ENNIS, INC.
Form 10-K
May 09, 2008

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

**FORM 10-K**
**Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
**For the fiscal year ended February 29, 2008**
**Commission File Number 1-5807**

**ENNIS, INC.**
(Exact Name of Registrant as Specified in Its Charter)

| **Texas** | **75-0256410** |
|---|---|
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |
| **2441 Presidential Pkwy., Midlothian, Texas** | **76065** |
| (Address of Principal Executive Offices) | (Zip code) |

**(Registrant s Telephone Number, Including Area Code) (972) 775-9801**
**Securities registered pursuant to Section 12(b) of the Act:**

| Title of each class | Name of each exchange on which registered |
|---|---|
| Common Stock, par value $2.50 per share | New York Stock Exchange |

**Securities registered pursuant to Section 12(g) of the Act: None**

Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes o No þ

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes o No þ

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 þ No o

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of Registrant s knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. o

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 12b-2 of the Exchange Act. (Check one):

| Large accelerated filer: o | Accelerated filer: þ | Non-accelerated filer: o | Smaller reporting company: o |
|---|---|---|---|
| | | (Do not check if a smaller reporting company) | |

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

The aggregate market value of voting stock held by non-affiliates of the Registrant as of August 31, 2007 was approximately $546 million. Shares of voting stock held by executive officers, directors and holders of more than 10% of the outstanding voting stock have been excluded from this calculation because such persons may be deemed to be affiliates. Exclusion of such shares should not be construed to indicate that any of such persons possesses the power, direct or indirect, to control the Registrant, or that any such person is controlled by or under common control with the Registrant.

The number of shares of the Registrant s Common Stock, par value $2.50, outstanding at April 30, 2008 was 25,720,166.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the Registrant s Proxy Statement for the 2008 Annual Meeting of Shareholders are incorporated by reference into Part III of this Report.

**ENNIS, INC. AND SUBSIDIARIES**
**FORM 10-K**
**FOR THE PERIOD ENDED FEBRUARY 29, 2008**
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Subsidiaries of Registrant
Consent of Independent Registered Public Accounting Firm
Certification Pursuant to Rule 13a-14(a)/15d-14(a) (Chief Executive Officer)
Certification Pursuant to Rule 13a-14(a)/15d-14(a) (Chief Financial Officer)
Certification Pursuant to Section 906
Certification Pursuant to Section 906

## PART I

### ITEM 1. BUSINESS

### Overview

Ennis, Inc. (formerly Ennis Business Forms, Inc.) was organized under the laws of Texas in 1909. Ennis, Inc. and its subsidiaries (collectively known as the Company, Registrant, Ennis, we, us, or our ) print and manufacture line of business forms and other business products and also manufacture a line of activewear for distribution throughout North America. Distribution of business products and forms throughout the United States and Canada is primarily through independent dealers, and with respect to our activewear products, through sales representatives. This distributor channel encompasses print distributors, stationers, quick printers, computer software developers, activewear wholesalers, screen printers, and advertising agencies, among others. The company s apparel business was acquired on November 19, 2004. Apparel Segment produces and sells activewear, including t-shirts, fleece goods and other wearables. With apparel being the hottest product on the market, we are growing in every way to help our distributors profits continue to rise. We now 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 new apparel line features a wide variety of tees, fleece, shorts and yoga pants, and two headwear brands.

On October 5, 2007, we acquired certain assets of B & D Litho, Inc. ( B & D ) headquartered in Phoenix, Arizona, and certain assets and related real estate of Skyline Business Forms, operating in Denver, Colorado for $12.5 million. The acquisition of B&D Litho, Inc. did not include the acquisition of B&D Litho California, Inc., which is mainly a commercial printing operation located in Ontario, California. No significant liabilities were assumed in the transactions. The combined sales of the purchased operations were $25.0 million during the most recent twelve month period. The acquisition will add additional medium and long run multi-part forms, laser cut sheets, jumbo rolls and mailer products sold through the indirect sales (distributorship) marketplace.

On September 17, 2007, we acquired certain assets of Trade Envelope, Inc. ( Trade ) for $2.7 million. Under the terms of the purchase agreement, we have agreed to pay the former owners of Trade under a contingent earn-out arrangement over three years for intangibles, subject to certain set-offs. Trade is an envelope manufacturer (converter) and printer, offering high quality, 1-4 color process with lithograph and flexography capabilities with locations in Tullahoma, Tennessee and Carol Stream, Illinois. The combined sales of Trade during the most recent twelve month period were $11.4 million. The acquisition expanded and strengthened the envelope line of products currently being offered by the Company.

On August 8, 2006, we purchased the outstanding stock of Block Graphics, Inc. ( Block ), a privately held company headquartered in Portland, Oregon for $14.8 million in cash. Block had sales of approximately $38.6 million for the year ended December 31, 2005. The acquisition of Block continues the strategy of growth in our print segment through related manufactured products to further service our existing customer base. The acquisition added additional short-run print products (snaps, continuous forms, and cut-sheet forms) as well as the production of envelopes, a new product for the Company.

On March 31, 2006, we purchased all of the outstanding stock of Specialized Printed Forms, Inc. ( SPF ), a privately held company headquartered in Caledonia, New York and the associated land and buildings for $4.6 million in cash. SPF had sales of $9.2 million for the twelve month period ended July 31, 2005. The acquisition of SPF continues the strategy of growth through related manufactured products to further service our existing customer base. The acquisition added additional short-run print products, long-run (jumbo rolls) products and solutions as well as integrated labels and form/label combinations sold through the indirect sales (distributorship) marketplace.

On January 3, 2006, we purchased the outstanding stock of Tennessee Business Forms, Inc. ( TBF ), a privately held company located in Tullahoma, Tennessee, as well as the associated land and buildings from a partnership which leased the facility to TBF. The purchase price of this transaction was $1.2 million. TBF had sales of $2.2 million for the twelve month period ended December 31, 2005. The acquisition of TBF continues the Ennis strategy of growth through acquisition of complimentary manufactured products to further service our existing customer base. The acquisition added additional short-run print products and solutions as well as integrated labels and form/label combinations sold through the indirect sales (distributorship) marketplace.

**Business Segment Overview**

We operate in two business segments, the Print Segment and the Apparel Segment. For additional financial information concerning segment reporting, please see note 14 of the notes to our consolidated financial statements beginning on page F-26 included elsewhere herein, which information is incorporated herein by reference.

**Print Segment**

The Print Segment, which has represented approximately 57% of our consolidated net sales during each of the past 3 years, 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 40 manufacturing locations throughout the United States in 16 strategically located domestic states. Approximately 95% 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 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®, Royal Business Forms , Block Graphics , Specialized Printed Forms , 360º Custom Labels , Enfusion , Witt Printing , B&D Litho of Arizona™, Genforms™ and Calibrated Forms . The Print Segment also sells the Adams-McClure brand (which provides Point of Purchase advertising for large franchise and fast food chains as well as kitting and fulfillment); the Admore brand (which provides presentation folders and document folders); Ennis Tag & Label (which provides tags and labels, promotional products and advertising concept products); Trade Envelopes™ and Block Graphics™ (which provide custom and imprinted envelopes) and Northstar® and GFS (which provide financial and security documents).

The Print Segment sells predominantly through private printers and independent distributors. Northstar and Adams McClure also sell 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 acquired several of the top 25 banks in the United States as customers and is actively working on other large banks within the top 25 tier of banks in the United States. Adams-McClure sales are generally provided through advertising agencies.

The printing industry generally sells its products in two ways. One market direction is to sell predominately to end users, and is dominated by a few large manufacturers, such as Moore Wallace (a subsidiary of R.R. Donnelly), Standard Register, and Cenveo. The other market direction, which the Company primarily serves, sells forms and other business products 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, such as Cenveo and their resale brand known as: PrintXcel, Discount Label, and Printegra. 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.

**Apparel Segment**

The Apparel Segment, which has represented approximately 43% of our consolidated net sales for the last 3 fiscal years, operates under the name of Alstyle Apparel ( Alstyle ). Alstyle markets high quality knit basic activewear (t-shirts, tank tops and fleece) across all market segments. Approximately 95% of Alstyle s revenues are derived from t-shirt sales, and 93% of those are domestic sales. Alstyle s branded product lines are AAA Alstyle Apparel & Activewear®, Gaziani®, Diamond Star®, Murina®, A Classic, Tennessee River®, D Drive , and Hyland® Headware.

Alstyle is headquartered in Anaheim, California, where it knits domestic cotton yarn and some polyester fibers into tubular material. The material is dyed at that facility and then shipped to its plants in Ensenada or Hermosillo, Mexico, where it is cut and sewn into finished goods. Alstyle also ships their dyed and cut product to outsourced manufacturers in El Salvador and Nicaragua for sewing. After sewing and packaging is completed, product is shipped to one of Alstyle s eight distribution centers located across the United States, Canada, and Mexico. The products of the Apparel Segment are standardized shirts manufactured in a variety of sizes and colors. The Apparel Segment operates six manufacturing facilities, one in California, and five in Mexico.

Alstyle utilizes a customer-focused internal sales team comprised of 21 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 approximately half 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 to direct customer branded products, and the remainder relates to private label and re-labels programs. Generally, sales to screen printers and mass marketers are driven by the availability of competitive products and price considerations, which drive our requirements for inventory levels of our various products, while 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 quarters generally being the highest. The general 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 that Alstyle sells to 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. Its primary competitors are Delta Apparel ( Delta ), Russell, Hanes and Gildan Activewear ( Gildan ). 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. Alstyle competes with many branded and private label manufacturers of knit apparel in the United States and Canada, 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 s 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.

Distribution of the Apparel Segment s products is through Alstyle s own staff of sales representatives and regional distribution centers selling to local distributors who resell to retailers, or directly to screen printers, embellishers, retailers and mass marketers.

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 more than 70% of our cotton and yarn from one supplier. Reference is made to Risk Factors of this Report.

**Patents, Licenses, Franchises and Concessions**

The Company does not have any significant patents, licenses, franchises, or concessions.

**Intellectual Property**

We market our products under a number of trademarks and tradenames. We have registered trademarks in the United States for Ennis, A Alstyle Apparel, AA Alstyle Apparel & Activewear, AAA Alstyle Apparel & Activewear, American Diamond, Classic by Alstyle Apparel, Diamond Star, Executive by Alstyle, Gaziani, Gaziani Fashions, Hyland, Hyland Headwear by Alstyle, Murina, Tennessee River, 360º Custom Labels, Admore, CashManagementSupply.com, Securestar, Northstar, MICRLink, MICR Connection, Ennisstores.com, General Financial Supply, Calibrated, Witt Printing, GenForms, Royal, Crabar/GBF, Adams McClure, Advertising Concepts, ColorWorx, Star Award Ribbon, and variations of these brands as well as other trademarks. We have similar trademark registrations internationally. The protection of our trademarks is important to our business. We believe that our registered and common law trademarks have significant value and these trademarks are instrumental to our ability to create and sustain demand for our products.

**Customers**

No single customer accounts for as much as five percent of consolidated net sales.

**Backlog**

At February 29, 2008, the Company s backlog of orders believed to be firm was approximately $27,134,000 as compared to approximately $18,658,000 at February 28, 2007.

**Research and Development**

While the Company continuously looks for new products to sell through its distribution channel, there have been no material amounts spent on research and development in the fiscal year ended February 29, 2008.

**Environment**

We are subject to various federal, state, and local environment laws and regulations concerning, among other things, wastewater discharges, air emissions and solid waste disposal. Our manufacturing processes do not emit substantial foreign substances into the environment. We do not believe that our compliance with federal, state, or local statutes or regulations relating to the protection of the environment has any material effect upon capital expenditures, earnings or our competitive position. There can be no assurance, however, that future changes in federal, state, or local regulations, interpretations of existing regulations or the discovery of currently unknown problems or conditions will not require substantial additional expenditures. Similarly, the extent of our liability, if any, for past failures to comply with laws, regulations, and permits applicable to our operations cannot be determined.

**Employees**

At February 29, 2008, the Company had approximately 6,256 employees. Approximately 2,939 of the employees are in Mexico and approximately 19 employees are in Canada. Of the USA employees, approximately 410 were

represented by three unions, fewer than seven separate contracts expiring at various times. Of the employees in Mexico, two unions represent substantially all employees with contracts expiring at various times.

**Available Information**

The Company makes its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities and Exchange Act of 1934 available free of charge under the Investors Relations page on its website, www.ennis.com, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission ( SEC ). Information on our website is not included as a part of, or incorporated by reference into, this report. The Company s SEC filings are also available through the SEC s website, www.sec.gov. In addition, the public may read and copy any materials we file with the SEC at the SEC s Public Reference Room at 450 Fifth Street, NW. Washington, DC 20549. Information regarding the operation of the Public Reference Room may be obtained by calling the SEC at 1-800-SEC-0330.

**ITEM 1A. RISK FACTORS**

You should carefully consider the risks described below, as well as the other information included or incorporated by reference in this Annual Report on Form 10-K, before making an investment in our common stock. The risks described below are not the only ones we face in our business. Additional risks and uncertainties not presently known to us or that we currently believe to be immaterial may also impair our business operations. If any of the following risks occur, our business, financial condition or operating results could be materially harmed. In such an event, our common stock could decline in price and you may lose all or part of your investment.

