printing ${ }^{\circledR}$, B\&D Litho ${ }^{\circledR}$, Genforms ${ }^{\circledR}$, PrintGraphics ${ }^{\text {SM }}$, Calibrated Forms ${ }^{\circledR}$, PrintXcel and Printegra. The Print Segment also sells the Adams-McClure ${ }^{\circledR}$ brand (which provides Point of Purchase advertising for large franchise and fast food chains as well as kitting and fulfillment); the Admore ${ }^{\circledR}$ brand (which provides presentation folders and document folders); Ennis Tag \& Label ${ }^{\text {SM }}$ (which provides tags and labels, promotional products and advertising concept products); Atlas Tag \& Label ${ }^{\circledR}$ (which provides tags and labels); Trade Envelopes ${ }^{\circledR}$ and Block Graphics ${ }^{\circledR}$ (which provide custom and imprinted envelopes) and Northstar ${ }^{\circledR}$ and General Financial Supply ${ }^{\circledR}$ (which provide financial and security documents).

The Print Segment sells predominantly through private printers and independent distributors. Northstar also sells to a small number of direct customers. Northstar has continued its focus with large banking organizations on a direct basis (where a distributor is not acceptable or available to the end-user) and has several of the top 25 banks in the United States as customers and is actively working on other banks within the top 25 tier of banks in the United States. Adams-McClure sales are generally provided through advertising agencies.

The Apparel Segment, which accounted for $38 \%$ of the Company s consolidated net sales for the three and six months ended August 31, 2012, consists of Alstyle Apparel. This group is primarily engaged in the production and sale of activewear including $t$-shirts, fleece goods, and other wearables. Alstyle sales are seasonal, with sales in the first and second quarters generally being the highest. Substantially all of the Apparel Segment sales are to customers in the United States.

Corporate information is included to reconcile segment data to the consolidated financial statements and includes assets and expenses related to the Company s corporate headquarters and other administrative costs.

Segment data for the three and six months ended August 31, 2012 and 2011 were as follows (in thousands):

|  | Print <br> Segment | Apparel <br> Segment | Corporate | Consolidated <br> Totals |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Three months ended August 31, 2012: | $\$ 86,069$ | $\$ 52,275$ | $\$$ | $\$$ | 138,344 |
| Net sales | 1,464 | 946 | 66 | 2,476 |  |
| Depreciation | 462 | 366 | $(3,906)$ | 11,956 |  |
| Amortization of identifiable intangibles | 14,815 | 1,047 | 19,939 | 505,537 |  |
| Segment earnings (loss) before income tax | 173,880 | 311,718 | 19 | 729 |  |
| Segment assets | 710 |  |  |  |  |
| Capital expenditures |  |  |  |  |  |

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## ENNIS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

## FOR THE PERIOD ENDED AUGUST 31, 2012

## 14. Segment Information and Geographic Information-continued

|  | Print <br> Segment | Apparel <br> Segment | Corporate | Consolidated <br> Totals |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Three months ended August 31, 2011: | $\$ 69,212$ | $\$ 61,172$ | $\$$ | $\$$ | 130,384 |
| Net sales | 1,219 | 1,029 | 106 | 2,354 |  |
| Depreciation | 233 | 366 |  | 599 |  |
| Amortization of identifiable intangibles | 11,941 | 6,715 | $(3,377)$ | 15,279 |  |
| Segment earnings (loss) before income tax | 134,346 | 336,224 | 17,522 | 488,092 |  |
| Segment assets | 785 | 1,260 | 7 | 2,052 |  |
| Capital expenditures |  |  |  |  |  |


| Six months ended August 31, 2012: |  |  |  | $\$ 280,872$ |  |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Net sales | $\$ 173,368$ | $\$ 107,504$ | $\$$ | 139 | 5,048 |
| Depreciation | 3,008 | 1,901 | 1,660 |  |  |
| Amortization of identifiable intangibles | 927 | 733 |  | 18,064 |  |
| Segment earnings (loss) before income tax | 27,429 | $(1,774)$ | $(7,591)$ | 505,537 |  |
| Segment assets | 173,880 | 311,718 | 19,939 | 34 | 84 |
| Capital expenditures | 828 |  | 34 |  |  |

Six months ended August 31, 2011:

| Net sales | $\$ 136,326$ | $\$ 137,316$ | $\$$ | 226 | 273,642 |
| :--- | ---: | ---: | ---: | ---: | ---: |
| Depreciation | 2,454 | 2,166 | 4,846 |  |  |
| Amortization of identifiable intangibles | 465 | 733 |  | 1,198 |  |
| Segment earnings (loss) before income tax | 22,943 | 17,630 | $(7,444)$ | 33,129 |  |
| Segment assets | 134,346 | 336,224 | 17,522 | 488,092 |  |
| Capital expenditures | 1,471 | 2,685 | 13 | 4,169 |  |

Identifiable long-lived assets by country include property, plant, and equipment, net of accumulated depreciation. The Company attributes revenues from external customers to individual geographic areas based on the country where the sale originated. Information about the Company s operations in different geographic areas as of and for the three and six months ended is as follows (in thousands):

|  | United States |  | Canada |  | Mexico |  | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Three months ended August 31, 2012: |  |  |  |  |  |  |  |  |
| Net sales to unaffiliated customers |  |  |  |  |  |  |  |  |
| Print Segment | \$ | 86,069 | \$ |  | \$ |  | \$ | 86,069 |
| Apparel Segment |  | 46,837 |  | 5,246 |  | 192 |  | 52,275 |
|  | \$ | 132,906 | \$ | 5,246 | \$ | 192 | \$ | 138,344 |
| Identifiable long-lived assets |  |  |  |  |  |  |  |  |
| Print Segment | \$ | 42,505 | \$ |  | \$ |  | \$ | 42,505 |
| Apparel Segment |  | 146 |  | 28 |  | 48,152 |  | 48,326 |
| Corporate |  | 3,410 |  |  |  |  |  | 3,410 |

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$\begin{array}{lllllll}\$ & 46,061 & \$ & 28 & \$ 8,152 & \$ 44,241\end{array}$

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## ENNIS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE PERIOD ENDED AUGUST 31, 2012

## 14. Segment Information and Geographic Information-continued

|  | United States |  | Canada |  | Mexico |  | Total |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Three months ended August 31, 2011: |  |  |  |  |  |  |  |  |
| Net sales to unaffiliated customers |  |  |  |  |  |  |  |  |
| Print Segment | \$ | 69,212 | \$ |  | \$ |  | \$ | 69,212 |
| Apparel Segment |  | 56,208 |  | 4,758 |  | 206 |  | 61,172 |
|  | \$ | 125,420 |  | 4,758 | \$ | 206 | \$ | 130,384 |
| Identifiable long-lived assets |  |  |  |  |  |  |  |  |
| Print Segment | \$ | 34,875 | \$ |  | \$ |  | \$ | 34,875 |
| Apparel Segment |  | 587 |  | 31 |  | 53,114 |  | 53,732 |
| Corporate |  | 3,678 |  |  |  |  |  | 3,678 |
|  | \$ | 39,140 | \$ | 31 | \$ | 53,114 | \$ | 92,285 |
| Six months ended August 31, 2012: |  |  |  |  |  |  |  |  |
| Net sales to unaffiliated customers |  |  |  |  |  |  |  |  |
| Print Segment | \$ | 173,368 | \$ |  | \$ |  | \$ | 173,368 |
| Apparel Segment |  | 96,118 |  | 10,920 |  | 466 |  | 107,504 |
|  | \$ | 269,486 | \$ | 10,920 | \$ | 466 | \$ | 280,872 |

Six months ended August 31, 2011:

| Net sales to unaffiliated customers | $\$$ | 136,326 | $\$$ |  |  |  |  |
| :--- | :--- | :--- | :--- | :--- | :--- | :--- | :--- |
| Print Segment |  |  |  |  |  |  |  |
| Apparel Segment |  | 126,113 |  | 10,761 |  | 442 | $\$ 136,326$ |
|  |  |  |  |  |  | 137,316 |  |
|  | $\$$ | 262,439 | $\$$ | 10,761 | $\$$ | 442 | $\$ 273,642$ |

## 15. Supplemental Cash Flow Information

Net cash flows from operating activities reflect cash payments for interest and income taxes as follows (in thousands):

|  | Six months ended August 31, |  |  |  |
| :---: | :---: | :---: | :---: | :---: |
|  |  | 2012 |  | 2011 |
| Interest paid | \$ | 818 |  | 1,498 |
| Income taxes paid | \$ | 5,842 |  | 14,348 |

## 16. Concentrations of Risk

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Financial instruments that potentially subject the Company to a concentration of credit risk principally consist of cash and trade receivables. Cash is placed with high-credit quality financial institutions. The Company believes its credit risk with respect to trade receivables is limited due to industry and geographic diversification. As disclosed on the Consolidated Balance Sheets, the Company maintains an allowance for doubtful receivables to cover estimated credit losses associated with accounts receivable.

The Company, for quality and pricing reasons, purchases its paper, cotton and yarn products from a limited number of suppliers. To maintain its high standard of color control associated with its apparel products, the Company purchases its dyeing chemicals from limited sources. While other sources may be available to the Company to purchase these products, they may not be available at the cost or at the quality the Company has come to expect.

For the purposes of the Consolidated Statements of Cash Flows, the Company considers cash to include cash on hand and in bank accounts. All funds in a Non interest-bearing transaction account are insured in full by the Federal

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## ENNIS, INC. AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

FOR THE PERIOD ENDED AUGUST 31, 2012

## 16. Concentrations of Risk-continued

Deposit Insurance Corporation ( FDIC ) from December 31, 2010 through December 31, 2012. This temporary unlimited coverage is in addition to, and separate from, the coverage of at least $\$ 250,000$ available to depositors under the FDIC s general deposit insurance rules. Currently all of the Company s domestic cash balances meet these criteria. At August 31, 2012, the Company had $\$ 0.4$ million in Canadian and $\$ 1.9$ million in Mexican bank accounts.

## 17. Subsequent Events

On September 21, 2012, the Board of Directors of Ennis, Inc. declared a $17 \frac{1}{2}$ cents a share quarterly dividend to be payable on October 30, 2012 to shareholders of record on October 8, 2012.

## Item 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS Overview

Ennis, Inc. (formerly Ennis Business Forms, Inc.) was organized under the laws of Texas in 1909. Ennis, Inc. and its subsidiaries (collectively referred to as the Company, Registrant, Ennis, or we, us, or our ) print and manufacture a broad line of business forms and other business products (the Print Segment ) and also manufacture a line of activewear (the Apparel Segment ) for distribution throughout North America. The Print Segment distributes business products and forms throughout the United States is primarily through independent dealers. This distributor channel encompasses print distributors, stationers, quick printers, computer software developers, and advertising agencies, among others. The Apparel Segment produces and sells activewear, including t-shirts, fleece goods and other wearables. Distribution of our activewear throughout the United States, Canada and Mexico is primarily through sales representatives. The distributor channel encompasses activewear wholesalers and screen printers. We offer a great selection of high-quality activewear apparel and hats with a wide variety of styles and colors in sizes ranging from toddler to 6XL. The apparel line features a wide variety of tees, fleece and shorts.

On February 10, 2012, we acquired from Cenveo Corporation ( Cenveo ), and its subsidiaries, Cenveo Resale Ohio, LLC, and Printegra Corporation, certain assets of Cenveo s document business, including the manufacturing facilities branded under the names of PrintXcel and Printegra for $\$ 40.0$ million plus the assumption of certain trade liabilities. The cash portion of the purchase price was funded by borrowing under our line of credit facility. The original purchase price of $\$ 40.0$ million was subsequently reduced to $\$ 36.2$ million as a result of an adjustment made during the quarter ended August 31, 2012 to the acquisition date inventory balances and pursuant to the terms of the purchase agreement. The combined sales of the purchased operations were $\$ 74.4$ million during the most recent twelve month period ended December 31, 2011. The acquired assets will continue to be operated under their respective trade names of PrintXcel and Printegra. We expect the acquired assets will expand our pressure seal capabilities, our high color commercial print capabilities, and business check product lines, which will be sold through our independent distributor network.

On September 30, 2011, we purchased all of the outstanding stock of PrintGraphics, LLC ( PrintGraphics ), as well as the associated land and buildings for an aggregate of $\$ 6.0$ million in cash. PrintGraphics has locations in Vandalia, Ohio and Nevada, Iowa. The sales of the purchased operations were $\$ 15.1$ million during the twelve month period ended December 31, 2012. The acquisition of PrintGraphics continues our strategy of targeted growth in our Print Segment of products to further service our existing customer base.

## Business Segment Overview

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We are one of the largest providers of business forms to independent distributors in the United States and are also one of the largest providers of blank t-shirts in North America to the activewear market. We operate in two reportable segments: Print and Apparel. For additional financial information concerning segment reporting, please see Note 14 of the Notes to the Consolidated Financial Statements beginning on page 18 included elsewhere herein, which information is incorporated herein by reference.

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## Print Segment

The Print Segment, which represented $62 \%$ of our consolidated net sales for the three and six months ended August 31, 2012, is in the business of manufacturing, designing and selling business forms and other printed business products primarily to distributors located in the United States. The Print Segment operates 50 manufacturing locations throughout the United States in 20 strategically located domestic states. Approximately $94 \%$ of the business products manufactured by the Print Segment are custom and semi-custom products, constructed in a wide variety of sizes, colors, and quantities on an individual job basis depending upon customers specifications.

The products sold include snap sets, continuous forms, laser cut sheets, tags, labels, envelopes, integrated products, jumbo rolls and pressure sensitive products in short, medium and long runs under the following labels: Ennis ${ }^{\circledR}$, Royal Business Forms ${ }^{\circledR}$, Block Graphics ${ }^{\circledR}$, Specialized Printed Forms ${ }^{\circledR}, 360^{\circ}$ Custom Labels ${ }^{\text {SM }}$, Enfusion ${ }^{\circledR}$, Uncompromised Check Solutions ${ }^{\circledR}$, VersaSeal ${ }^{\circledR}$, Witt Printing ${ }^{\circledR}$, B\&D Litho ${ }^{\circledR}$, Genforms ${ }^{\circledR}$, PrintGraphics ${ }^{\text {SM }}$, Calibrated Forms ${ }^{\circledR}$, PrintXcel and Printeg®. The Print Segment also sells the Adams-McClure ${ }^{\circledR}$ brand (which provides Point of Purchase advertising for large franchise and fast food chains as well as kitting and fulfillment); the Admore ${ }^{\circledR}$ brand (which provides presentation folders and document folders); Ennis Tag \& Label ${ }^{\text {SM }}$ (which provides tags and labels, promotional products and advertising concept products); Atlas Tag \& Label ${ }^{\circledR}$ (which provides tags and labels); Trade Envelopes ${ }^{\circledR}$ and Block Graphics ${ }^{\circledR}$ (which provide custom and imprinted envelopes) and Northstar ${ }^{\circledR}$ and General Financial Supply ${ }^{\circledR}$ (which provide financial and security documents).

The Print Segment sells predominantly through private printers and independent distributors. Northstar also sells direct to a small number of customers, generally large banking organizations (where a distributor is not acceptable or available to the end-user), as does Adams-McClure, where sales are generally through advertising agencies.

The printing industry generally sells its products either through sales made predominantly to end users, a market dominated by a few large manufacturers, such as Moore Wallace (a subsidiary of R.R. Donnelley), Standard Register, and Cenveo, or, like the Company, through a variety of independent distributors and distributor groups. While it is not possible, because of the lack of adequate statistical information, to determine Ennis share of the total business products market, management believes Ennis is one of the largest producers of business forms in the United States distributing primarily through independent dealers and that its business forms offering is more diversified than that of most companies in the business forms industry.

There are a number of competitors that operate in this segment, ranging in size from single employee-owner operations to multi-plant organizations. We believe our strategic locations and buying power permit us to compete on a favorable basis within the distributor market on competitive factors, such as service, quality, and price.

Distribution of business forms and other business products throughout the United States is primarily done through independent dealers, including business forms distributors, stationers, printers, computer software developers, and advertising agencies.

Raw materials of the Print Segment principally consist of a wide variety of weights, widths, colors, sizes, and qualities of paper for business products purchased from a number of major suppliers at prevailing market prices.

Business products usage in the printing industry is generally not seasonal. General economic conditions and contraction of the traditional business forms industry are the predominant factor in quarterly volume fluctuations.