***We may be required to write down goodwill and other intangible assets in the future, which could cause our financial condition and results of operations to be negatively affected in the future.***

When we acquire a business, a portion of the purchase price of the acquisition may be allocated to goodwill and other identifiable intangible assets. The amount of the purchase price allocated to goodwill and other intangible assets is the excess of the purchase price over the net identifiable assets acquired. At February 29, 2008, our goodwill and other intangible assets were approximately $178.4 million and $88.2 million, respectively. Under current accounting standards, if we determine goodwill or intangible assets are impaired, we would be required to write down the value of these assets. Annually, we have conducted a review of our goodwill and other identifiable intangible assets to determine whether there has been impairment. We cannot provide assurance that we will not be required to take an impairment charge in the future. Any impairment charge would have a negative effect on our shareholders equity and financial results and may cause a decline in our stock price.

***Printed business forms may be superseded over time by paperless business forms or otherwise affected by technological obsolescence and changing customer preferences, which could reduce our sales and profits.***

Printed business forms and checks may eventually be superseded by paperless business forms, which could have a material adverse effect on our business over time. The price and performance capabilities of personal computers and related printers now provide a cost-competitive means to print low-quality versions of many of our business forms on plain paper. In addition, electronic transaction systems and off-the-shelf business software applications have been designed to automate several of the functions performed by our business form and check products. In response to the gradual obsolescence of our standardized forms business, we continue to develop our capability to provide custom and full-color products. If new printing capabilities and new product introductions do not continue to offset the obsolescence of our standardized business forms products, there is a risk that the number of new customers we attract and existing customers we retain may diminish, which could reduce our sales and profits. Decreases in sales of our standardized business forms and products due to obsolescence could also reduce our gross margins. This reduction could in turn adversely impact our profits, unless we are able to offset the reduction through the introduction of new high margin products and services or realize cost savings in other areas.

***Our distributors face increased competition from various sources, such as office supply superstores. Increased competition may require us to reduce prices or to offer other incentives in order to enable our distributors to attract new customers and retain existing customers.***

Low price, high value office supply chain stores offer standardized business forms, checks, and related products. Because of their size, these superstores have the buying power to offer many of these products at competitive prices. These superstores also offer the convenience of one-stop shopping for a broad array of office supplies that our distributors do not offer. In addition, superstores have the financial strength to reduce prices or increase promotional discounts to expand market share. This could result in us reducing our prices or offering incentives in order to enable our distributors to attract new customers and retain existing customers.

***Technological improvements may reduce our competitive advantage over some of our competitors, which could reduce our profits.***

Improvements in the cost and quality of printing technology are enabling some of our competitors to gain access to products of complex design and functionality at competitive costs. Increased competition from these competitors could force us to reduce our prices in order to attract and retain customers, which could reduce our profits.

***We could experience labor disputes that could disrupt our business in the future.***

As of February 29, 2008, approximately 12% of our domestic employees are represented by labor unions under collective bargaining agreements, which are subject to periodic renegotiations. Two unions represent all of our hourly employees in Mexico. There can be no assurance that any future labor negotiations will prove successful, which may result in a significant increase in the cost of labor, or may break down and result in the disruption of our business or operations.

***We obtain our raw materials from a limited number of suppliers and any disruption in our relationships with these suppliers, or any substantial increase in the price of raw materials, material shortages, or an increase in transportation costs, could have a material adverse effect on us.***

Cotton yarn is the primary raw material used in Alstyle s manufacturing processes. Cotton accounts for approximately 40% of the manufactured product cost. Alstyle acquires its yarn from three major sources that meet stringent quality and on-time delivery requirements. The largest supplier provides more than 70% of Alstyle s yarn requirements and has an entire yarn mill dedicated to Alstyle s production. If Alstyle s relations with its suppliers are disrupted, Alstyle may not be able to enter into arrangements with substitute suppliers on terms as favorable as its current terms and our results of operations could be materially adversely affected.

Alstyle generally acquires its cotton yarn under short-term purchase orders with its suppliers, and has exposure to swings in cotton market prices. Alstyle does not use derivative instruments, including cotton option contracts, to manage its exposure to movements in cotton market prices. Alstyle may use such derivative instruments in the future. We believe we are competitive with other companies in the United States apparel industry in negotiating the price of cotton. However, any significant increase in the price of cotton or shortages in the availability of cotton as the result of farmers switching to alternative crops, such as corn, could have a material adverse effect on our results of operations.

Freight costs also represent a significant cost to our apparel company. We incur freight costs associated with the delivery of yarn to our manufacturing facility in Anaheim, CA. We also incur freight costs associated with transporting our knit and dyed products to Mexico and our final sewn products from Mexico to our various distribution centers. Any significant increase in transportation costs due to increased fuel costs, etc. could have a material impact on our reported apparel margins.

We also purchase our paper products from a limited number of sources, which meet stringent quality and on-time delivery standards under long-term contracts. However, fluctuations in the quality of our paper, unexpected price increases, etc. could have a material adverse effect on our operating results.

***Alstyle faces intense competition to gain market share, which may lead some competitors to sell substantial amounts of goods at prices against which we cannot profitably compete.***

Demand for Alstyle s products is dependent on the general demand for shirts and the availability of alternative sources of supply. Alstyle s strategy in this market environment is to be a low cost producer and to differentiate itself by providing quality service to its customers. Even if this strategy is successful, its results may be offset by reductions in demand or price declines.

***Apparel business is subject to cyclical trends.***

The United States apparel industry is sensitive to the business cycle of the national economy. Moreover, the popularity, supply and demand for particular apparel products can change significantly from year to year. Alstyle may be unable to compete successfully in any industry downturn due to excess capacity.

***Our apparel foreign operations could be subject to unexpected changes in regulatory requirements, tariffs and other market barriers and political and economic instability in the countries where it operates, which could negatively impact our operating results.***

Alstyle operates cutting and sewing facilities in Mexico, and sources certain product manufacturing and purchases in El Salvador, Nicaragua, Honduras, Pakistan, China, and Southeast Asia. Alstyle s foreign operations could be subject to unexpected changes in regulatory requirements, tariffs, and other market barriers and political and economic instability in the countries where it operates. The impact of any such events that may occur in the future could subject Alstyle to additional costs or loss of sales, which could adversely affect our operating results. In particular, Alstyle operates its facilities in Mexico pursuant to the maquiladora duty-free program established by the Mexican and United States governments. This program enables Alstyle to take advantage of generally lower costs in Mexico, without paying duty on inventory shipped into or out of Mexico. There can be no assurance that the governments of Mexico and the United States will continue the program currently in place or that Alstyle will continue to be able to benefit from this program. The loss of these benefits could have an adverse effect on our business.

***Our apparel products are subject to foreign competition, which in the past has been faced with significant U.S. government import restrictions.***

Foreign producers of apparel often have significant labor cost advantages. Given the number of these foreign producers, the substantial elimination of import protections that protect domestic apparel producers could materially adversely affect Alstyle s business. The extent of import protection afforded to domestic apparel producers has been, and is likely to remain, subject to considerable political considerations.

The North American Free Trade Agreement (NAFTA) became effective on January 1, 1994 and has created a free-trade zone among Canada, Mexico, and the United States. NAFTA contains a rule of origin requirement that products be produced in one of the three countries in order to benefit from the agreement. NAFTA has phased out all trade restrictions and tariffs among the three countries on apparel products competitive with those of Alstyle. Alstyle performs substantially all of its cutting and sewing in five plants located in Mexico in order to take advantage of the NAFTA benefits. Subsequent repeal or alteration of NAFTA could adversely affect our business.

The Central American Free Trade Agreement (CAFTA) became effective May 28, 2004 and retroactive to January 1, 2004 for textiles and apparel. It creates a free trade zone similar to NAFTA by and between the United States and Central American countries (El Salvador, Honduras, Costa Rica, Nicaragua, and Dominican Republic.) Textiles and apparel will be duty-free and quota-free immediately if they meet the agreement s rule of origin, promoting new opportunities for U.S. and Central American fiber, yarn, fabric and apparel manufacturing. The agreement will also give duty-free benefits to some apparel made in Central America that contains certain fabrics from NAFTA partners Mexico and Canada. Alstyle sources approximately 20% of its sewing to a contract manufacturer in El Salvador, and we do not anticipate that this will have a material effect on our operations.

The World Trade Organization (WTO), a multilateral trade organization, was formed in January 1995 and is the successor to the General Agreement on Tariffs and Trade (GATT). This multilateral trade organization has set forth mechanisms by which world trade in clothing is being progressively liberalized by phasing-out quotas and reducing duties over a period of time that began in January of 1995. As it implements the WTO mechanisms, the United States government is negotiating bilateral trade agreements with developing countries, which are generally exporters of textile and apparel products, that are members of the WTO to get them to reduce their tariffs on imports of textiles and

apparel in exchange for reductions by the United States in tariffs on imports of textiles and apparel.

In January 2005, United States import quotas have been removed on knitted shirts from China. The elimination of quotas and the reduction of tariffs under the WTO may result in increased imports of certain apparel products into North America. In May 2005, quotas on three categories of clothing imports, including knitted shirts, from China were re-imposed. A reduction of import quotas and tariffs could make Alstyle s products less competitive against low cost imports from developing countries.

***Environmental regulations may impact our future operating results.***

We are subject to extensive and changing federal, state, and foreign laws and regulations establishing health and environmental quality standards, and may be subject to liability or penalties for violations of those standards. We are also subject to laws and regulations governing remediation of contamination at facilities currently or formerly owned or operated by us or to which we have sent hazardous substances or wastes for treatment, recycling or disposal. We may be subject to future liabilities or obligations as a result of new or more stringent interpretations of existing laws and regulations. In addition, we may have liabilities or obligations in the future if we discover any environmental contamination or liability at any of our facilities, or at facilities we may acquire.

***We depend upon the talents and contributions of a limited number of individuals, many of whom would be difficult to replace.***

The loss or interruption of the services of our Chief Executive Officer, Executive Vice President, Chief Financial Officer and Vice President Apparel Division, could have a material adverse effect on our business, financial condition and results of operations. Although we maintain employment agreements with these individuals, it cannot be assured that the services of such individuals will continue.

## ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable

## ITEM 2. PROPERTIES

The Company s corporate headquarters are located in Midlothian, Texas. It operates manufacturing and distribution facilities throughout the United States and in Mexico and Canada. See the table below for additional information on our locations.

All of the Print Segment properties are used for the production, warehousing and shipping of the following: business forms, flexographic printing, advertising specialties and Post-it® Notes (Wolfe City, Texas); presentation products (Macomb, Michigan and Anaheim, California); and printed and electronic promotional media (Denver, Colorado); envelopes (Portland, Oregon; Tullahoma, Tennessee and Carol Stream, Illinois); financial forms and other business products. The Apparel Segment properties are used for the manufacturing or distribution of T-shirts and other activewear apparel.

The plants are being operated at normal production capacity. Capacity fluctuates with market demands and depends upon the product mix at any given point in time. Equipment is added as existing machinery becomes obsolete or not repairable, and as new equipment becomes necessary to meet market demands; however, at any given time, these additions and replacements are not considered to be material additions to property, plant and equipment, although such additions or replacements may increase a plant s efficiency or capacity.

All of the foregoing facilities are considered to be in good condition. The Company does not anticipate that substantial expansion, refurbishing, or re-equipping will be required in the near future.

All of the rented property is held under leases with original terms of one or more years, expiring at various times from March 2008 through October 2013. No difficulties are presently foreseen in maintaining or renewing such leases as they expire.

The accompanying list contains each of our owned and leased locations:

| Location | General Use | Approximate Square Footage Owned | Leased |
|---|---|---|---|
| **Print Segment** | | | |
| Ennis, Texas | Three Manufacturing Facilities | 325,118 | |
| Chatham, Virginia | Two Manufacturing Facilities | 127,956 | |
| Paso Robles, California | Manufacturing | 94,120 | |
| DeWitt, Iowa | Two Manufacturing Facilities | 95,000 | |
| Knoxville, Tennessee | Manufacturing | 48,057 | |
| Ft. Scott, Kansas | Manufacturing | 86,660 | |
| Portland, Oregon | Manufacturing | | 139,330 |
| Wolfe City, Texas | Two Manufacturing Facilities | 119,259 | |
| Moultrie, Georgia | Manufacturing | 25,000 | |
| Coshocton, Ohio | Manufacturing | 24,750 | |
| Macomb, Michigan | Manufacturing | 56,350 | |
| Anaheim, California | Three Manufacturing Facilities | | 63,750 |
| Bellville, Texas | Manufacturing | 70,196 | |
| Denver, Colorado | Four Manufacturing Facilities & Warehouse | 60,000 | 105,200 |
| San Antonio, Texas | Manufacturing | 47,426 | |
| Brooklyn Park, Minnesota | Manufacturing | 94,800 | |
| Roseville, Minnesota | Manufacturing | | 42,500 |
| Arden Hills, Minnesota | Warehouse | | 31,684 |
| Nevada, Iowa | Manufacturing | 232,000 | |
| Bridgewater, Virginia | Manufacturing | | 27,000 |
| Columbus, Kansas | Manufacturing | 201,000 | |
| Leipsic, Ohio | Manufacturing | 83,216 | |
| El Dorado Springs, Missouri | Manufacturing | 70,894 | |
| Princeton, Illinois | Manufacturing | | 74,340 |
| Arlington, Texas | Manufacturing and Warehouse | 88,235* | 33,120 |
| Mechanicsburg, Pennsylvania | Warehouse | | 7,500 |
| Sacramento, California | Administrative Offices | | 414 |
| Tullahoma, Tennessee | Two Manufacturing Facilities** | 24,950 | 25,000 |
| Caledonia, New York | Manufacturing | 138,730 | |
| Sun City, California | Manufacturing | 52,617 | |
| Sparks, Nevada | Sublease | | 18,589 |
| Carol Stream, Illinois | Manufacturing | | 14,400 |
| Phoenix, Arizona | Manufacturing and Warehouse | | 82,800 |
| | | 2,166,334 | 665,627 |
| **Apparel Segment** | | | |
| Anaheim, California | Office and Distribution Center | | 200,000 |
| Anaheim, California | Manufacturing*** | | 450,315 |
| Chicago, Illinois | Distribution Center | | 120,000 |
| Atlanta, Georgia | Distribution Center | | 31,958 |

| | | | |
|---|---|---|---|
| Carrollton, Texas | Distribution Center | | 26,136 |
| Bensalem, Pennsylvania | Distribution Center | | 60,848 |
| Mississauga, Canada | Distribution Center | | 53,982 |
| Los Angeles, California | Distribution Center | | 31,600 |
| Ensenada, Mexico | Two Manufacturing Facilities | 112,622 | 53,820 |
| Ensenada, Mexico | Car Parking | | 22,000 |
| Ensenada, Mexico | Warehouse | | 2,583 |
| Hermosillo, Mexico | Administrative Offices | | 215 |
| Hermosillo, Mexico | Three Manufacturing Facilities | | 126,263 |

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| Location | General Use | Approximate Square Footage Owned | Leased |
|---|---|---|---|
| Hermosillo, Mexico | Yard Space | | 19,685 |
| Hermosillo, Mexico | Vacant | | 8,432 |
| Hermosillo, Mexico | Storage for Machines | | 1,640 |
| | | 112,622 | 1,209,477 |
| **Corporate Offices** | | | |
| Ennis, Texas | Administrative Offices | 9,300 | |
| Midlothian, Texas | Executive and Administrative Offices | 28,000 | |
| | | 37,300 | |
| | Totals | 2,316,256 | 1,875,104 |

* 18,300 square foot is classified as an asset held for sale.