Our Print Business Challenges - In our Print Segment, we are engaged in an industry undergoing significant changes. Technology advances have made electronic distribution of documents, internet hosting, digital printing and print-on-demand valid, cost-effective alternatives to traditional custom printed documents and customer communications. In addition, the recent downturn in the economy and credit markets, which created highly competitive conditions in an already over-supplied, price-competitive industry, continue to present challenges today. Thus, we believe we are facing the following challenges in the Print Segment of our business:

## Transformation of our portfolio of products

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Excess production capacity and price competition within our industry

## Continued economic uncertainties

The following is a discussion of these business challenges and our strategy for managing their effect on our print business.

Transformation of our portfolio of products Traditional business documents are essential in order to conduct business. However, many are being replaced or devalued with advances in digital technologies, causing steady declines in demand for a large portion of our current product line. The same digital advances also introduce potential new opportunities for growth for us, such as print-on-demand services and product offerings that assist customers in their transition to digital business environments. In addition, we will continue to look for new market opportunities and niches, such as the addition of our envelope offerings, healthcare wristbands, secure document solutions, innovative in-mold label offerings and long-run integrated products with high color web printing that provide us with an opportunity for growth and differentiate us from our competition. Transforming our product offerings in order to continue to provide innovative, valuable solutions to our customers on a proactive basis will require us to make investments in new and existing technology and to develop key strategic business relationships.

Excess production capacity and price competition within our industry Paper mills continue to adjust production capacity through downtime and closures to attempt to keep supply in line with demand. Due to the limited number of paper mills, paper prices have been and are expected to remain fairly volatile.

Despite a continued competitive marketplace, we have generally been able to pass through increased paper costs, although it can often take several quarters to push these through due to the custom nature of our products and/or contractual relationships with some of our customers. We expect this trend to continue, however, any downturn in the economy or continued protraction of the current recovery may limit our ability to recover all these costs. As such, we will continue to focus our efforts on effectively managing and controlling our product costs to minimize the effects of the foregoing on our operational results, primarily through the use of forecasting models and production and costing models. However, an inherent risk in this process is that our assumptions are inaccurate, which could have a negative impact on our reported profit margins.

Continued economic uncertainties As a result of the past recessionary conditions, the economic climate has been volatile and challenging. Decreased demand and intense price competition resulted in a significant decline in our revenue during the past several fiscal years. Although we have seen improvement in some economic indicators within our markets, a generally weak domestic job market, global economic instabilities and a rather anemic domestic economic recovery continue to present a challenging environment for revenue growth. As we cannot predict the pace or continuance of the domestic economic recovery or the impact of continued global economic instability, we continue to focus on customer retention, expanding our growth targeted products and continuing to develop new market niches. In addition, we have a proven history of managing our costs during tough economic times and would not expect this to change in the future.

## Apparel Segment

The Apparel Segment represented $38 \%$ of our consolidated net sales for the three and six months ended August 31, 2012, and operates under the name of Alstyle Apparel ( Alstyle ). Alstyle markets high quality knitted activewear (including t-shirts, tank tops and fleece) across all market segments. The main products of Alstyle are standardized shirts manufactured in a variety of sizes and colors. Approximately $97 \%$ of Alstyle s revenues are derived from $t$-shirt sales, which make up $90 \%$ of domestic sales. Alstyle s branded product lines are sold mainly under the AAA and Murina ${ }^{\circledR}$ brands.

Effective July 2011, Alstyle operates in an owned manufacturing facility located in Agua Prieta, Mexico. Previously Alstyle operated in a leased manufacturing facility located in Anaheim, CA. Alstyle has three cut and sew facilities in Mexico (Agua Prieta, Ensenada and Hermosillo). In addition to its own cut and sew facilities, Alstyle also uses outsourced manufacturers located in El Salvador from time to time to supplement a portion of its cut and sew needs. After sewing and packaging is completed, the product is shipped to one of Alstyle s nine distribution centers located across the United States, Canada, and Mexico.

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Alstyle utilizes a customer-focused internal sales team comprised of 22 sales representatives assigned to specific geographic territories in the United States, Canada, and Mexico. Sales representatives are allocated performance objectives for their respective territories and are provided financial incentives for achievement of their target objectives. Sales representatives are responsible for developing business with large accounts and spend a majority of their time in the field.

Alstyle employs a staff of customer service representatives that handle call-in orders from smaller customers. Sales personnel sell directly to Alstyle s customer base, which consists primarily of screen printers, embellishers, retailers, and mass marketers.

A majority of Alstyle s sales are branded products, with the remainder being customer private label products. Generally, sales to screen printers and mass marketers are driven by price and the availability of products, which directly impacts our inventory level requirements. Sales in the private label business are characterized by slightly higher customer loyalty.

Alstyle s most popular styles are produced based on demand management forecasts to permit quick shipment and to level production schedules. Alstyle offers same-day shipping and uses third-party carriers to ship products to its customers.

Alstyle s sales are seasonal, with sales in the first and second fiscal quarters generally being the highest. The apparel industry is characterized by rapid shifts in fashion, consumer demand and competitive pressures, resulting in both price and demand volatility. However, the imprinted activewear market to which Alstyle sells is generally event driven. Blank t -shirts can be thought of as walking billboards promoting movies, concerts, sports teams, and image brands. Still, the demand for any particular product varies from time to time based largely upon changes in consumer preferences and general economic conditions affecting the apparel industry.

The apparel industry is comprised of numerous companies who manufacture and sell a wide range of products. Alstyle is primarily involved in the activewear market and produces t-shirts and outsources such products as fleece, hats, shorts, pants and other such activewear apparel from China, Thailand, Pakistan, and other foreign sources to sell to its customers through its sales representatives. Alstyle competes with many branded and private label manufacturers of knit apparel in the United States, Canada, and Mexico, some of which are larger in size and have greater financial resources than Alstyle. Alstyle competes on the basis of price, quality, service, and delivery. Alstyle strategy is to provide the best value to its customers by delivering a consistent, high-quality product at a competitive price. Alstyle s competitive disadvantage is that its brand name, Alstyle Apparel, is not as well known as the brand names of its largest competitors, such as Gildan, Delta, Hanes, and Russell. While it is not possible to calculate precisely, based on public information available, management believes that Alstyle is one of the top three providers of blank t-shirts in North America.

Raw materials of the Apparel Segment principally consist of cotton and polyester yarn purchased from a number of major suppliers at prevailing market prices, although we purchase $49 \%$ of our cotton and yarn from one supplier.

Our Apparel Business Challenges - In our Apparel Segment, our market niche is highly competitive, commodity driven, and is generally dominated by a limited number of companies. The downturn in the economy and turmoil in the credit markets in 2009 and 2010 created an over-supply situation which further increased competitive pressures in this market. While the economic environment improved somewhat in 2011, which led to increased demand for our product during the later part of fiscal year 2011 and the start of fiscal year 2012, we have seen some recent softness in the market due to destocking strategies and current economic uncertainties both domestically and internationally. Whether the current softness in the market is a temporary situation or one we will have to manage for an extended period of time is unknown. However, such uncertainty and volatility in the marketplace could have unanticipated adverse effects on our business during this fiscal year and beyond. In addition, the current spot price of cotton has contributed negatively to an already competitive marketplace, which has made it even more difficult for large manufacturers to maintain their margins given the high cost of cotton still residing in their finished goods

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inventory. While current spot prices on various input costs are down considerably from comparable periods, costs in their finished goods inventory are still at much higher costs than these spot prices. We have been and will continue working through these higher input costs over the next few quarters before the current lower costs will have a positive impact on our operational results. As such, our operating costs are subject to significant swings, which may or may not be passed on to the marketplace due to competitive or current economic conditions, competitors pricing strategies, etc. Thus, we believe we are facing the following challenges in our Apparel Segment business in the remainder of fiscal 2013:

> Cotton prices and market pricing

New manufacturing facility


#### Abstract

Continued economic uncertainties Cotton prices Cotton, which represents a significant portion of our cost, is a commodity product and subject to volatile fluctuations in price. Over the past several years, we have seen cotton prices reach levels never before seen in its history and have seen the prices recede back to levels, while still high, which are more in line with historical averages. Whether prices will stay at current levels for a sustained period of time or continue to recede is unknown. For the current quarter, our effective cost of cotton flowing into our operational results was $45 \%$ higher than during the comparable period last year. Costs for cotton yarn and cotton-based textiles vary based upon the fluctuating cost of cotton, which is affected by, among other factors, weather, consumer demand, commodities market speculation, currency fluctuations, international actions and other factors that are generally unpredictable and beyond our control. We are able to lock in the cost of cotton reflected in the price we pay for yarn from our primary suppliers in an attempt to protect our business from the volatility of the market price of cotton. However, our business can be affected by dramatic movements in cotton prices. Due to the high price of cotton during calendar year 2010, Alstyle, like most large manufacturers, was relatively short with respect to their cotton purchases entering calendar year 2011. However, during the middle part of the calendar year 2011, we entered in cotton contracts in order to guarantee an uninterrupted supply of cotton and price stability covering approximately six months of projected cotton buys. Unfortunately, these locked in prices were significantly higher than the current spot price of cotton today. The costs incurred for materials are capitalized into inventory and impact the Company s operating results as the inventory is sold, which could be anywhere from six to nine months after the materials were in fact purchased. Consequently, these peak cotton costs have been flowing into our operational results during the past several quarters; and while our apparel results will continue to be impacted by these higher raw material costs for another quarter or so, we did see improvement in this segment s margin during the second quarter (improved 740 basis points over the preceding quarter) and we would expect its margin to continue to improve during the coming quarters as finished goods produced with higher cost raw materials are replaced with goods produced with lower cost raw materials. However, due to continued economic softness, both domestically and globally, the market continues to be extremely competitive and somewhat constrained. This will continue to put pressure on the sell-side from a market pricing perspective. Whether this will offset the positive impact of the lower costs of raw material now starting to flow out of manufacturers finished goods inventory has yet to be seen.


New manufacturing facility The new manufacturing facility in Agua Prieta, Mexico ( AP ) is operational and all production has now been transitioned from our Anaheim, CA ( Anaheim ) facility to the AP facility. We began producing fabric from this facility during the first quarter of fiscal 2012 and current production capabilities are on target with our original estimates. While the transition from Anaheim to AP has been completed, much still needs to be accomplished, such as increasing production levels and improving the operational efficiency. We believe that operational efficiency will improve as production levels are increased. However, the increase in production levels is dependent on improved market conditions (see below).

Continued economic uncertainties As a result of the past recessionary conditions, the economic climate has been and continues to be volatile and challenging both domestically and internationally. Although we saw an increase in our apparel revenues during fiscal 2011 due to improving economic conditions, we saw a significant drop in our sales during the latter half of fiscal 2012 due to competitive pricing pressures, which we attributed to recent softness in the market. International instability and continued domestic economic issues (i.e., high unemployment, housing
sector weakness, etc.) have taken a toll on the domestic economic environment. In addition, the decline in spot pricing of cotton has also given some retailers, distributors, and screen-printers reason to pause or be judicious with their replenishment orders. As such, we saw some softness in the market during the latter half of fiscal year 2012,

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which continued through the first half of fiscal year 2013. Whether these conditions are temporary or one we will have to manage through for sometime is unknown. A prolonged softness in the market could have a negative impact on our revenues, operational results and lengthen the time it takes us to get to the lower priced cotton residing in our finished goods inventory.

## Cautionary Statements

You should read this discussion and analysis in conjunction with our Consolidated Financial Statements and the related notes appearing elsewhere in this Report. In addition, certain statements in this Report, and in particular, statements found in Management s Discussion and Analysis of Financial Condition and Results of Operations, constitute forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. We believe these forward-looking statements are based upon reasonable assumptions. All such statements involve risks and uncertainties, and as a result, actual results could differ materially from those projected, anticipated or implied by these statements. Such forward-looking statements involve known and unknown risks, including but not limited to, general economic, business and labor conditions and the potential impact on our operations; our ability to implement our strategic initiatives and control our operational costs; dependence on a limited number of key suppliers; our ability to recover the rising cost of raw materials and other costs (i.e., energy, freight, labor, benefit costs, etc.) in markets that are highly price competitive; our ability to timely or adequately respond to technological changes in the industry; the impact of the Internet and other electronic media on the demand for forms and printed materials; the impact of foreign competition, tariffs and import restrictions; customer credit risk; competitors pricing strategies; a decline in business volume and profitability could result in an impairment in our recorded goodwill and negatively impact our operational results; our ability to retain key management personnel; our ability to identify, manage or integrate future acquisitions; and changes in government regulations. In addition to the factors indicated above, you should carefully consider the risk described in and incorporated by reference herein the risk factors in our Annual Report on Form 10-K before making an investment in our common stock.

In view of such uncertainties, investors should not place undue reliance on our forward-looking statements since such statements may prove to be inaccurate and speak only as of the date when made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## Critical Accounting Policies and Estimates

In preparing our consolidated financial statements, we are required to make estimates and assumptions that affect the disclosures and reported amounts of assets and liabilities at the date of the consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. We evaluate our estimates and judgments on an ongoing basis, including those related to allowance for doubtful receivables, inventory valuations, property, plant and equipment, intangible assets, pension plan obligations, accrued liabilities and income taxes. We base our estimates and judgments on historical experience and on various other factors that we believe to be reasonable under the circumstances. Actual results may differ materially from these estimates under different assumptions or conditions. We believe the following accounting policies are the most critical due to their effect on our more significant estimates and judgments used in preparation of our consolidated financial statements.

We maintain a defined benefit retirement plan (the Pension Plan ) for employees. Included in our financial results are pension costs that are measured using actuarial valuations. The actuarial assumptions used may differ from actual results. As our pension assets are invested in marketable securities, fluctuations in market values could potentially impact our funding status and associated liability recorded.

Amounts allocated to amortizable intangibles are determined based on valuation analysis for our acquisitions and are amortized over their expected useful lives. We evaluate these amounts periodically (at least once a year) to determine whether a triggering event has occurred during the year that would indicate potential impairment.

We exercise judgment in evaluating our long-lived assets for impairment. We assess the impairment of long-lived assets that include other intangible assets, goodwill, and property, plant, and equipment annually or whenever events or changes in circumstances indicate that the carrying value may not be recoverable. In performing tests of impairment, we must make assumptions regarding the estimated future cash flows

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and other factors to determine the

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fair value of the respective assets in assessing the recoverability of our long-lived assets. If these estimates or the related assumptions change, we may be required to record impairment charges for these assets in the future. Actual results could differ from assumptions made by management. At August 31, 2012, our goodwill and other intangible assets were approximately $\$ 121.7$ million and $\$ 85.8$ million (includes $\$ 0.7$ million relating to patents included in other long-term assets), respectively. We believe our businesses will generate sufficient undiscounted cash flow to more than recover the investments we have made in property, plant and equipment, as well as the goodwill and other intangibles recorded as a result of our acquisitions. However, we cannot predict the occurrence of future impairments or specific triggering events nor the impact such events might have on our reported asset values.

Revenue is generally recognized upon shipment of products. Net sales consist of gross sales invoiced to customers, less certain related charges, including discounts, returns and other allowances. Returns, discounts and other allowances have historically been insignificant. In some cases and upon customer request, we print and store custom print product for customer specified future delivery, generally within twelve months. In this case, risk of loss from obsolescence passes to the customer, the customer is invoiced under normal credit terms and revenue is recognized when manufacturing is complete. Approximately $\$ 3.0$ million and $\$ 6.1$ million of revenue were recognized under these agreements during the three and six months ended August 31, 2012 as compared to $\$ 2.7$ million and $\$ 4.7$ million during the three and six months ended August 31, 2011.

We maintain an allowance for doubtful receivables to reflect estimated losses resulting from the inability of customers to make required payments. On an on-going basis, we evaluate the collectability of accounts receivable based upon historical collection trends, current economic factors, and the assessment of the collectability of specific accounts. We evaluate the collectability of specific accounts using a combination of factors, including the age of the outstanding balances, evaluation of customers current and past financial condition and credit scores, recent payment history, current economic environment, discussions with our project managers, and discussions with the customers directly.

Our inventories are valued at the lower of cost or market. We regularly review inventory values on hand, using specific aging categories, and write down inventory deemed obsolete and/or slow-moving based on historical usage and estimated future usage to its estimated market value. As actual future demand or market conditions may vary from those projected by management, adjustments to inventory valuations may be required.