** The envelope production currently being performed in a leased facility in Tullahoma, Tennessee is being moved into the company owned facility in Tullahoma, Tennessee at the end of the lease term July 1, 2008.

*** Apparel Segment 150,000 square feet of the manufacturing facilities in

Anaheim,
California is
subleased.

**ITEM 3. LEGAL PROCEEDINGS**

From time to time we are involved in various litigation matters arising in the ordinary course of our business. We do not believe the disposition of any current matter will have a material adverse effect on our consolidated financial position or results of operations.

**ITEM 4. SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

No matters were submitted to a vote of security holders during the fourth quarter of fiscal 2008.

**PART II**

**ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

Our common stock is traded on the New York Stock Exchange ( NYSE ) under the trading symbol EBF . The following table sets forth for the periods indicated: the high and low sales prices, the common stock trading volume as reported by the New York Stock Exchange and dividends per share paid by the Company.

| | Common Stock Price Range | | Common Stock Trading Volume (number of shares in thousands) | Dividends per share of Common Stock |
|---|---|---|---|---|
| | High | Low | | |
| Fiscal Year Ended February 29, 2008 | | | | |
| First Quarter | $28.12 | $22.41 | 6,700 | $0.155 |
| Second Quarter | 25.53 | 18.36 | 8,183 | $0.155 |
| Third Quarter | 22.92 | 16.46 | 5,442 | $0.155 |
| Fourth Quarter | 20.28 | 14.93 | 6,018 | $0.155 |
| Fiscal Year Ended February 28, 2007 | | | | |
| First Quarter | $20.16 | $18.57 | 6,684 | $0.155 |
| Second Quarter | 20.87 | 18.52 | 6,185 | $0.155 |
| Third Quarter | 23.37 | 19.99 | 6,850 | $0.155 |
| Fourth Quarter | 27.11 | 22.19 | 4,801 | $0.155 |

The last reported sale price of our common stock on NYSE on April 30, 2008 was $16.94. As of that date, there were approximately 1,176 shareholders of record of our common stock. Cash dividends may be paid or repurchases

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of our common stock may be made from time-to-time, as our Board of Directors deems appropriate, after considering our growth rate, operating results, financial condition, cash requirements, restrictive lending covenants, and such other factors as the Board of Directors may deem appropriate. The Company does not currently have an approved stock repurchase program.

See Item 12 Security Ownership of Beneficial Owners and Management and Related Stockholder Matters section of this Report for information relating to our equity compensation plans.

**Stock Performance Graph**

The graph below compares the cumulative 5-year total return of shareholders of Ennis, Inc. s common stock relative to the cumulative total returns of the S & P 500 index and the Russell 2000 index. The graph assumes that the value of the investment in the Company s common stock and in each of the indexes (including reinvestment of dividends) was $100 on February 28, 2003 and tracks it through February 29, 2008.

* $100 invested on 2/28/03 in stock or index-including reinvestment of dividends. Fiscal year ending February 28 or February 29.

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www.researchdatagroup.com/S&P.htm

| | **2003** | **2004** | **2005** | **2006** | **2007** | **2008** |
|---|---|---|---|---|---|---|
| Ennis, Inc. | 100.00 | 155.44 | 163.06 | 195.04 | 262.73 | 167.31 |
| S&P 500 | 100.00 | 138.52 | 148.19 | 160.63 | 179.86 | 173.39 |
| Russell 2000 | 100.00 | 164.41 | 180.08 | 209.95 | 230.67 | 201.98 |

*The stock price performance included in this graph is not necessarily indicative of future stock price performance.*

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## ITEM 6. SELECTED FINANCIAL DATA

The following selected financial data has been derived from our audited consolidated financial statements. Our consolidated financial statements and notes thereto as of February 29, 2008 and February 28, 2007, and for the three years in the period ended February 29, 2008, and the reports of Grant Thornton LLP are included in Item 15 of this Report. The selected financial data should be read in conjunction with Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations and the consolidated financial statements and notes thereto included in Item 15 of this Report.

| | Fiscal Years Ended | | | | |
|---|---|---|---|---|---|
| | **2008** | **2007** | **2006** | **2005** | **2004** |
| | *(Dollars and shares in thousands, except per share amounts)* | | | | |
| **Operating results:** | | | | | |
| Net sales | $610,610 | $584,713 | $559,397 | $365,353 | $259,360 |
| Gross profit | 152,647 | 145,937 | 142,090 | 90,757 | 68,548 |
| SG&A expenses | 77,624 | 72,736 | 69,953 | 51,100 | 38,922 |
| Net earnings | 44,590 | 41,601 | 40,537 | 22,959 | 17,951 |
| **Earnings and dividends per share:** | | | | | |
| Basic | $ 1.74 | $ 1.63 | $ 1.59 | $ 1.21 | $ 1.10 |
| Diluted | 1.72 | 1.62 | 1.58 | 1.19 | 1.08 |
| Dividends | 0.62 | 0.62 | 0.62 | 0.62 | 0.62 |
| **Weighted average shares outstanding:** | | | | | |
| Basic | 25,623 | 25,531 | 25,453 | 18,936 | 16,358 |
| Diluted | 25,860 | 25,759 | 25,728 | 19,260 | 16,602 |
| **Financial Position:** | | | | | |
| Working capital | $133,993 | $102,269 | $ 94,494 | $ 70,247 | $ 38,205 |
| Current assets | 185,819 | 151,516 | 158,455 | 151,630 | 63,605 |
| Total assets | 513,131 | 478,228 | 494,401 | 497,246 | 154,043 |
| Current liabilities | 51,826 | 49,247 | 63,961 | 81,383 | 25,400 |
| Long-term debt | 90,710 | 88,971 | 102,916 | 112,342 | 7,800 |
| Total liabilities | 164,652 | 161,825 | 197,066 | 225,515 | 43,461 |
| Equity | 348,479 | 316,403 | 297,335 | 271,731 | 110,582 |
| Current ratio | 3.59 to 1.0 | 3.08 to 1.0 | 2.48 to 1.0 | 1.86 to 1.0 | 2.50 to 1.0 |
| Long-term debt to equity | .26 to 1.0 | .28 to 1.0 | .35 to 1.0 | .41 to 1.0 | .07 to 1.0 |

## ITEM 7. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

### 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 within the bounds of our knowledge of Ennis. 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; the ability to implement

our strategic initiatives; the ability to be profitable on a consistent basis; dependence on

sales that are not subject to long-term contracts; dependence on suppliers; the ability to recover the rising cost of key raw materials in markets that are highly price competitive; the ability to meet customer demand for additional value-added products and services; the 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; postage rates; the ability to manage operating expenses; the ability to manage financing costs and interest rate risk; a decline in business volume and profitability could result in an impairment of goodwill; the ability to retain key management personnel; the ability to identify, manage or integrate future acquisitions; the costs associated with and the outcome of outstanding and future litigation; and changes in government regulations.

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.

**Results of Operations**

| Consolidated Statements of Earnings - Data | Fiscal Years Ended 2008 | | 2007 | | 2006 | |
|---|---|---|---|---|---|---|
| Net sales | $ 610,610 | 100.0% | $ 584,713 | 100.0% | $ 559,397 | 100.0% |
| Cost of goods sold | 457,963 | 75.0 | 438,776 | 75.0 | 417,307 | 74.6 |
| Gross profit | 152,647 | 25.0 | 145,937 | 25.0 | 142,090 | 25.4 |
| Selling, general and administrative | 77,624 | 12.7 | 72,736 | 12.4 | 69,953 | 12.5 |
| Gain from disposal of assets | (757) | (0.1) | (258) | 0.0 | (188) | 0.0 |
| Income from operations | 75,780 | 12.4 | 73,459 | 12.6 | 72,325 | 12.9 |
| Other expense, net | (5,995) | (1.0) | (7,094) | (1.2) | (8,354) | (1.5) |
| Earnings before income taxes | 69,785 | 11.4 | 66,365 | 11.4 | 63,971 | 11.4 |
| Provision for income taxes | 25,195 | 4.1 | 24,764 | 4.2 | 23,434 | 4.2 |
| Net earnings | $ 44,590 | 7.3% | $ 41,601 | 7.2% | $ 40,537 | 7.2% |

**Critical Accounting Policies and Judgments**

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, 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 affect on our more significant estimates and judgments used in preparation of our consolidated financial statements.

We maintain a defined-benefit 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.

Amounts allocated to intangibles are determined based on independent valuations for our acquisitions and are amortized over their expected useful lives. We evaluate these amounts periodically (at least once a year) to determine whether the value has been impaired by events occurring during the fiscal year.

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 and other factors to determine the fair value of the respective assets in assessing the recoverability of our goodwill and other intangibles. 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. 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. We cannot predict the occurrence of future impairment 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 $20.2 million, $20.1 million, and $16.4 million of revenue were recognized under these agreements during fiscal years ended February 29, 2008, February 28, 2007, and February 28, 2006 respectively.

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 Consolidated**

*Net Sales.* Net sales for fiscal year 2008 were $610.6 million, compared to $584.7 million for fiscal year 2007, an increase of $25.9 million, or 4.4%. The increase in our sales for the period related primarily to an increase in our Print Segment sales, which increased $19.3 million during the fiscal year, or 5.9%. Our Apparel Segment sales increased by approximately $6.6 million, or 2.5% during the period. See Results of Operations Segments of this Report for further discussion.

Our net sales for fiscal year 2007 were $584.7 million, compared to $559.4 million for fiscal year 2006, an increase of $25.3 million, or 4.5%. The increase in our sales for the period related primarily to an increase in our Apparel Segment sales which increased $21.0 million during the period, or 8.8%. Our Print Segment sales increased by approximately $4.3 million, or 1.3% during the period. See Results of Operations Segments of this Report for further discussion.

*Cost of Goods Sold.* Our cost of goods sold for fiscal year 2008 was approximately $458.0 million compared to $438.8 million for fiscal year 2007. As a percentage of sales, our cost of goods sold was 75.0% for both fiscal years 2007 and 2008. The increase in our cost of sales, on a dollar-basis relates primarily to our increased sales volume as previously discussed. Our gross profit margins (net sales less cost of goods sold), as a percentage of sales, was 25.0% for both fiscal years. Our gross profit margins increased in our Print Segment from 25.2% to 27.2%, while our Apparel Segment margins decreased from 24.7% to 22.2% for fiscal year 2007 and 2008, respectively. See Results of Operations Segments of this Report for further discussion.

Our cost of goods sold for fiscal year 2007 was approximately $438.8 million, or 75.0% of sales, compared to $417.3 million, or 74.6% of sales for fiscal year 2006. The increase in our cost of sales, on a dollar-basis relates primarily to our increased sales volume during the period. Our cost of sales, as a percentage of sales, increased primarily as a result of raw material cost increases experienced by both our Print and Apparel Segments during the year and market penetration pricing strategies employed by our Apparel Segment during the later half of fiscal year 2007. As a result, our gross profit margins, as a percentage of sales, decreased slightly from 25.4 % in fiscal year 2006 to 25.0% in fiscal year 2007.

*Selling, general, and administrative expenses.* For fiscal year 2008, our selling, general and administrative expenses were $77.6 million, or 12.7% of sales, compared to $72.7 million, or 12.4% of sales for fiscal year 2007, or an increase of $4.9 million, or 6.7%. On a dollar and percentage basis, these expenses increased primarily as a result of our acquisitions and the increase in our miscellaneous expenses, which was attributable to a significant increase in our credit card fees due to increased usage of credit/purchase cards by our customers.

For fiscal year 2007, our selling, general and administrative expenses increased approximately $2.8 million, or 4.0% from $70.0 million, or 12.5% of sales for fiscal year 2006 to $72.7 million, or 12.4% of sales for fiscal year 2007. On a dollar and percentage basis, these expenses increased primarily as a result of the Print Segment acquisitions of Block, SPF, and full year expenses associated with the acquisition of TBF.