As part of the process of preparing our consolidated financial statements, we are required to estimate our income taxes in each jurisdiction in which we operate. This process involves estimating our actual current tax exposure together with assessing temporary differences resulting from different treatment of items for tax and accounting purposes. These 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. To the extent we believe that recovery is not likely, we must establish a valuation allowance. To the extent we establish a valuation allowance, we must include an expense within the tax provision in the consolidated statements of earnings. In the event that actual results differ from these estimates, our provision for income taxes could be materially impacted.

In addition to the above, we also have to make assessments as to the adequacy of our accrued liabilities, more specifically our liabilities recorded in connection with our workers compensation and health insurance, as these plans are self funded. To help us in this evaluation process, we routinely get outside third-party assessments of our potential liabilities under each plan.

In view of such uncertainties, investors should not place undue reliance on our forward-looking statements since such statements speak only as of the date when made. We undertake no obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise.

## Results of Operations

The discussion that follows provides information which we believe is relevant to an understanding of our results of operations and financial condition. The discussion and analysis should be read in conjunction with the accompanying consolidated financial statements and notes thereto, which are incorporated herein by reference. This analysis is presented in the following sections:

Consolidated Summary this section provides an overview of our consolidated results of operations for the three and six months ended August 31, 2012 and 2011.

Segment Operating Results this section provides an analysis of our net sales, gross profit margin and operating income by segment.

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## Consolidated Summary

| Consolidated | Three Months Ended August 31, |  |  |  | Six Months Ended August 31, |  |  |  |
| :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: | :---: |
| Statements of Earnings - Data | 2012 |  | 2011 |  | 2012 |  | 2011 |  |
| Net sales | \$ 138,344 | 100.0\% | \$ 130,384 | 100.0\% | \$ 280,872 | 100.0\% | \$ 273,642 | 100.0\% |
| Cost of goods sold | 104,395 | 75.5 | 96,290 | 73.9 | 218,674 | 77.9 | 199,847 | 73.0 |
| Gross profit margin | 33,949 | 24.5 | 34,094 | 26.1 | 62,198 | 22.1 | 73,795 | 27.0 |
| Selling, general and administrative | 21,331 | 15.4 | 18,447 | 14.1 | 43,357 | 15.4 | 39,304 | 14.3 |
| Gain from disposal of assets | (5) |  | (125) | (0.1) | (9) |  | (125) |  |
| Income from operations | 12,623 | 9.1 | 15,772 | 12.1 | 18,850 | 6.7 | 34,616 | 12.7 |
| Other expense, net | (667) | (0.5) | (493) | (0.4) | (786) | (0.3) | $(1,487)$ | (0.6) |
| Earnings before income taxes | 11,956 | 8.6 | 15,279 | 11.7 | 18,064 | 6.4 | 33,129 | 12.1 |
| Provision for income taxes | 4,364 | 3.1 | 5,567 | 4.3 | 6,593 | 2.3 | 11,993 | 4.4 |
| Net earnings | \$ 7,592 | 5.5\% | \$ 9,712 | 7.4\% | \$ 11,471 | 4.1\% | \$ 21,136 | 7.7\% |

## Three Months ended August 31, 2012 compared to Three Months ended August 31, 2011

Net Sales. Our consolidated net sales were $\$ 138.3$ million for the second quarter ended August 31, 2012 compared to $\$ 130.4$ million for the second quarter ended August 31, 2011, or an increase of $6.1 \%$. Print sales increased $24.3 \%$ for the quarter, from $\$ 69.2$ million to $\$ 86.0$ million. Apparel sales for the quarter declined by $14.5 \%$ (down $4.5 \%$ on units and down $10 \%$ on price) from $\$ 61.2$ million to $\$ 52.3$ million. During the quarter we were able to offset the decline in our apparel sales by the additional sales associated with our print acquisitions. Our apparel sales continue to be impacted by softness in the market and resulting competitive pricing pressures.

Cost of Goods Sold. Our manufacturing costs increased by $\$ 8.1$ million from $\$ 96.3$ million for the three months ended August 31,2011 to $\$ 104.4$ million for the current quarter, or $8.4 \%$. Our consolidated gross profit margin ( margin ) decreased from $26.1 \%$ to $24.5 \%$ for the quarters ended August 31, 2011 and August 31, 2012, respectively. Our print margin increased from $28.6 \%$ to $30.7 \%$, due to increased efficiencies, while our apparel margin, which continues to be impacted by higher cotton costs, decreased from $23.4 \%$ to $14.4 \%$ for the quarter. While our apparel results continue to be negatively impacted by higher raw material costs, we are beginning to see improvement in this segment s margin. Apparel s margin during the second quarter improved 740 basis points over the preceding quarter; and we expect their margin to continue to improve during the current quarter as higher cost raw materials are being replaced with raw materials with significantly lower costs.

Selling, general and administrative expense. For the three months ended August 31, 2012, our selling, general and administrative expenses were $\$ 21.3$ million, or $15.4 \%$ of sales, compared to $\$ 18.4$ million, or $14.1 \%$ of sales for the three months ended August 31 , 2011, or an increase of approximately $\$ 2.9$ million, or $15.8 \%$. Selling, general and administrative expenses were up slightly as a result of our two print acquisitions last fiscal year.

Gain from disposal of assets. The gain from disposal of assets of $\$ 5,000$ during the quarter related to the sale of a vehicle. The gain from disposal of assets of $\$ 125,000$ for the three months ended August 31, 2011 resulted primarily from the sale of unused manufacturing equipment during the quarter.

Income from operations. Our income from operations for the three months ended August 31, 2012 was $\$ 12.6$ million or $9.1 \%$ of sales, as compared to $\$ 15.8$ million, or $12.1 \%$ of sales for the three months ended August 31, 2011, a decrease of $\$ 3.2$ million, or $20.3 \%$. The decrease in our operational earnings related to our decreased apparel margin during the quarter.

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Other income and expense. Interest expense decreased from $\$ 0.7$ million for the three months ended August 31, 2011 to $\$ 0.4$ million for the three months ended August 31, 2012. Although our average outstanding borrowings were higher during the quarter when compared to the same quarter last year, our interest expense decreased due to our lower effective borrowing rate as well as an additional $\$ 0.2$ million in interest related to the Interest Rate Swap Agreement ( Swap ) during the same quarter last year.

Provision for income taxes. Our effective tax rate was $36.5 \%$ for the three months ended August 31, 2012 compared to $36.4 \%$ for the three months ended August 31, 2011. The increase in our effective tax rate during the current period related to a reduction in the benefit associated with our Domestic Production Activities Deduction, which was caused by moving our apparel manufacturing from the United States to Mexico. Our effective tax rate for all of fiscal 2012 was $36.5 \%$.

Net earnings. Due to the above factors, our net earnings for the three months ended August 31, 2012 was $\$ 7.6$ million, or $5.5 \%$ of sales, as compared to $\$ 9.7$ million, or $7.4 \%$ of sales for the three months ended August 31, 2011. Our basic earnings per share were $\$ 0.29$ per share for the three months ended August 31, 2012, as compared to $\$ 0.37$ per share for the three months ended August 31, 2011. Our diluted earnings per share were $\$ 0.29$ per share for the three months ended August 31,2012 , as compared to $\$ 0.37$ per share for the three months ended August 31, 2011.

## Six Months ended August 31, 2012 compared to Six Months ended August 31, 2011

Net Sales. For the six month period, our net consolidated sales increased from $\$ 273.6$ million to $\$ 280.9$ million, or $2.7 \%$. Print sales for the six month period were $\$ 173.4$ million, compared to $\$ 136.3$ million for the same period last year, an increase of $\$ 37.1$ million, or $27.2 \%$. Apparel sales for the six month period were $\$ 107.5$ million, compared to $\$ 137.3$ million for the same period last year, or a decrease of $21.7 \%$ (down $14.7 \%$ on units and down $7 \%$ on price). During the period we have been able to offset the decline in our apparel sales by the additional sales associated with our print acquisitions. Our apparel sales continue to be impacted by softness in the market and resulting competitive pricing pressures.

Cost of Goods Sold. Our manufacturing costs increased by $\$ 18.9$ million from $\$ 199.8$ million, or $73.0 \%$ of sales for the six months ended August 31, 2011 to $\$ 218.7$ million, or $77.9 \%$ of sales for the comparable period this year. Overall our margin decreased from $27.0 \%$ to $22.1 \%$ for the six months ended August 31, 2011 and 2012, respectively. Our print margin increased during the period from $28.7 \%$ to $29.3 \%$, while our apparel margin decreased from $25.3 \%$ to $10.6 \%$, again due to higher cotton costs. As mentioned earlier, the negative impact associated with the higher cotton costs in our apparel inventory has begun to abate and we expect to see our apparel margin continue to improve in each succeeding quarter.

Selling, general and administrative expense. For the six months ended August 31, 2012, our selling, general and administrative expenses were $\$ 43.4$ million compared to $\$ 39.3$ million for the six months ended August 31,2011 , or an increase of approximately $\$ 4.1$ million, or $10.4 \%$. Selling, general and administrative expenses were up as a result of our two print acquisitions last fiscal year.

Gain from disposal of assets. The gain from disposal of assets of $\$ 9,000$ for the six months ended August 31, 2012 resulted from the sale of a vehicle and miscellaneous manufacturing equipment. The gain from disposal of assets of $\$ 125,000$ for the six months ended August 31,2011 resulted primarily from the sale of unused manufacturing equipment.

Income from operations. Our income from operations for the six months ended August 31, 2012 was $\$ 18.9$ million, or $6.7 \%$ of sales compared to $\$ 34.6$ million, or $12.7 \%$ of sales for the same period last year, or a decrease of $\$ 15.7$ million, or $45.4 \%$. The decrease in our operational earnings related to our decreased apparel margin during the period.

Other income and expense. Our interest expense decreased from $\$ 1.5$ million for the six months ended August 31, 2011 to $\$ 0.9$ million for the six months ended August 31, 2012. Although our average outstanding borrowings were higher during this period when compared to the same period last year, our interest expense decreased due to our lower effective borrowing rate as well as an additional $\$ 0.6$ million in interest related to the Swap during the same period last year.

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## ENNIS, INC. AND SUBSIDIARIES

## FORM 10-Q

## FOR THE PERIOD ENDED AUGUST 31, 2012

Provision for income taxes. Our effective tax rate was $36.5 \%$ for the six months ended August 31, 2012 compared to $36.2 \%$ for the six months ended August 31, 2011. The increase in our effective tax rate during the current period related to a reduction in the benefit associated with our Domestic Production Activities Deduction, which was caused by moving our apparel manufacturing from the United States to Mexico.

Net earnings. Due to the above factors, our net earnings for the six months ended August 31, 2012 was $\$ 11.5$ million, or $4.1 \%$ of sales, compared to $\$ 21.1$ million, or $7.7 \%$ of sales for the six months ended August 31, 2011. Our basic earnings per share for the six months ended August 31,2012 was $\$ 0.44$ per share compared to $\$ 0.82$ per share for the six months ended August 31,2011 . Our diluted earnings per share for the six months ended August 31, 2012 was $\$ 0.44$ per share compared to $\$ 0.81$ per share for the six months ended August 31, 2011.

## Segment Operating Results

|  | Three months ended |  | Six months ended <br> August 31, |  |  |
| :--- | :---: | :---: | :---: | :---: | :---: |
| Net Sales by Segment (in thousands) | August 31, |  | $\mathbf{2 0 1 1}$ | $\mathbf{2 0 1 2}$ | $\mathbf{2 0 1 1}$ |
| Print | $\$ 26,069$ | $\$ 69,212$ | $\$ 173,368$ | $\$ 136,326$ |  |
| Apparel | 52,275 | 61,172 | 107,504 | 137,316 |  |
| Total |  |  |  |  |  |

Print Segment. Our net print sales, which represented $62 \%$ of our consolidated sales during the three and six months ended August 31, 2012, were approximately $\$ 86.0$ million and $\$ 173.4$ million, respectively, compared to $\$ 69.2$ million and $\$ 136.3$ million for the three and six months ended August 31, 2011, respectively, an increase of $\$ 16.8$ million, or $24.3 \%$ for the quarter and an increase of $\$ 37.1$ million, or $27.2 \%$ for the period. The increase in our sales during the quarter and period related primarily to our print acquisitions, which added $\$ 21.3$ million and $\$ 44.2$ million for the quarter and period, respectively. While the growth has related primarily to our acquisitions, we continue to see signs of stability in our underlying business.

Apparel Segment. Our net apparel sales, which represented $38 \%$ of our consolidated sales for the three and six months ended August 31, 2012, were approximately $\$ 52.3$ million and $\$ 107.5$ million, respectively, compared to approximately $\$ 61.2$ million and $\$ 137.3$ million for the three and six months ended August 31, 2011, respectively, a decrease of $\$ 8.9$ million, or $14.5 \%$ for the quarter and a decrease of $\$ 29.8$ million, or $21.7 \%$ for the period. Our apparel sales continue to be impacted by soft market conditions; reduced retail and consumer sentiment attributed to the protracted and volatile economic recovery; the destocking of inventories at the retail, distributor, and screen-print levels; a drop in commodity prices and competitors pricing strategies. The drop in commodity prices caused some unrealistic expectations with respect to selling prices. These unrealistic expectations caused some destocking of inventories at the retail and distributor levels, which added to the competitive pressures in the marketplace as manufacturers attempted to maintain their production levels. We believe our competitors instituted various rebate programs (stock/restock programs, etc.) or announced price decreases, sometimes even selling their products at prices less than their associated raw material costs. Since our pricing strategy has been to try to cover our costs, we feel this has negatively impacted our top-line results during this fiscal year. However, as the higher priced inventory in the marketplace is worked through, sales volumes should return to more normalized levels, pricing should stabilize as selling prices and the cost of cotton in inventories being consumed are in better alignment, and as such we continue to expect a better business environment during the second half of fiscal 2013.

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## ENNIS, INC. AND SUBSIDIARIES

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## FOR THE PERIOD ENDED AUGUST 31, 2012

|  | Three months ended August 31, |  | Six months ended August 31, |  |
| :---: | :---: | :---: | :---: | :---: |
| Gross Profit by Segment (in thousands) | 2012 | 2011 | 2012 | 2011 |
| Print | \$ 26,420 | \$ 19,771 | \$ 50,787 | \$ 39,101 |
| Apparel | 7,529 | 14,323 | 11,411 | 34,694 |
| Total | \$ 33,949 | \$ 34,094 | \$ 62,198 | \$ 73,795 |

Print Segment. Our print gross profit margin for the three and six months ended August 31, 2012 was $\$ 26.4$ million and $\$ 50.8$ million, respectively, as compared to $\$ 19.8$ million and $\$ 39.1$ million for the three and six months ended August 31, 2011, respectively, an increase for the quarter of $\$ 6.6$ million, or $33.3 \%$ and an increase for the period of $\$ 11.7$ million, or $29.9 \%$. As a percentage of sales, the print gross profit increased from $28.6 \%$ to $30.7 \%$ for the three months ended August 31, 2011 and 2012, respectively, and increased from $28.7 \%$ to $29.3 \%$ for the six months ended August 31, 2011 and 2012, respectively. The increase in our print gross profit on a dollar basis related to our print acquisitions last year. The percentage basis increase improved due to improved operational efficiencies at these same plants.

Apparel Segment. Our apparel gross profit margin ( margin ), for the three and six months ended August 31, 2012 was $\$ 7.5$ million and $\$ 11.4$ million, respectively, as compared to $\$ 14.3$ million and $\$ 34.7$ million for the three and six months ended August 31, 2011, respectively. As a percentage of sales, our apparel gross profit margin was $14.4 \%$ and $10.6 \%$ for the three and six months ended August 31, 2012, respectively, as compared to $23.4 \%$ and $25.3 \%$ for the three and six months ended August 31, 2011, respectively. Our apparel margin continues to be impacted by higher input costs and competitive pressures in the marketplace. Cotton costs flowing through our cost of sales was $45 \%$ percent higher this quarter as compared to the same quarter last year. While our apparel results continue to be negatively impacted by these higher costs, we are beginning to see improvement in this segment s margin. The Apparel Segment margin during the second quarter improved 740 basis points over the preceding quarter; and we expect its margin will continue to improve during the second half of the year as higher cost raw materials are being replaced with raw materials with significantly lower costs.

|  | Three months ended August 31, |  | Six months ended August 31, |  |
| :---: | :---: | :---: | :---: | :---: |
| Profit by Segment (in thousands) | 2012 | 2011 | 2012 | 2011 |
| Print | \$ 14,815 | \$ 11,941 | \$ 27,429 | \$ 22,943 |
| Apparel | 1,047 | 6,715 | $(1,774)$ | 17,630 |
| Total | 15,862 | 18,656 | 25,655 | 40,573 |
| Less corporate expenses | 3,906 | 3,377 | 7,591 | 7,444 |
| Earnings before income taxes | \$ 11,956 | \$ 15,279 | \$ 18,064 | \$ 33,129 |

Print Segment. As a result of the increase in our print margin and our two print acquisitions last year, our print profit for the three and six months ended August 31, 2012 was $\$ 14.8$ million and $\$ 27.4$ million, respectively, compared to $\$ 11.9$ million and $\$ 22.9$ million for the three and six months ended August 31, 2011, respectively. As a percent of sales, our print profits decreased from $17.3 \%$ and $16.8 \%$ to $17.2 \%$ and $15.8 \%$ for the three and six months ended August 31, 2011 and 2012, respectively.