*Gain from disposal of assets.* The gain from disposal of assets of $0.8 million during fiscal year 2008 resulted primarily from the sale of two print manufacturing facilities located in Dallas, Texas. The gain of $0.3 million from disposal of assets during fiscal year 2007 and gain of $0.2 million during fiscal year 2006 resulted primarily from sale of manufacturing equipment.

*Income from operations.* Our earnings from operations for fiscal year 2008 increased by approximately $2.3 million, or 3.2%, from operational earnings of $73.5 million in fiscal year 2007 to operational earnings of $75.8 million in fiscal year 2008. As a percentage of sales, our operational earnings were 12.4% for fiscal year 2008 and 12.6% for fiscal year 2007, respectively. The increase in our operational earnings, on a dollar basis, during fiscal year 2008 related primarily to the increase in sales due to our acquisitions of Trade and B&D in fiscal year 2008 and full year revenue associated with our fiscal year 2007 acquisition of Block . The slight decrease in our operational earnings, as a percentage of sales, related primarily to the increase of selling, general and administrative expenses during fiscal year 2008 as previously discussed.

Our income from operations for fiscal year 2007 increased from operational earnings of $72.3 million, or 12.9% of sales for fiscal year 2006, to operational earnings of $73.5 million, or 12.6% for fiscal year 2007. The dollar increase in our operational earnings, during fiscal year 2007, related primarily to the increase in sales from our acquisition of SPF and Block. The slight decrease, as a percentage of sales, related primarily to the reduction in our gross profit margin during the year as discussed above.

*Other income and expense* Our interest expense was $5.7 million, $6.9 million and $8.3 million for fiscal years 2008, 2007 and 2006, respectively. Our interest expense decreased in fiscal year 2008 and 2007 due to less debt on average being outstanding for each prior fiscal year and a lower effective borrowing rate during fiscal year 2008.

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*Provision for income taxes.* Our effective tax rates for fiscal years 2008, 2007 and 2006 were 36.1%, 37.3% and 36.6%, respectively. The decrease in our effective tax rate during 2008 over the comparable prior year related primarily to an increase in our Domestic Production Activities Deduction and State Income Tax Credit. The increase in our overall effective tax rate during fiscal year 2007 related primarily to an increase in our effective foreign and state income tax rates.

*Net earnings.* Our net earnings increased from earnings of $41.6 million, or 7.1% of sales in fiscal year 2007 to $44.6 million, or 7.3% of sales in fiscal year 2008. Basic earnings per share increased from earnings of $1.63 per share to $1.74 per share in fiscal years 2007 and 2008, respectively. Diluted earnings per share increased from earnings of $1.62 per share to $1.72 per share in fiscal years 2007 and 2008, respectively. The increase in our net earnings during the period related primarily to our increased sales volume and our lower effective tax rate.

Our net earnings increased from approximately $40.5 million, or 7.2% of sales for fiscal year 2006 to $41.6 million, or 7.1% of sales for fiscal year 2007. Basic earnings per share increased from earnings of $1.59 per share for fiscal year 2006 to $1.63 for fiscal year 2007. Diluted earnings per share increased from earnings of $1.58 per share for fiscal year 2006 to $1.62 for fiscal year 2007, or an increase of 2.5%.

**Results of Operations Segments**

| | Fiscal Years Ended | | |
|---|---|---|---|
| **Net Sales by Segment (in thousands)** | **2008** | **2007** | **2006** |
| Print | $ 345,042 | $ 325,679 | $ 321,410 |
| Apparel | 265,568 | 259,034 | 237,987 |
| Total | $ 610,610 | $ 584,713 | $ 559,397 |

***Print Segment*.** The print segment net sales represented 56.5%, 55.7%, and 57.5% of our consolidated net sales for fiscal years 2008, 2007, and 2006, respectively.

Our net sales for the Print Segment were approximately $345.0 million for fiscal year 2008 compared to approximately $325.7 million for fiscal year 2007, or an increase of $19.3 million, or 5.9%. The increase in the Print Segment s net sales for the fiscal year 2008 related primarily to our acquisition of B&D and Trade which were acquired October 5, 2007 and September 17, 2007, respectively and the full year impact of our acquisition of Block which was acquired on August 8, 2006. Net sales for the acquired entities were $53.3 million for the fiscal year ended 2008 compared to $24.9 million for the fiscal year ended 2007. The impact of the increase in sales from our acquired entities was offset by the planned attrition of low margin print sales and the decline in our commercial print operations over comparable periods last year due to the impact of the loss of two large promotional customers. While this impacted our sales during the current fiscal year by approximately $3.3 million, we feel the impact associated with these accounts has matured as the sales in our commercial print operations during the last six months has been above comparable sales levels last year. Due to the contracting nature of the print industry, our traditional print plants saw their sales decline by approximately $5.8 million, or 2.0% during the current fiscal year.

Our net sales for the Print Segment were approximately $325.7 million for fiscal year 2007 compared to approximately $321.4 million for fiscal year 2006, or an increase of $4.3 million, or 1.3%. The increase in the Print Segment s net sales for the fiscal year 2007 was primarily due to our acquisitions of SPF, TBF, and Block which added approximately $32.0 million to our print sales during fiscal year 2007. This increase was offset by the exit of two large customers, which we ceased doing business with during the fourth quarter of fiscal year 2006 and second quarter of fiscal year 2007, respectively. This loss amounted to approximately $19.6 million in lost revenues for fiscal year 2007. The decision to cease doing business with these large customers impacted our top-line revenue in the short-term; however, given the gross profit margins afforded by these customers, this business decision was beneficial to our gross profit. In addition, due to the contracting nature of the print industry, our traditional print plants saw their sales decline by $8.1 million or 2.8% during the fiscal year 2007.

***Apparel Segment*.** The Apparel Segment net sales represented 43.5%, 44.3%, and 42.5% of our consolidated net sales for fiscal years 2008, 2007 and 2006 respectively.

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For fiscal year 2008, our Apparel Segment net sales were approximately $265.6 million compared to approximately $259.0 million for fiscal year 2007, or an increase of $6.6 million, or 2.5%. The increase in the Apparel Segment s net sales was primarily due to increased volume associated with new customers and increased sales to existing customers. Management believes that the Apparel sales during fiscal year 2008 were negatively impacted during the first six months by lower inventory levels at the beginning of the fiscal year, which hindered the Apparel Segment s ability to capture certain opportunity sales during this period. Traditionally, the Apparel Segment rebuilds its inventory levels in the last half of the fiscal year for the upcoming summer buying season due to the normal falloff of demand during the winter season. However, during the second half of last fiscal year demand was at or above forecasted sales levels. As a result, production levels were only able to stay abreast of then current sales levels, which resulted in inventory levels not being as robust in the fourth quarter of fiscal year 2007 as during the same period last fiscal year. Consequently, several initiatives were implemented during the first and second quarters of this fiscal year to improve the Apparel Segment s inventory levels and to meet forecasted demand. Significant progress was made on these initiatives during the second and third quarters of this fiscal year and the Apparel Segment s inventory levels during the third quarter were significantly improved, which management believes allowed the apparel sales to return to more normalized sales growth levels during the third and fourth quarters (5.1% during the third quarter and 11.6% during the fourth quarter).

Our fiscal year 2007 net sales for the Apparel Segment was approximately $259.0 million compared to approximately $238.0 million for fiscal year 2006, or an increase of $21.0 million, or 8.8%. The increase in the Apparel Segment s net sales was primarily due to increased volume associated with new customers, which is attributable to our market penetration pricing strategies deployed during the third and fourth quarter of fiscal year 2007.

| | Fiscal Years Ended | | |
|---|---|---|---|
| **Gross Profit by Segment (in thousands)** | **2008** | **2007** | **2006** |
| Print | $ 93,767 | $ 81,986 | $ 79,859 |
| Apparel | 58,880 | 63,951 | 62,231 |
| Total | $ 152,647 | $ 145,937 | $ 142,090 |

***Print Segment.*** Our Print Segment s gross profit increased approximately $11.8 million, or 14.4% for fiscal year 2008 compared to $2.1 million, or 2.7% for fiscal year 2007. The increase in gross profit, on a dollar-basis relates primarily to our increased sales volume as previously discussed. As a percentage of sales, our gross profit was 27.2%, 25.2%, and 24.8% for fiscal years 2008, 2007 and 2006, respectively. Our 2008 Print margin, as a percentage of sales, increased primarily as a result of improved operational efficiencies and planned attrition of low margin sales. Our gross profit during fiscal year 2006 was impacted by the decrease in margins at our Adams McClure facility, which related primarily to operational performance issues encountered in executing several large promotional contracts. This conversely had a positive impact on our margins during fiscal year 2007 when we exited these contracts in the later half of fiscal year 2006 and the first half of fiscal year 2007.

***Apparel Segment***. Our Apparel Segment s gross profit decreased approximately $5.1 million, or 8.0% for fiscal year 2008 and increased approximately $1.7 million or 2.7% for fiscal year 2007. As a percentage of sales, our gross profit was 22.2%, 24.7%, and 26.1% for fiscal years 2008, 2007 and 2006, respectively.

Our Apparel margins during the year were impacted mainly by the increased costs associated with our apparel inventory build, and to a lesser extent by higher cotton prices during our fourth quarter and lower selling prices on certain products due to competitive pressures. During the first nine months of the year and in connection with our inventory build initiative, we incurred approximately $2.1 million in additional overtime charges, $0.8 million in additional temporary labor charges and $1.5 million in additional cut/sew costs, all of which had a negative impact on our reported margins (for further discussion on the increased cut/sew costs and changes made, reference is made to our Form 10-Q filed for the first, second and third quarters of this fiscal year with the Securities and Exchange Commission). During the fourth quarter, we saw cotton prices increase significantly, and while we increased selling

prices during this period to offset a portion of this cost increase, our margins were negatively impacted.

Our Apparel Segment s gross profit, as a percentage of sales, decreased during fiscal year 2007 due to raw material cost increases and the inability to pass these increased costs through to the marketplace, lower absorption of

fixed manufacturing costs due to lower manufacturing levels and market penetration pricing strategies employed during the third and fourth quarters of fiscal year 2007 which drove higher sales. In addition, our margins during the fiscal year 2007 were impacted by a lower manufacturing absorption factor as we reduced our apparel inventory levels during the year by over $10 million. While the aforementioned factors had a negative impact on our apparel margins in 2007, they in turn had a positive impact on our apparel margins in 2006.

| | Fiscal Years Ended | | |
|---|---|---|---|
| **Profit by Segment (in thousands)** | **2008** | **2007** | **2006** |
| Print | $ 56,012 | $ 46,077 | $ 45,121 |
| Apparel | 29,367 | 33,321 | 30,085 |
| Total | 85,379 | 79,398 | 75,206 |
| Less corporate expenses | 15,594 | 13,033 | 11,235 |
| **Earnings before income taxes** | $ 69,785 | $ 66,365 | $ 63,971 |

***Print Segment***. Our Print Segment s profit for fiscal year 2008 increased by approximately $9.9 million, or 21.5%, from $46.1 million for the fiscal year 2007, to $56.0 million for the fiscal year ended February 29, 2008 and increased approximately $1.0 million, or 2.1% for fiscal year 2007, from $45.1 million in fiscal year 2006 primarily as a result of our acquisitions. As a percent of sales, this Segment s profits were 16.2%, 14.1%, and 14.0% for fiscal years 2008, 2007 and 2006, respectively. The increase in our Print profit, as a percent of sales is related to the increase in our sales and our gross profit margin, as previously discussed. This Segment s profits during fiscal year 2006, as discussed previously, was impacted by operational performance issues encountered by our Adams McClure plant in executing several large contracts. We exited these contracts during the later part of fiscal year 2006 and the first part of fiscal year 2007, which as indicated above had a positive impact of this segment s operational margins and profits during the current fiscal year.

***Apparel Segment.*** Our Apparel profit decreased approximately $3.9 million, or 11.9%, from $33.3 million for the fiscal year ended February 28, 2007, to $29.4 million for the fiscal year ended February 29, 2008 primarily due to the decrease in gross margins as previously discussed. Our Apparel Segment s profit increased approximately $3.2 million, or 10.8% for fiscal year 2007 primarily due to increased sales. As a percent of sales, this Segment s profits were 11.1%, 12.9%, and 12.6% for fiscal years 2008, 2007 and 2006, respectively. During the fiscal year 2007, while this segment s gross margins were down slightly due to the factors previously mentioned, we were able to successfully leverage increased sales volume to bring increased profits to our bottom-line. We were unable to do this during the current fiscal year due to the factors discussed above (see discussion on Apparel Segment Net Sales) which hindered our annual growth this year.

## Liquidity and Capital Resources

| | Fiscal Years Ended | | |
|---|---|---|---|
| ***(Dollars in thousands)*** | **2008** | **2007** | **Change** |
| Working Capital | $133,993 | $102,269 | 31.0% |
| Cash and cash equivalents | $ 3,393 | $ 3,582 | -5.3% |

***Working Capital.*** Our working capital increased by approximately $31.7 million, or 31.0% from $102.3 million at February 28, 2007 to $134.0 million at February 29, 2008. The increase in our working capital during the period related primarily to an increase in our receivables and inventories. The increase in our receivables related primarily to the phasing out of Alstyle s factoring arrangement. The increase in our inventory levels related primarily to our acquisitions during the period and our planned increase in Alstyle s inventory level. Our current ratio, calculated by dividing our current assets by our current liabilities increased from 3.1-to-1.0 at February 28, 2007 to 3.6-to-1.0 at February 29, 2008.