Apparel Segment. As a result of the decrease in our apparel sales and margin, our apparel profit decreased approximately $\$ 5.7$ million, from $\$ 6.7$ million for the three months ended August 31, 2011 to $\$ 1.0$ million for the three months ended August 31, 2012. The apparel profit decreased $\$ 19.4$ million, from $\$ 17.6$ million to a loss of $\$ 1.8$ million for the six months ended August 31, 2011 and 2012, respectively. As a percent of sales, our apparel profits were $2.0 \%$ and $-1.7 \%$ for the three and six months ended August 31, 2012, respectively, compared to $11.0 \%$ and $12.8 \%$ for the three and six months ended August 31, 2011, respectively.

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## ENNIS, INC. AND SUBSIDIARIES

## FORM 10-Q

## FOR THE PERIOD ENDED AUGUST 31, 2012

## Liquidity and Capital Resources

|  | August 31, | February 29, |  |
| :--- | :---: | :---: | :---: |
| (Dollars in thousands) | $\mathbf{2 0 1 2}$ | $\mathbf{2 0 1 2}$ |  |
| Working Capital | $\$ 158,213$ | $\$$ | 168,969 |
| Cash | $\$ 13,205$ | $\$$ | 10,410 |

Working Capital. Our working capital decreased by approximately $\$ 10.8$ million, or $6.4 \%$, from $\$ 169.0$ million at February 29, 2012 to $\$ 158.2$ million at August 31, 2012, due primarily to the continued decrease in the value of our apparel finished goods inventory. This will continue to occur as higher priced cotton is replaced by lower priced cotton in their finished goods. Our current ratio, calculated by dividing our current assets by our current liabilities, increased from 4.4 to 1.0 at February 29, 2012 to 4.8 to 1.0 at August 31, 2012. Our current ratio increased primarily because on a percentage basis, our current liabilities decreased by a larger percentage than our current assets, $17.3 \%$ and $8.9 \%$, respectively.

|  | Six months ended August 31, |  |
| :--- | :---: | :---: |
| (Dollars in thousands) | $\mathbf{2 0 1 2}$ | $\mathbf{2 0 1 1}$ |
| Net Cash provided by operating activities | $\$ 29,360$ | $\$ 12,744$ |
| Net Cash provided by (used in) investing activities | $\$ 2,889$ | $\$(3,965)$ |
| Net Cash used in financing activities | $\$(29,111)$ | $\$(7,860)$ |

Cash flows from operating activities. Cash provided by operating activities increased by $\$ 16.6$ million from $\$ 12.7$ million for the six months ended August 31, 2011 to $\$ 29.4$ million for the six months ended August 31, 2012. Our lower operational profits, which decreased our operational cash by $\$ 9.7$ million during the period, was more than offset by our decreased inventory balances which increased our operational cash flow by $\$ 40.6$ million. This was partially offset by a decrease in our outstanding payables, an increase in our accounts receivable and a decrease in our prepaid expenses, which impacted our operational cash by ( $\$ 8.6$ ) million, ( $\$ 9.7$ ) million and $\$ 3.0$ million, respectively, during the period.

Cash flows from investing activities. The decrease in our capital expenditures for the period relates primarily to the fact that our new apparel manufacturing facility located in Agua Prieta, Mexico was completed last fiscal year. Cash provided during the current quarter related to an adjustment to the purchase price on one of our acquisitions.

Cash flows from financing activities. We used $\$ 29.1$ million in cash for financing activities this period, compared to $\$ 7.9$ million for the same period last year. This related primarily to the repayment of $\$ 20.0$ million of outstanding debt on our credit line and an increase of $\$ 1.1$ million in our dividends, which resulted from our Board of Directors approving an increase in our quarterly dividend from $\$ 0.155$ to $\$ 0.175$.

Credit Facility. On February 22, 2012, we entered into the Second Amendment to Second Amended and Restated Credit Agreement (the Facility ) with a group of lenders led by Bank of America, N.A. (the Lenders ). The Facility provides us access to $\$ 150.0$ million in revolving credit, which we may increase to $\$ 200.0$ million in certain circumstances, and matures on August 18,2016 . The Facility bears interest at the London Interbank Offered Rate ( LIBOR ) plus a spread ranging from 1.0\% to 2.25\% (LIBOR + 1.75\% or 1.98\% at August 31, 2012 and $2.47 \%$ at August 31, 2011), depending on our ratio of total funded debt to the sum of net earnings plus interest, tax, depreciation and amortization ( EBITDA ). As of August 31, 2012, we had $\$ 70.0$ million of borrowings under the revolving credit line and $\$ 3.5$ million outstanding under standby letters of credit arrangements, leaving us availability of approximately $\$ 76.5$ million. The Facility contains financial covenants, restrictions on capital expenditures, acquisitions, asset dispositions, and additional debt, as well as other customary covenants, such as total funded debt to EBITDA ratio. We were in compliance with all these covenants as of August 31, 2012. The Facility is secured by substantially all of our domestic assets as well as all capital securities of each of the Company s U.S. subsidiaries and $65 \%$ of all capital securities of each of the Company s direct foreign subsidiaries.

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It is anticipated that the available line of credit is sufficient to cover working capital requirements for the foreseeable future, should it be required.

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## ENNIS, INC. AND SUBSIDIARIES

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## FOR THE PERIOD ENDED AUGUST 31, 2012

We use derivative financial instruments to manage our exposure to interest rate fluctuations on our floating rate $\$ 150.0$ million revolving credit facility from time to time. We account for our derivatives as cash flow hedges and record them as either assets or liabilities in the balance sheet, measure those instruments at fair value and recognize changes in the fair value of derivatives in earnings in the period of change, unless the derivative qualifies as an effective hedge that offsets certain exposures, at which time the changes in fair value would be recorded in Accumulated Other Comprehensive Income.

On July 7, 2008, we entered into a three-year Swap for a notional amount of $\$ 40.0$ million which matured on July 22, 2011. The Swap effectively fixed the LIBOR rate at $3.79 \%$.

Pension Plan We are required to make contributions to our defined benefit retirement plan. These contributions are required under the minimum funding requirements of the Employee Retirement Pension Plan Income Security Act of 1974 (ERISA). Due to the recent enactment of the Moving Ahead for Progress in the $21^{\text {st }}$ Century (MAP-21) in July 2012, which effectively raises the discount rates mandated for determining the value of a plan $s$ benefit liability and annual cost of accruals, our minimum required contribution to the Pension Plan is zero for the Pension Plan year ending February 28, 2013. However, we do expect to make a cash contribution to the Pension Plan of between $\$ 2.0$ million and $\$ 3.0$ million during the fourth quarter of fiscal year 2013. We made contributions of $\$ 3.0$ million to our Pension Plan during fiscal 2012. As our pension assets are invested in marketable securities, fluctuations in market values could potentially impact our funding status, associated liabilities recorded and future required minimum contributions. At August 31, 2012, we had an unfunded pension liability recorded on our balance sheet of $\$ 8.6$ million.

Inventories We believe our current inventory levels are sufficient to satisfy our customer demands and we anticipate having adequate sources of raw materials to meet future business requirements. We have long-term contracts in effect with paper and yarn suppliers that govern prices, but do not require minimum purchase commitments. Certain of our rebate programs do, however, require minimum purchase volumes. Management anticipates meeting the required volumes.

Capital Expenditures We expect our capital requirements for our current fiscal year, exclusive of capital required for possible acquisitions, will be in line with our historical levels of between $\$ 4.0$ million and $\$ 5.0$ million. For the six months ended August 31, 2012, capital expenditures were approximately $\$ 0.9$ million. We expect to fund these expenditures through existing cash flows.

We rely on our cash flows generated from operations and the borrowing capacity under our Facility to meet cash requirements of our business. The primary cash requirements of our business are payments to vendors in the normal course of business, capital expenditures, debt repayments and related interest payments, contributions to our pension plan, and the payment of dividends to our shareholders. We expect to generate sufficient cash flows from operations supplemented by our Facility as required to cover our operating and capital requirements for the foreseeable future.

Contractual Obligations \& Off-Balance Sheet Arrangements There have been no significant changes in our contractual obligations since February 29, 2012 that have, or are reasonably likely to have, a material impact on our results of operations or financial condition. We had no off-balance sheet arrangements in place as of August 31, 2012.

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

## Market Risk

## Interest Rates

We are exposed to interest rate risk on short-term and long-term financial instruments carrying variable interest rates. We may from time to time utilize interest rate swaps to manage overall borrowing costs and reduce exposure to adverse fluctuations in interest rates. We do not use derivative instruments for trading purposes. Our variable rate financial instruments, including the outstanding credit facility, totaled $\$ 70.0$

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million at August 31, 2012. We

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## ENNIS, INC. AND SUBSIDIARIES

## FORM 10-Q

FOR THE PERIOD ENDED AUGUST 31, 2012
had entered into a $\$ 40.0$ million interest rate swap designated as a cash flow hedge related to this debt, but this arrangement matured July 22 , 2011; as such the entire balance of our line of credit is subject to fluctuations in the LIBOR rate. The impact on our results of operations of a one-point interest rate change on the outstanding balance of the variable rate financial instruments as of August 31, 2012 would be approximately $\$ 0.7$ million.

## Foreign Exchange

We have global operations and thus make investments and enter into transactions in various foreign currencies. The value of our consolidated assets and liabilities located outside the United States (translated at period end exchange rates) and income and expenses (translated using average rates prevailing during the period), generally denominated in Pesos and Canadian Dollars, are affected by the translation into our reporting currency (the U.S. Dollar). Such translation adjustments are reported as a separate component of consolidated statements of comprehensive income. In future periods, foreign exchange rate fluctuations could have an increased impact on our reported results of operations.

This market risk discussion contains forward-looking statements. Actual results may differ materially from this discussion based upon general market conditions and changes in domestic and global financial markets.

## Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures. A review and evaluation were carried out under the supervision and with the participation of our management, including our Chief Executive Officer and our Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures (as such term is defined in Rule 13a-15(e) of the Securities Exchange Act of 1934, as amended (the Exchange Act )) as of the end of the period covered by this Quarterly Report on Form 10-Q, pursuant to Exchange Act Rule 13a-15. Based upon that review and evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that our disclosure controls and procedures as of August 31, 2012 are effective to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the Securities and Exchange Commission s rules and forms and include controls and procedures designed to ensure that information required to be disclosed by us in such reports is accumulated and communicated to our management, including our principal executive and financial officers as appropriate to allow timely decisions regarding required disclosure. Due to the inherent limitations of control systems, not all misstatements may be detected. Those inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple errors or mistakes. Additionally, controls could be circumvented by the individual acts of some persons or by collusion of two or more people. Our controls and procedures can only provide reasonable, not absolute, assurance that the above objectives have been met.

There were no changes in our internal control over financial reporting identified in connection with the evaluation required by paragraph (d) of Exchange Act Rule 13a-15 that occurred during our fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting ended August 31, 2012.

## PART II. OTHER INFORMATION

## Item 1. Legal Proceedings

There are no material pending proceedings, other than ordinary routine litigation incidental to the business, to which the Company or any of its subsidiaries is a party or of which any of their property is subject.

## Item 1A. Risk Factors

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There have been no material changes in our Risk Factors as previously discussed in our Annual Report on Form 10-K for the year ended February 29, 2012.

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## ENNIS, INC. AND SUBSIDIARIES

## FORM 10-Q

## FOR THE PERIOD ENDED AUGUST 31, 2012

## Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

Under the Company s stock repurchase plan which was approved by the Board on October 20, 2008, the Company was authorized to repurchase up to $\$ 5.0$ million of the Company s common stock. On April 20, 2012, the Board increased the authorized amount available to repurchase our shares by an additional $\$ 5.0$ million, bringing the total to $\$ 10.0$ million. As of October 5, 2012, the Company has repurchased 96,000 shares under the repurchase program since its inception at an average price per share of $\$ 10.45$. No repurchases were made under the plan during the second quarter ended August 31, 2012. There is a maximum amount of approximately $\$ 9.0$ million that may yet be used to purchase shares under the program. Unrelated to the stock repurchase program, the Company purchased 93 and 175 shares of common stock during the three and six months ended August 31, 2012, respectively.

| Period | Total <br> Number of Shares Purchased | Average Price Paid per Share | Total Number of Shares <br> Purchased as <br> Part of Publicly <br> Announced Programs | Maximum Amount that May Yet Be Used to Purchase Shares Under the Program |  |
| :---: | :---: | :---: | :---: | :---: | :---: |
| June 1, 2012 - June 30, 2012 | 93 | \$ 14.30 |  | \$ | 8,897,084 |
| July 1, 2012 - July 31, 2012 |  | \$ |  | \$ | 8,897,084 |
| August 1, 2012 - August 31, 2012 |  | \$ |  | \$ | 8,897,084 |
| Total | 93 | \$ 14.30 |  | \$ | 8,897,084 |

Items 3, 4 and 5 are not applicable and have been omitted

## Item 6. Exhibits

The following exhibits are filed as part of this report.

Exhibit
Number

Description
Exhibit 3.1(a) Restated Articles of Incorporation as amended through June 23, 1983 with attached amendments dated June 20, 1985, July 31, 1985 and June 16, 1988 incorporated herein by reference to Exhibit 5 to the Registrant s Form 10-K Annual Report for the fiscal year ended February 28, 1993 (File No. 001-05807).
Exhibit 3.1(b) Amendment to Articles of Incorporation dated June 17, 2004 incorporated herein by reference to Exhibit 3.1(b) to the Registrant s Form 10-K Annual Report for the fiscal year ended February 28, 2007, filed May 9, 2007 (File No. 001-05807).

Exhibit 3.2 Second Amended and Restated Bylaws of Ennis, Inc. dated September 21, 2012 incorporated herein by reference to Exhibit 3.1 to the Registrant s Current Report on Form 8-K filed on September 27, 2012 (File No. 001-05807).

Exhibit 31.1 Certification Pursuant to Rule 13a-14(a) of Chief Executive Officer.*
Exhibit $31.2 \quad$ Certification Pursuant to Rule 13a-14(a) of Chief Financial Officer.*
Exhibit 32.1 Section 1350 Certification of Chief Executive Officer.**

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## Exhibit 32.2 Section 1350 Certification of Chief Financial Officer.**

Exhibit 101 The following information from Ennis, Inc. s Quarterly Report on Form 10-Q for the quarter ended August 31, 2012, filed on October 5, 2012, formatted in XBRL: (i) Consolidated Balance Sheets, (ii) Consolidated Statements of Earnings, (iii) Consolidated Statements of Comprehensive Income, (iv) Consolidated Statements of Cash Flows, and (v) the Notes to Consolidated Financial Statements, tagged as blocks of text and in detail.***

* Filed herewith
** Furnished herewith
*** As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.


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## ENNIS, INC. AND SUBSIDIARIES

## FORM 10-Q

FOR THE PERIOD ENDED AUGUST 31, 2012

## SIGNATURES

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

Date: October 5, 2012

Date: October 5, 2012

ENNIS, INC.
/s/ Keith S. Walters
Keith S. Walters
Chairman, Chief Executive Officer and
President
/s/ Richard L. Travis, Jr.
Richard L. Travis, Jr.
V.P. Finance and CFO, Treasurer and

Principal Financial and Accounting Officer

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## INDEX TO EXHIBITS

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* Filed herewith
** Furnished herewith
*** As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933 and Section 18 of the Securities Exchange Act of 1934.