***Cash and cash equivalents.*** Cash and cash equivalents consists of highly liquid investments, such as time deposits held at major banks, commercial paper, United States government agency discount notes, money market mutual funds and other money market securities with original maturities of 90 days or less. We used cash during the period to pay down our debt, finance the phase-out of Alstyle s factoring arrangements, build our apparel inventory, and to acquire certain businesses.

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| *(Dollars in thousands)* | Fiscal Years Ended 2008 | 2007 | Change |
|---|---|---|---|
| Net Cash provided by operating activities | $ 30,444 | $ 49,517 | -38.5% |
| Net Cash used in investing activities | $(17,285) | $(19,825) | -12.8% |
| Net Cash used in financing activities | $(13,516) | $(39,978) | -66.2% |

***Cash flows from operating activities.*** Cash provided by our operating activities decreased by $19.1 million, or 38.5% to $30.4 million for fiscal year 2008 as compared to $49.5 million for fiscal year 2007. During the fiscal year 2008, approximately 32% of our Apparel credit sales were factored compared to 73% for the fiscal year 2007. As a result, approximately $25.0 million of operational cash during the period was used to fund the transition of these previously factored sales to in-house credit (see Credit Facility following for further discussion). In addition, we used operational cash during the period to increase our apparel inventory levels by approximately $12.0 million, see Results of Operations Segments for further discussion. We were able to offset these uses of our operational cash during the period by increased management of our print inventory levels, accounts receivable and payables. While both the aforementioned apparel initiatives required the use of a significant amount of our operational cash during the period, approximately $37.0 million, we view both as one-time uses of cash and as such neither would be expected to have a significant impact on our operational cash flow for fiscal year 2009.

***Cash flows from investing activities.*** Cash used for our investing activities decreased by $2.5 million, or 12.8% to $17.3 million for fiscal year 2008, compared to $19.8 million for fiscal year 2007. During the fiscal year 2008, we acquired two businesses, B&D and Trade for $14.6 million. During the fiscal year 2007, we acquired two businesses, Specialized Printed Forms and Block Graphics for $17.6 million. Our capital expenditures for each of the last 2 years have been relatively consistent. In addition to the above, we generated cash during the past 2 years by selling some of our unused or under-utilized property, plant and equipment.

***Cash flows from financing activities.*** We used $26.5 million less in cash associated with our financing activities in fiscal year 2008 when compared to the same period last year. We repaid debt in the amount of $16.7 million during the fiscal year ended 2008, as compared to $40.6 million during fiscal year ended 2007. We borrowed $18.0 million in fiscal year 2008 to finance the acquisition of B&D and to finance the phase-out of the apparel s factoring arrangements, as compared to $15.6 million in fiscal year 2007 to finance the acquisition of Block.

***Credit Facility* -** On March 31, 2006, we entered into an amended and restated credit agreement with a group of lenders led by LaSalle Bank N.A. (the Facility ). The Facility provides us access to $150 million in revolving credit and matures on March 31, 2010. The facility bears interest at the London Interbank Offered Rate ( LIBOR ) plus a spread ranging from .50% to 1.50% (currently LIBOR + .75% or 3.89% at February 29, 2008), depending on our total funded debt to EBITDA ratio, as defined. The Facility contains financial covenants, restrictions on capital expenditures, acquisitions, asset dispositions, and additional debt, as well as other customary covenants. As of February 29, 2008, we had $90.5 million of borrowings under the revolving credit line and $4.5 million outstanding under standby letters of credit arrangements, leaving us availability of approximately $55.0 million. The Facility is secured by substantially all of our personal and investment property.

During fiscal year 2008, we repaid $16.0 million on the revolver and $0.7 million on other debt and borrowed $18.0 million, mainly for acquisitions and the phase-out of the Apparel s factoring arrangements. It is anticipated that the available line of credit is sufficient to cover, should it be required, working capital requirements for the foreseeable future.

Alstyle continues to sell a portion of its accounts receivable to factors (fiscal year 2007 - 72.5%, fiscal year 2008 32.1%, last fiscal quarter 9.8%) based upon agreements in place with these factors. As previously discussed, due to potential cost savings, we are continuing with our initiative to reduce the amount of receivables we factor each year through the utilization of our existing bank line or from working capital generated by our Apparel Segment. While this initiative did require the use of a substantial amount of our operational cash during the period, we do not anticipate that the final phase-out of this program, which will occur during fiscal year 2009, will have a significant impact on our operational cash during the year.

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***Pension*** We are required to make contributions to our defined benefit pension plan. These contributions are required under the minimum funding requirements of the Employee Retirement Pension Plan Income Security Act (ERISA). We anticipate that we will contribute from $2.0 million to $3.0 million during our next fiscal year. We have made contributions of $3 million to our pension plan during each of our last 2 fiscal years.

***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. The previously reported long-term contracts (that govern prices, but do not require minimum volume) with paper and yarn suppliers continue to be in effect. 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 2009, exclusive of capital required for possible acquisitions, will be in-line with our historical levels of between $4.0 million and $8.0 million. We would expect to fund these expenditures through existing cash flows. We would expect to generate sufficient cash flows from our operating activities in order to cover our operating and other capital requirements for our foreseeable future.

***Contractual Obligations & Off-Balance Sheet Arrangements*** **-** With the exceptions noted below, there have been no significant changes in our contractual obligations since February 28, 2007 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 February 29, 2008 (in thousands).

| | Total | 2009 | 2010 | 2011 | 2012 | 2013 to 2018 |
|---|---|---|---|---|---|---|
| **Debt:** | | | | | | |
| Revolving credit facility | $ 90,500 | $ | $ | $ 90,500 | $ | $ |
| Notes to finance companies | | | | | | |
| Capital leases | 452 | 242 | 210 | | | |
| Other | 13 | 13 | | | | |
| Debt subtotal | 90,965 | 255 | 210 | 90,500 | | |
| Interest on capital leases | 22 | 17 | 5 | | | |
| Debt and interest total | 90,987 | 272 | 215 | 90,500 | | |
| **Other contractual commitments:** | | | | | | |
| Estimated pension benefit payments | 38,670 | 3,620 | 3,080 | 4,025 | 4,225 | 23,720 |
| Letters of credit | 4,473 | 4,473 | | | | |
| Operating leases | 18,736 | 8,293 | 4,346 | 3,101 | 1,727 | 1,269 |
| Total other contractual commitments | 61,879 | 16,386 | 7,426 | 7,126 | 5,952 | 24,989 |
| Total | $ 152,866 | $ 16,658 | $ 7,641 | $ 97,626 | $ 5,952 | $ 24,989 |

Subsequent to February 29, 2008 and through April 30, 2008, we made repayments on our revolving credit facility of approximately $10.0 million

**New Accounting Pronouncements**

**FIN 48**. We adopted the provisions of Financial Accounting Standards Board Interpretation No. 48 ( FIN 48 ), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, on March 1, 2007. As a part of the implementation of FIN 48, we made a comprehensive review of our uncertain tax positions and recorded $240,000 of unrecognized tax benefits in connection with certain state tax positions, as non-current other liabilities on the consolidated balance sheet, with no net impact to the consolidated statement of earnings. This amount was accounted for as a reduction to the March 1, 2007 balance of retained earnings, in accordance with the adoption provisions of FIN 48. These unrecognized tax benefits related to uncertain tax positions would impact the effective tax rate if recognized. Approximately $76,000 of unrecognized tax benefits relate to items that are affected by expiring statutes of limitation within the next 12 months.

The unrecognized tax benefits mentioned above includes an aggregate $26,000 of interest expense. Upon adoption of FIN 48, we elected an accounting policy to classify interest expense on underpayments of income

taxes and accrued penalties related to unrecognized tax benefits in the income tax provision. Prior to the adoption of FIN 48, our policy was to classify interest expense on underpayments of income taxes as interest expense and to classify penalties as an operating expense in arriving at earnings before income taxes.

We are subject to U.S. federal income tax as well as to income tax of multiple state jurisdictions and foreign tax jurisdictions. We have concluded all U.S. federal income tax matters for years through 2005. All material state and local income tax matters have been concluded for years through 2002 and foreign tax jurisdictions through 2000.

**FAS 157.** In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements ( FAS 157 ). The provisions of FAS 157 define fair value, establish a framework for measuring fair value in generally accepted accounting principles, and expand disclosures about fair value measurements. The provisions of FAS 157 are effective for fiscal years beginning after November 15, 2007. However, in February 2008, the FASB issued FSP FAS 157-2 which delays the effective date of FAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). This FSP partially defers the effective date of Statement 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP. The adoption of FAS 157 is not expected to have a material impact on our consolidated financial position, results of operations, or cash flows.

**FAS 159.** In February 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FAS No. 115 ( FAS 159 ). FAS 159 allows measurement at fair value of eligible financial assets and liabilities that are not otherwise measured at fair value. If the fair value option for an eligible item is elected, unrealized gains and losses on that item shall be reported in current earnings at each subsequent reporting date. FAS 159 also establishes presentation and disclosure requirements designed to draw comparison between the different measurement attributes the company elects for similar types of assets and liabilities. FAS 159 is effective for fiscal years beginning after November 15, 2007. FAS 159 is effective for us beginning March 1, 2008. The adoption of FAS 159 is not expected to have a material impact on our consolidated financial position, results of operations or cash flows.

**FAS 141R.** In December 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141 (revised 2007), Business combinations ( FAS 141R ), which replaces FAS 141. FAS 141R establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. FAS 141R is to be applied prospectively to business combinations for which the acquisition date is on or after an entity s fiscal year that begins after December 15, 2008 (our fiscal year ended February 28, 2009). We have not completed our evaluation of the potential impact, if any, of the adoption of FAS 141R on our consolidated financial position, results of operations and cash flows.

**FAS 160.** In December 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 160 Noncontrolling Interests in Consolidated Financial Statements an amendment to ARB No. 51 ( FAS 160 ). FAS 160 establishes accounting and reporting standards that require the ownership interest in subsidiaries held by parties other than the parent to be clearly identified and presented in the consolidated balance sheets within equity, but separate from the parent s equity; the amount of consolidated net income attributable to the parent and the noncontrolling interest to be clearly identified and presented on the face of the consolidated statement of earnings; and changes in a parent s ownership interest while the parent retains its controlling financial interest in its subsidiary to be accounted for consistently. This statement is effective for fiscal years beginning on or after December 15, 2008 (our fiscal year ended February 28, 2009). We have not completed our evaluation of the potential impact, if any, of the adoption of FAS 160 on our consolidated financial position, results of operations and cash flows.

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## ITEM 7A. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

**Market Risk**

***Interest Rates***

We are exposed to market risk from changes in interest rates on debt. 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. We are exposed to interest rate risk on short-term and long-term financial instruments carrying variable interest rates. Our variable rate financial instruments, including the outstanding credit facilities, totaled $90.5 million at February 29, 2008. 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 February 29, 2008 would be approximately $0.9 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 shareholders equity. In future periods, foreign exchange rate fluctuations could have an increased impact on our reported results of operations. However, due to the self-sustaining nature of our foreign operations, we believe we can effectively manage the effect of these currency fluctuations.

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 8. CONSOLIDATED FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA

Our Consolidated Financial Statements and Supplementary Data required by this Item 8 are set forth following the signature page of this report and are incorporated herein by reference.

## ITEM 9. CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE

No matter requires disclosure.

## ITEM 9A. CONTROLS AND PROCEDURES

**Evaluation of Disclosure Controls and Procedures.** An evaluation was 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 of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of February 29, 2008, pursuant to Exchange Act Rule 13a-15. Based upon that evaluation, the Chief Executive Officer and the Chief Financial Officer have concluded that our disclosure controls and procedures as of February 29, 2008 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 SEC 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.

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During the year ended February 29, 2008, there were changes in our internal control over our financial reporting related to implementing our new ERP System. Our management, with the participation of our President and Chief Executive Officer and Chief Financial Officer, have evaluated such changes in our internal control over financial reporting and determined that such changes did not materially affect, or are not reasonably likely to materially affect our internal control over financial reporting. We continually modify and enhance our ERP System and believe the future enhancements or modifications will not have a material effect on our internal control over financial reporting.

**MANAGEMENT S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING**

The financial statements, financial analysis and all other information in this Annual Report on Form 10-K were prepared by management, who is responsible for their integrity and objectivity and for establishing and maintaining adequate internal controls over financial reporting.

The Company s internal control over financial reporting is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America. The Company s internal control over financial reporting includes those policies and procedures that:

i. Pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of assets of the Company;

ii. Provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the Company are being made only in accordance with authorizations of management and directors of the Company; and

iii. Provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or dispositions of the Company s assets that could have a material effect on the financial statements.

There are inherent limitations in the effectiveness of any internal control, including the possibility of human error and the circumvention or overriding of controls. Accordingly, even effective internal controls can provide only reasonable assurances with respect to financial statement preparation. Further, because of changes in conditions, the effectiveness of internal controls may vary over time.

Management assessed the design and effectiveness of the Company s internal control over financial reporting as of February 29, 2008. In making this assessment, management used the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission ( COSO ) in *Internal Control Integrated Framework*. Based on management s assessment using those criteria, we believe that, as of February 29, 2008, the Company s internal control over financial reporting is effective.

Grant Thornton, LLP, an independent registered public accounting firm, has audited the consolidated financial statements of the Company for the fiscal year ended February 29, 2008 and has attested to the effectiveness of the Company s internal control over financial reporting as of February 29, 2008. Their report is presented on page F-3 of this Report.

**ITEM 9B. OTHER INFORMATION**

No matter requires disclosure.

**PART III**

**ITEM 10. DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

Except as set forth below, the information required by Item 10 is incorporated herein by reference to the definitive Proxy Statement for our 2008 Annual Meeting of Shareholders.

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In the wake of well-publicized corporate scandals, the Securities and Exchange Commission and the New York Stock Exchange have issued multiple new regulations, requiring the implementation of policies and procedures in the corporate governance area. In complying with new regulations requiring the institution of policies and procedures, it has been the goal of the Ennis Board of Directors and senior leadership to do so in a way which does not inhibit or constrain Ennis unique culture, and which does not unduly impose a bureaucracy of forms and checklists. Accordingly, formal, written policies and procedures have been adopted in the simplest possible way, consistent with legal requirements, including a Code of Ethics applicable to the Company s principal executive officer, principal financial officer, and principal accounting officer or controller. The Company s Corporate Governance Guidelines, its charters for each of its Audit, Compensation, Nominating and Corporate Governance Committees and its Code of Ethics covering all Employees are available on the Company s website, www.ennis.com, and a copy will be mailed upon request to Ms. Sharlene Reagan at 2441 Presidential Parkway, Midlothian, TX 76065. If we make any substantive amendments to the Code, or grant any waivers to the Code for any of our senior officers or directors, we will disclose such amendment or waiver on our website and in a report on Form 8-K.

**ITEM 11. EXECUTIVE COMPENSATION**

The information required by Item 11 is hereby incorporated herein by reference to the definitive Proxy Statement for our 2008 Annual Meeting of Shareholders.

**ITEM 12. SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

The information required by Item 12, as to certain beneficial owners and management, is hereby incorporated by reference to the definitive Proxy Statement for our 2008 Annual Meeting of Shareholders.

| **Plan Category** | **Number of securities to be issued upon exercise of outstanding options (a)** | **Weighted average exercise price of outstanding options (b)** | **Number of securities available for future issuances under equity compensation plans (excluding securities reflected in column (a)) ( c )** |
|---|---|---|---|
| Equity compensation plans approved by the security holders (1) | 543,429 | $ 10.97 | 258,276 |
| Equity compensation plans not approved by security holders | | | |
| Total | 543,429 | $ 10.97 | 258,276 |

The following table provides information about securities authorized for issuance under the Company s equity compensation plans as of February 29, 2008.

(1) Includes the 1998 Option

and Restricted Stock Plan, amended and restated as of June 17, 2004 and the 1991 Incentive Stock Option Plan. Includes 73,916 shares of restricted stock.

**ITEM 13. CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

The information required by Item 13 is hereby incorporated herein by reference to the definitive Proxy Statement for our 2008 Annual Meeting of Shareholders.

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**ITEM 14. PRINCIPAL ACCOUNTANT FEES AND SERVICES**

The information required by Item 14 is hereby incorporated herein by reference to the definitive Proxy Statement for our 2008 Annual Meeting of Shareholders.

**PART IV**

**ITEM 15. EXHIBITS AND FINANCIAL STATEMENT SCHEDULES**

**(a) Documents filed as a part of the report:**

**(1) Index to Consolidated Financial Statements of the Company**

An Index to Consolidated Financial Statements has been filed as a part of this Report beginning on page F-1 hereof.

**(2)** All schedules for which provision is made in the applicable accounting regulation of the SEC have been omitted because of the absence of the conditions under which they would be required or because the information required is included in the consolidated financial statements of the Registrant or the notes thereto.

**(3) Exhibits**

An Index to Exhibits has been filed as a part of this Report beginning on page E-1 and is herein incorporated by reference.

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## SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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.

| | |
|---|---|
| | **ENNIS, INC.** |
| Date: May 9, 2008 | BY: /s/ KEITH S. WALTERS |
| | Keith S. Walters,<br>Chairman of the Board,<br>Chief Executive Officer and President |
| Date: May 9, 2008 | BY: /s/ RICHARD L. TRAVIS, JR. |
| | Richard L. Travis, Jr.<br>Vice President Finance and CFO,<br>Secretary and Principal Financial and<br>Accounting Officer |

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

| | |
|---|---|
| Date: May 9, 2008 | BY: /s/ KEITH S. WALTERS |
| | Keith S. Walters, Chairman |
| Date: May 9, 2008 | BY: /s/ RONALD M. GRAHAM |
| | Ronald M. Graham, Director |
| Date: May 9, 2008 | BY: /s/ JAMES B. GARDNER |
| | James B. Gardner, Director |
| Date: May 9, 2008 | BY: /s/ GODFREY M. LONG, JR. |
| | Godfrey M. Long, Jr., Director |
| Date: May 9, 2008 | BY: /s/ THOMAS R. PRICE |
| | Thomas R. Price, Director |
| Date: May 9, 2008 | BY: /s/ KENNETH G. PRITCHETT |
| | Kenneth G. Pritchett, Director |
| Date: May 9, 2008 | BY: /s/ ALEJANDRO QUIROZ |
| | Alejandro Quiroz, Director |

| | |
|---|---|
| Date: May 9, 2008 | BY: /s/ MICHAEL J. SCHAEFER |
| | Michael J. Schaefer, Director |
| Date: May 9, 2008 | BY: /s/ JAMES C. TAYLOR |
| | James C. Taylor, Director |

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**ENNIS, INC. AND SUBSIDIARIES**
**Index to Consolidated Financial Statements**


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| Report of Independent Registered Public Accounting Firm | F-2 |
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| Consolidated Balance Sheets February 29, 2008 and February 28, 2007 | F-4 |
| Consolidated Statements of Earnings Fiscal years ended 2008, 2007 and 2006 | F-6 |
| Consolidated Statements of Changes in Shareholders Equity and Comprehensive Income Fiscal years ended 2008, 2007 and 2006 | F-7 |
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## Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Ennis, Inc.

We have audited the accompanying consolidated balance sheets of Ennis, Inc. (a Texas corporation) and subsidiaries as of February 29, 2008 and February 28, 2007 and the related consolidated statements of earnings, changes in shareholders equity and comprehensive income, and cash flows for each of the three years in the period ended February 29, 2008. These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of Ennis, Inc. and subsidiaries as of February 29, 2008 and February 28, 2007, and the results of their operations and their cash flows for each of the three years in the period ended February 29, 2008 in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 10 to the consolidated financial statements, the Company has adopted Financial Accounting Standard Board (FASB) Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*, effective March 1, 2006. As discussed in Note 11 to the consolidated financial statements, the Company also adopted FASB Statement of Financial Accounting Standards No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans: An Amendment of FASB Statements No. 87, 88, 106, and 132R*, effective February 28, 2007.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), Ennis, Inc. and subsidiaries internal control over financial reporting as of February 29, 2008, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) and our report dated May 9, 2008 expressed an unqualified opinion on the effectiveness of Ennis, Inc. s internal control over financial reporting.

/s/ Grant Thornton LLP

Dallas, Texas
May 9, 2008

## Report of Independent Registered Public Accounting Firm

Board of Directors and Shareholders
Ennis, Inc.

We have audited Ennis, Inc. (a Texas corporation) and subsidiaries internal control over financial reporting as of February 29, 2008, based on criteria established in *Internal Control Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Ennis, Inc. s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the accompanying Management s Report on Internal Control over Financial Reporting. Our responsibility is to express an opinion on Ennis, Inc. s internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, testing and evaluating the design and operating effectiveness of internal control based on the assessed risk, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company s internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company s internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company s assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, Ennis, Inc. and subsidiaries maintained, in all material respects, effective internal control over financial reporting as of February 29, 2008, based on criteria established in *Internal Control-Integrated Framework* issued by COSO.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of Ennis, Inc. and subsidiaries as of February 29, 2008 and February 28, 2007 and the related consolidated statements of earnings, changes in shareholders equity and comprehensive income, and cash flows for each of the three years in the period ended February 29, 2008 and our report dated May 9, 2008 expressed an unqualified opinion on those financial statements.

/s/ Grant Thornton LLP

Dallas, Texas
May 9, 2008

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**ENNIS, INC. AND SUBSIDIARIES**
**CONSOLIDATED BALANCE SHEETS**
***(Dollars in thousands)***

| | Fiscal Years Ended | |
|---|---|---|
| | **2008** | **2007** |
| **Assets** | | |
| Current assets | | |
| Cash and cash equivalents | $ 3,393 | $ 3,582 |
| Accounts receivable, net of allowance for doubtful receivables of $3,954 at February 29, 2008 and $2,698 at February 28, 2007 | 72,278 | 47,285 |
| Prepaid expenses | 3,500 | 5,628 |
| Inventories | 98,570 | 85,696 |
| Deferred income taxes | 7,786 | 7,444 |
| Assets held for sale | 292 | 1,881 |
| Total current assets | 185,819 | 151,516 |
| Property, plant and equipment, at cost | | |
| Plant, machinery and equipment | 130,214 | 127,521 |
| Land and buildings | 42,793 | 40,680 |
| Other | 22,586 | 22,506 |
| Total property, plant and equipment | 195,593 | 190,707 |
| Less accumulated depreciation | 136,605 | 127,650 |
| Net property, plant and equipment | 58,988 | 63,057 |
| Goodwill | 178,388 | 178,314 |
| Trademarks and tradenames, net | 63,880 | 63,052 |
| Customer lists, net | 24,260 | 20,287 |
| Deferred finance charges, net | 934 | 1,382 |
| Prepaid pension asset | 260 | |
| Other assets | 602 | 620 |
| Total assets | $ 513,131 | $ 478,228 |

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)***

| | Fiscal Years Ended | |
|---|---|---|
| | **2008** | **2007** |
| **Liabilities and Shareholders Equity** | | |
| Current liabilities | | |
| Accounts payable | $ 29,658 | $ 25,597 |
| Accrued expenses | | |
| Employee compensation and benefits | 14,840 | 15,799 |
| Taxes other than income | 989 | 611 |
| Federal and state income taxes payable | 501 | 973 |
| Other | 5,583 | 5,615 |
| Current installments of long-term debt | 255 | 652 |
| Total current liabilities | 51,826 | 49,247 |
| Long-term debt, less current installments | 90,710 | 88,971 |
| Liability for pension benefits | | 2,702 |
| Deferred income taxes | 20,775 | 19,603 |
| Other liabilities | 1,341 | 1,302 |
| Total liabilities | 164,652 | 161,825 |
| Commitments and contingencies | | |
| Shareholders equity | | |
| Series A junior participating preferred stock of $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 in 2008 and 2007 | 75,134 | 75,134 |
| Additional paid in capital | 122,566 | 122,305 |
| Retained earnings | 235,624 | 207,190 |
| Accumulated other comprehensive income (loss): | | |
| Foreign currency translation | 929 | 25 |
| Minimum pension liability | (6,450) | (7,396) |
| | (5,521) | (7,371) |
| | 427,803 | 397,258 |
| Treasury stock | | |
| Cost of 4,391,193 shares in 2008 and 4,475,962 shares in 2007 | (79,324) | (80,855) |
| Total shareholders equity | 348,479 | 316,403 |

| | | |
|---|---|---|
| Total liabilities and shareholders equity | $ 513,131 | $ 478,228 |

See accompanying notes to consolidated financial statements.

**ENNIS, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF EARNINGS**
***(Dollars in thousands, except share and per share amounts)***

| | Fiscal Years Ended | | |
|---|---|---|---|
| | **2008** | **2007** | **2006** |
| Net sales | $ 610,610 | $ 584,713 | $ 559,397 |
| Cost of goods sold | 457,963 | 438,776 | 417,307 |
| Gross profit | 152,647 | 145,937 | 142,090 |
| Selling, general and administrative | 77,624 | 72,736 | 69,953 |
| Gain from disposal of assets | (757) | (258) | (188) |
| Income from operations | 75,780 | 73,459 | 72,325 |
| Other income (expense) | | | |
| Interest expense | (5,678) | (6,936) | (8,331) |
| Other expense, net | (317) | (158) | (23) |
| | (5,995) | (7,094) | (8,354) |
| Earnings before income taxes | 69,785 | 66,365 | 63,971 |
| Provision for income taxes | 25,195 | 24,764 | 23,434 |
| Net earnings | $ 44,590 | $ 41,601 | $ 40,537 |
| Weighted average common shares outstanding | | | |
| Basic | 25,623,325 | 25,530,732 | 25,452,582 |
| Diluted | 25,860,358 | 25,758,948 | 25,728,299 |
| Per share amounts | | | |
| Net earnings basic | $ 1.74 | $ 1.63 | $ 1.59 |
| Net earnings diluted | $ 1.72 | $ 1.62 | $ 1.58 |
| Cash dividends per share | $ 0.62 | $ 0.62 | $ 0.62 |

See accompanying notes to consolidated financial statements.

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**ENNIS, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CHANGES IN SHAREHOLDERS EQUITY AND COMPREHENSIVE INCOME FOR THE FISCAL YEARS ENDED 2006, 2007, AND 2008**
***(Dollars in thousands, except share and per share amounts)***

| | Common Stock | | Additional Paid-in | Retained | Accumulated Other Comprehensive Income | Treasury Stock | | |
|---|---|---|---|---|---|---|---|---|
| | **Shares** | **Amount** | **Capital** | **Earnings** | **(Loss)** | **Shares** | **Amount** | **Total** |
| **Balance March 1, 2005** | 30,053,443 | $ 75,134 | $ 123,640 | $ 156,666 | $ 6 | (4,635,444) | $ (83,715) | $ 271,731 |
| Net earnings | | | | 40,537 | | | | 40,537 |
| Foreign currency translation, net of deferred tax of $270 | | | | | 455 | | | 455 |
| Unrealized loss on derivative instruments, net | | | | | (1) | | | (1) |
| Comprehensive income | | | | | | | | 40,991 |
| Dividends declared $(.62 per share) | | | | (15,780) | | | | (15,780) |
| Exercise of stock options and restricted stock grants | | | (718) | | | 79,369 | 1,434 | 716 |
| Treasury stock purchases | | | | | | (18,254) | (323) | (323) |
| **Balance February 28, 2006** | 30,053,443 | 75,134 | 122,922 | 181,423 | 460 | (4,574,329) | (82,604) | 297,335 |
| Net earnings | | | | 41,601 | | | | 41,601 |
| Foreign currency translation, net of deferred tax of $255 | | | | | (435) | | | (435) |
| Comprehensive income | | | | | | | | 41,166 |
| Adjustment to initially apply FAS 158, net of tax of $4,739 | | | | | (7,396) | | | (7,396) |
| | | | | (15,834) | | | | (15,834) |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| Dividends declared $(.62 per share) | | | | | | | | |
| Excess tax benefit of stock option exercises and restricted stock grants | | | 169 | | | | | 169 |
| Stock based compensation | | | 302 | | | | | 302 |
| Exercise of stock options and restricted stock grants | | | (1,088) | | | 98,367 | 1,749 | 661 |
| **Balance February 28, 2007** | 30,053,443 | 75,134 | 122,305 | 207,190 | (7,371) | (4,475,962) | (80,855) | 316,403 |
| Net earnings | | | | 44,590 | | | | 44,590 |
| Foreign currency translation, net of deferred tax of $526 | | | | | 904 | | | 904 |
| Adjustment to pension net of deferred tax of $584 | | | | | 946 | | | 946 |
| Comprehensive income | | | | | | | | 46,440 |
| Cumulative impact of a change in accounting for income tax uncertainties pursuant to FIN 48 | | | | (240) | | | | (240) |
| Dividends declared $(.62 per share) | | | | (15,916) | | | | (15,916) |
| Excess tax benefit of stock option exercises and restricted stock grants | | | 385 | | | | | 385 |
| Stock based compensation | | | 734 | | | | | 734 |
| Exercise of stock options and restricted stock | | | (858) | | | 84,769 | 1,531 | 673 |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| grants | | | | | | | | |
| **Balance February 29, 2008** | 30,053,443 | $ 75,134 | $ 122,566 | $ 235,624 | $ (5,521) | (4,391,193) | $ (79,324) | $ 348,479 |

See accompanying notes to consolidated financial statements.

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**ENNIS, INC. AND SUBSIDIARIES**
**CONSOLIDATED STATEMENTS OF CASH FLOWS**
(Dollars in thousands)

| | Fiscal Years Ended | | |
|---|---|---|---|
| | **2008** | **2007** | **2006** |
| Cash flows from operating activities: | | | |
| Net earnings | $ 44,590 | $ 41,601 | $ 40,537 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: | | | |
| Depreciation | 12,217 | 14,670 | 15,474 |
| Amortization of deferred finance charges | 448 | 451 | 495 |
| Amortization of trademarks and customer lists | 2,062 | 1,957 | 2,337 |
| Gain on the sale of equipment | (757) | (258) | (188) |
| Bad debt expense | 1,970 | 1,390 | 317 |
| Stock based compensation | 734 | 302 | |
| Excess tax benefit of stock option exercises | (385) | (169) | |
| Deferred income taxes | 682 | (4,963) | 456 |
| Changes in operating assets and liabilities, net of the effects of acquisitions: | | | |
| Accounts receivable | (22,854) | (3,762) | 4,633 |
| Prepaid expenses | 2,239 | (1,225) | 761 |
| Inventories | (10,148) | 5,797 | (9,332) |
| Other current assets | | | 334 |
| Other assets | 16 | (482) | (2,320) |
| Accounts payable and accrued expenses | 2,348 | (8,313) | (7,227) |
| Other liabilities | (701) | (734) | 1,144 |
| Liability for pension benefits | (2,017) | 3,255 | 6 |
| Net cash provided by operating activities | 30,444 | 49,517 | 47,427 |
| Cash flows from investing activities: | | | |
| Capital expenditures | (4,294) | (4,999) | (9,040) |
| Purchase of businesses, net of cash acquired | (14,638) | (17,637) | (1,196) |
| Proceeds from disposal of plant and property | 1,647 | 2,811 | 294 |
| Net cash used in investing activities | (17,285) | (19,825) | (9,942) |
| Cash flows from financing activities: | | | |
| Borrowings on debt | 18,000 | 15,647 | 9,000 |
| Repayment of debt | (16,658) | (40,621) | (28,508) |
| Dividends | (15,916) | (15,834) | (15,780) |
| Proceeds from exercise of stock options | 673 | 661 | 393 |
| Excess tax benefit of stock option exercises | 385 | 169 | |
| Net cash used in financing activities | (13,516) | (39,978) | (34,895) |

| | | | |
|---|---|---|---|
| Effect of exchange rate changes on cash | 168 | 8 | 576 |
| Net change in cash and cash equivalents | (189) | (10,278) | 3,166 |
| Cash and cash equivalents at beginning of period | 3,582 | 13,860 | 10,694 |
| Cash and cash equivalents at end of period | $ 3,393 | $ 3,582 | $ 13,860 |

See accompanying notes to consolidated financial statements.

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**ENNIS, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Significant Accounting Policies and General Matters**

**Nature of Operations.** Ennis, Inc. and its wholly owned subsidiaries (the Company) are principally engaged in the production of and sale of business forms, other business products and apparel to customers primarily located in the United States.

**Basis of Consolidation.** The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated. The Company s fiscal years ended on the following days: February 29, 2008, February 28, 2007 and February 28, 2006 (fiscal years ended 2008, 2007, and 2006, respectively).

**Cash and Cash Equivalents.** Cash and cash equivalents consist of highly liquid investments, such as time deposits held at major banks, commercial paper, United States government agency discount notes, money market mutual funds and other money market securities with original maturities of 90 days or less. At February 29, 2008, the Company had $714,000 in Mexican and $839,000 in Canadian bank accounts.

**Accounts Receivable.** Trade receivables are uncollateralized customer obligations due under normal trade terms requiring payment generally within 30 days from the invoice date. The Company s allowance for doubtful receivables reserve 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.

Select trade accounts receivable are sold by the Company to various factors on both non-recourse and recourse bases. These transactions are accounted for as a sale of financial assets if sold without recourse and a secured borrowing if sold with recourse. Advances may be paid at the Company s request on receivables not yet collected by the factors.

**Inventories.** With the exception of approximately one third of the raw materials of its print segment inventories, which are valued at the lower of last-in, first-out (LIFO) cost or market, the Company values its inventories at the lower of first in, first out (FIFO) cost or market. At fiscal years ended 2008 and 2007, approximately 5.26% and 6.24% of inventories, respectively, are valued at LIFO with the remainder of inventories valued at FIFO. 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 Company provides reserves for excess and obsolete inventory when necessary based upon analysis of quantities on hand, recent sales volumes and reference to market prices. Reserve for obsolete inventory at fiscal years ended 2008 and 2007 were $1.6 million and $1.2 million, respectively.

**Property, Plant and Equipment**. Depreciation of property, plant and equipment is calculated using the straight-line method over a period presently considered adequate to amortize the total cost over the useful lives of the assets, which range from 3 to 11 years for plant, machinery and equipment and 10 to 40 years for buildings and improvements. Leasehold improvements are amortized over the shorter of the lease term or the estimated useful life of the improvements. Repairs and maintenance are expensed as incurred. Renewals and betterments are capitalized and depreciated over the remaining life of the specific property unit. The Company capitalizes all leases that are in substance acquisitions of property. As of February 29, 2008, the Company had land and building of approximately $0.3 million classified as assets held for sale on the consolidated balance sheet. This balance reflects the net book value of a vacant facility and the associated land under contract for sale which is the lower of carrying amount or fair value less cost to sell. At February 28, 2007, the Company had property, plant and equipment of approximately $1.9 million classified as assets held for sale on the consolidated balance sheet. This balance reflects the net book value of land and building of approximately $0.6 million and equipment with a net book value of $1.3 million. During the year, the buildings were sold for a gain of approximately $0.8 million and the equipment was returned to service.

**ENNIS, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Significant Accounting Policies and General Matters-continued**

**Goodwill and Other Intangible Assets.** Goodwill is the excess of the purchase price paid over the value of net assets of businesses acquired and is not amortized. Intangible assets with determinable lives are amortized on a straight-line basis over the estimated useful life. Intangible assets with indefinite lives are 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 related business unit to its carrying value.

**Long-Lived Assets**. Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is based upon future discounted net cash flows.

**Fair Value of Financial Instruments**. The carrying amounts of cash and cash equivalents, accounts receivables and accounts payable approximate fair value because of the short maturity of these instruments. Long-term debt as of fiscal years ended 2008 and 2007 approximates its fair value as the interest rate is tied to market rates.

**Deferred Finance Charges**. The Company accounts for deferred finance charges in connection with its revolving and term credit facility. The costs associated with the debt are amortized using the straight-line method over the term of the facility. If the facility is extinguished before the end of the term, the remaining balance of the deferred finance charges will be amortized fully in such year.

**Revenue Recognition**. Revenue is generally recognized upon shipment of products. Net sales represent gross sales invoiced to customers, less certain related charges, including sales tax, discounts, returns and other allowances. Returns, discounts and other allowances have historically been insignificant. In some cases and upon customer request, the Company prints and stores custom print product for customer specified future delivery, generally within twelve months. In this case, risk of loss passes to the customer, the customer is invoiced under normal credit terms, and revenue is recognized when manufacturing is complete. Approximately $20,250,000, $20,147,000, and $16,395,000 of revenue was recognized under these arrangements during fiscal years 2008, 2007, and 2006 respectively.

**Advertising Expenses**. The Company expenses advertising costs as incurred. Catalog and brochure preparation and printing costs, which are considered direct response advertising, are amortized to expense over the life of the catalog, which typically ranges from three to twelve months. Advertising expense was approximately $2,014,000, $1,905,000, and $1,559,000, during the fiscal years ended 2008, 2007, and 2006, respectively and is included in selling, general and administrative expenses in the consolidated statements of earnings. Included in advertising expense is amortization related to direct response advertising of $876,000, $703,000, and $622,000 for the fiscal years ended 2008, 2007 and 2006, respectively. Unamortized direct advertising costs included in prepaid expenses at fiscal years ended 2008 and 2007 were $231,000 and $529,000, respectively.

**Income Taxes.** Deferred tax assets and liabilities are recognized for the estimated future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date.

**Earnings Per Share**. Basic earnings per share is computed by dividing net earnings by the weighted average number of common shares outstanding during the period. Diluted earnings per share is computed by dividing net earnings by the weighted average number of common shares outstanding plus the number of additional shares that would have been outstanding if potentially dilutive securities had been issued, calculated using the treasury stock method. For fiscal year ended 2006, 61,619 of options were not included in the diluted earnings per share computation because their effect was anti-dilutive. In 2008 and 2007 all options and restricted stock grants were dilutive.

**ENNIS, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Significant Accounting Policies and General Matters-continued**

**Accumulated Other Comprehensive Income (Loss)**. Accumulated other comprehensive income (loss) includes adjustments of the changes resulting from exchange rate fluctuations from year to year and changes in the fair value of the Company s pension plan assets. Amounts charged directly to shareholders equity related to the Company s pension plan are included in other comprehensive income. Adjustments resulting from the translation of the financial statements of our Mexican and Canadian operations are charged or credited directly to shareholders equity and shown as cumulative translation adjustments in other comprehensive income (loss).

**Foreign Currency Translation.** The functional currency for the Company s foreign subsidiaries is the applicable local currency. Assets and liabilities of the foreign subsidiaries are translated to U.S. dollars at year-end exchange rates. Income and expense items are translated at the rates of exchange prevailing during the year. The adjustments resulting from translating the financial statements of the foreign subsidiary are reflected in shareholders equity as accumulated other comprehensive income or loss.

Transaction gains and losses that arise from exchange rate fluctuations on transactions denominated in a currency other than the functional currency are included in the results of operations in other income (expense), net as incurred. Transaction gains and losses totaled approximately $322,000, $265,000 and $68,000 for fiscal years ended 2008, 2007 and 2006, respectively.

**Estimates.** The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period. Actual results could differ from these estimates.

**Reclassifications.** Reclassifications were made to prior-year financial statements to conform to the current-year presentations. We reclassified $157,000 and ($107,000) of selling, general and administrative expense and $258,000 and $188,000 of gain from disposal of assets in fiscal 2007 and 2006, respectively, which were previously reported as part of other expense, net.

**Shipping and Handling Costs.** In accordance with Emerging Issues Task Force ( EITF ) 00-10, Accounting for Shipping and Handling Fees and Costs, the Company records amounts billed to customers for shipping and handling costs in net sales and related costs are included in cost of goods sold.

**Stock Based Compensation.** The Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (FAS 123R), effective March 1, 2006. FAS 123R requires the recognition of the fair value of stock-based compensation in net earnings. The Company recognizes stock-based compensation expense net of estimated forfeitures (estimated at 1.1%) over the requisite service period of the individual grants, which generally equals the vesting period. For the fiscal years 2008 and 2007, in accordance with FAS 123R, the Company recorded stock based compensation expense of approximately $734,000 and $302,000, and related tax benefit of $272,000 and $112,000, respectively. For a further discussion of the impact of FAS 123R on the results of our consolidated financial statements, see Note 10, Stock Option Plans and Stock Based Compensation.

Prior to March 1, 2006, the Company applied the disclosure-only provisions of Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation , (FAS 123). In accordance with the provisions of FAS 123, the Company accounted for stock options granted to its employees and Board of Directors using the recognition and measurement provisions of Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees, and its related interpretations, (APB 25) and accordingly did not recognize compensation expense for stock options issued to employees and board members. For disclosure purposes, the Company used the Black-Scholes option pricing model to calculate the related compensation expense for stock options granted, as if it had applied the fair value recognition provisions of FAS 123. The Company has elected to utilize the modified prospective transition method for adopting FAS 123R. Under this method, the provisions of FAS 123R apply to all awards granted or modified after the date of adoption and any unvested awards outstanding at the date of adoption.

**ENNIS, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Significant Accounting Policies and General Matters-continued**

The accompanying consolidated statements of earnings for fiscal year 2006 were not restated since the Company elected not to use the retrospective application method under FAS 123R. A summary of the effect on net earnings and earnings per share for fiscal years 2006 as if the Company had applied the fair value recognition provisions of FAS 123 to share-based compensation for all outstanding and nonvested stocks options and restricted shares is as follows (in thousands except per share amounts):

| | 2006 |
|---|---|
| Net earnings as reported | $ 40,537 |
| Deduct: Stock-based employee compensation expense not included in reported earnings, net of related tax effect of $85. | (134) |
| Pro forma earnings | $ 40,403 |
| Net earnings per share | |
| Basic as reported | $ 1.59 |
| Basic pro forma | $ 1.59 |
| Diluted as reported | $ 1.58 |
| Diluted pro forma | $ 1.57 |

For purposes of pro forma disclosures, the estimated fair value of stock-based compensation plans and other options is amortized to expense over the vesting period.

**New Accounting Pronouncements**

**FIN 48**. The Company adopted the provisions of Financial Accounting Standards Board Interpretation No. 48 ( FIN 48 ), Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109, on March 1, 2007. As a part of the implementation of FIN 48, the Company made a comprehensive review of its uncertain tax positions and recorded $240,000 of unrecognized tax benefits in connection with certain state tax positions, as non-current other liabilities on the consolidated balance sheet, with no net impact to the consolidated statement of earnings. This amount was accounted for as a reduction to the March 1, 2007 balance of retained earnings, in accordance with the adoption provisions of FIN 48. These unrecognized tax benefits related to uncertain tax positions would impact the effective tax rate if recognized. Approximately $76,000 of unrecognized tax benefits relate to items that are affected by expiring statute of limitations within the next 12 months.

The unrecognized tax benefits mentioned above includes an aggregate $26,000 of interest expense. Upon adoption of FIN 48, the Company elected an accounting policy to classify interest expense on underpayments of income taxes and accrued penalties related to unrecognized tax benefits in the income tax provision. Prior to the adoption of FIN 48, the Company s policy was to classify interest expense on underpayments of income taxes as interest expense and to classify penalties as an operating expense in arriving at earnings before income taxes.

The Company is subject to U.S. federal income tax as well as to income tax of multiple state jurisdictions and foreign tax jurisdictions. The Company has concluded all U.S. federal income tax matters for years through 2005. All material state and local income tax matters have been concluded for years through 2002 and foreign tax jurisdictions through 2000.

**FAS 157.** In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 157, Fair Value Measurements ( FAS 157 ). The provisions of FAS 157 define fair value, establish a framework for measuring fair value in generally accepted accounting principles, and expand disclosures about fair value measurements. The provisions of FAS 157 are effective for fiscal years beginning after November 15, 2007. However, in February 2008, the FASB issued FSP FAS 157-2 which delays the effective date of FAS 157 for all nonfinancial assets and nonfinancial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually).

**ENNIS, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(1) Significant Accounting Policies and General Matters-continued**

This FSP partially defers the effective date of Statement 157 to fiscal years beginning after November 15, 2008, and interim periods within those fiscal years for items within the scope of this FSP. The Company does not expect the adoption of FAS 157 to have a material impact on its consolidated financial position, results of operations, or cash flows.

**FAS 159.** In February 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FAS No. 115 ( FAS 159 ). FAS 159 allows measurement at fair value of eligible financial assets and liabilities that are not otherwise measured at fair value. If the fair value option for an eligible item is elected, unrealized gains and losses on that item shall be reported in current earnings at each subsequent reporting date. FAS 159 also establishes presentation and disclosure requirements designed to draw comparison between the different measurement attributes the company elects for similar types of assets and liabilities. FAS 159 is effective for fiscal years beginning after November 15, 2007. FAS 159 is effective for the Company beginning March 1, 2008. The Company does not expect the adoption of FAS 159 to have a material impact on its consolidated financial position, results of operations or cash flows.

**FAS 141R.** In December 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141 (revised 2007), Business combinations ( FAS 141R ), which replaces FAS 141. FAS 141R establishes principles and requirements for how an acquirer in a business combination recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any controlling interest; recognizes and measures the goodwill acquired in the business combination or a gain from a bargain purchase; and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. FAS 141R is to be applied prospectively to business combinations for which the acquisition date is on or after an entity s fiscal year that begins after December 15, 2008 (the Company s fiscal year ended February 28, 2009). The Company has not completed its evaluation of the potential impact, if any, of the adoption of FAS 141R on its consolidated financial position, results of operations and cash flows.

**FAS 160.** In December 2007, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 160 Noncontrolling Interests in Consolidated Financial Statements an amendment to ARB No. 51 ( FAS 160 ). FAS 160 establishes accounting and reporting standards that require the ownership interest in subsidiaries held by parties other than the parent to be clearly identified and presented in the consolidated balance sheets within equity, but separate from the parent s equity; the amount of consolidated net income attributable to the parent and the noncontrolling interest to be clearly identified and presented on the face of the consolidated statement of earnings; and changes in a parent s ownership interest while the parent retains its controlling financial interest in its subsidiary to be accounted for consistently. This statement is effective for fiscal years beginning on or after December 15, 2008 (the Company s fiscal year ended February 28, 2009). The Company has not completed its evaluation of the potential impact, if any, of the adoption of FAS 160 on its consolidated financial position, results of operations and cash flows.

**Concentrations of Risk**

Financial instruments that potentially subject the Company to a concentration of credit risk principally consist of cash and cash equivalents, and trade receivables. Cash and cash equivalents are placed with high-credit quality financial institutions. The Company s credit risk with respect to trade receivables is limited in management s opinion 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 a single source. 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.

**ENNIS, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(2) Due From Factors**

Pursuant to terms of an agreement between the Company and various factors, the Company sold approximately 32.1% of its trade accounts receivable of Alstyle Apparel ( Alstyle ) to the factors on a non-recourse basis in fiscal year 2008. The price at which the accounts are sold is the invoice amount reduced by the factor commission of between 0.25% and 1.50%. Additionally, some trade accounts receivable are sold to the factors on a recourse basis.

Trade accounts receivable not sold to the factor remain in the custody and control of the Company and the Company maintains all credit risk on those accounts as well as accounts which are sold to the factor with recourse. The Company accounts for receivables sold to factors with recourse as secured borrowings.

The Company may request payment from the factor in advance of the collection date or maturity. Any such advance payments are assessed interest charges through the collection date or maturity at the JP Morgan Chase Prime Rate. The Company s obligations with respect to advances from the factor are limited to the interest charges thereon. Advance payments are limited to a maximum of 90% (ninety percent) of eligible accounts receivable.

The following table represents amounts due from factors included in accounts receivable for the fiscal years ended (in thousands):

| | February 29, 2008 | February 28, 2007 |
|---|---|---|
| Outstanding factored receivables without recourse | $ 2,315 | $ 18,766 |
| Advances from factors | (1,467) | (15,683) |
| Due from factors | $ 848 | $ 3,083 |

**(3) Accounts Receivable and Allowance for Doubtful Receivables**

Accounts receivable are reduced by an allowance for an estimate of amounts that are uncollectible. Approximately 97% 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 (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 reserve 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.

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 fiscal years ended (in thousands):

| | 2008 | 2007 | 2006 |
|---|---|---|---|
| Balance at beginning of period | $ 2,698 | $ 3,001 | $ 3,567 |
| Bad debt expense | 1,970 | 1,390 | 317 |
| Other | | | 3 |
| Recoveries | 29 | 101 | 67 |
| Accounts written off | (743) | (1,794) | (953) |
| Balance at end of period | $ 3,954 | $ 2,698 | $ 3,001 |

**ENNIS, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(4) Inventories**

The following table summarizes the components of inventories at the different stages of production for the fiscal years ended (in thousands):

| | 2008 | 2007 |
|---|---|---|
| Raw material | $ 14,711 | $ 11,074 |
| Work-in-process | 15,467 | 16,694 |
| Finished goods | 68,392 | 57,928 |
| | $ 98,570 | $ 85,696 |

The excess of current costs at FIFO over LIFO stated values was approximately $4,860,000 and $4,671,000 at fiscal years ended 2008 and 2007, respectively. There were no significant liquidations of LIFO inventories during the fiscal years ended 2008, 2007 and 2006. Cost includes materials, labor and overhead related to the purchase and production of inventories.

**(5) Acquisitions and Disposal**

On October 5, 2007, the Company acquired certain assets of B & D Litho, Inc. ( B & D ) headquartered in Phoenix, Arizona, and certain assets and related real estate of Skyline Business Forms ( Skyline ), operating in Denver, Colorado through its wholly owned subsidiaries for $12.5 million in cash. The acquisition of B&D Litho, Inc. did not include the acquisition of B&D Litho California, Inc., which is primarily a commercial printing operation located in Ontario, California. No significant liabilities were assumed in the transactions. Acquired customer lists are being amortized over a 10 year period. The combined sales of the purchased operations were $25.0 million during the most recent twelve month period. The acquisition will add additional medium and long run multi-part forms, laser cut sheets, jumbo rolls and mailer products sold through the indirect sales (distributorship) marketplace.

The following is a summary of the purchase price allocation for B & D and Skyline (in thousands):

| | |
|---|---|
| Accounts receivable | $ 2,713 |
| Inventories | 1,711 |
| Other assets | 66 |
| Property, plant & equipment | 2,662 |
| Customer lists | 5,084 |
| Trademarks | 671 |
| Noncompete | 18 |
| Accounts payable and accrued liabilities | (443) |
| | $ 12,482 |

On September 17, 2007, the Company acquired certain assets of Trade Envelope, Inc. ( Trade ) for $2.7 million. Under the terms of the purchase agreement, the Company has agreed to pay the former owners of Trade under a contingent earn-out arrangement over three years for intangibles, subject to certain set-offs. Trade is an envelope manufacturer (converter) and printer, offering high quality, 1-4 color process with lithograph and flexography capabilities with locations in Tullahoma, Tennessee and Carol Stream, Illinois. The sales for the most recent twelve month period was $11.4 million. The acquisition expanded and strengthened the envelope product line for the Company.

**ENNIS, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(5) Acquisitions and Disposal-continued**

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

| | |
|---|---|
| Accounts receivable | $ 974 |
| Inventories | 346 |
| Property, plant & equipment | 419 |
| Customer lists | 767 |
| Trademarks | 306 |
| Noncompete | 15 |
| Accounts payable and accrued liabilities | (171) |
| | $ 2,656 |

The Company purchased all of the outstanding stock of Block Graphics, Inc. ( Block ), a privately held company headquartered in Portland, Oregon for $14.8 million in cash on August 8, 2006. Block Graphics had sales of approximately $38.6 million for the year ended December 31, 2005. The acquisition of Block continues the strategy of growth through related manufactured products to further service the Company s existing customer base. The acquisition added additional short-run print products (snaps, continuous forms, and cut-sheet forms) as well as the production of envelopes, a new product for the Company.

The following is a summary of the purchase price allocation for Block, net of cash acquired (in thousands):

| | |
|---|---|
| Accounts receivable | $ 2,492 |
| Inventories | 1,864 |
| Property, plant & equipment | 7,398 |
| Other assets | 152 |
| Deferred income taxes | 2,166 |
| Trademarks | 1,260 |
| Accounts payable and accrued liabilities | (2,292) |
| | $ 13,040 |

The Company purchased all of the outstanding stock of Specialized Printed Forms, Inc. ( SPF ), a privately held company headquartered in Caledonia, New York and the associated land and buildings for $4.6 million in cash on March 31, 2006. SPF had sales of $9.2 million for the twelve month period ended July 31, 2005. The acquisition of SPF continues the strategy of growth through related manufactured products to further service the Company s existing customer base. The acquisition added additional short-run print products, long-run (jumbo rolls) products and solutions as well as integrated labels and form/label combinations sold through the indirect sales (distributorship) marketplace.

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

| | |
|---|---|
| Accounts receivable | $ 826 |
| Inventories | 579 |
| Property, plant & equipment | 3,689 |
| Other assets | 5 |
| Deferred income taxes | 1,780 |
| Noncompete | 25 |
| Accounts payable and accrued liabilities | (2,316) |

$ 4,588

The results of operations for B&D, Trade, Block, and SPF 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 companies had been acquired as of March 1, 2006, 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):

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**ENNIS, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(5) Acquisitions and Disposal-continued**

| | Unaudited | |
|---|---|---|
| | **2008** | **2007** |
| Pro forma net sales | $631,786 | $638,371 |
| Pro forma net earnings | 44,979 | 42,217 |
| Pro forma earnings per share diluted | 1.74 | 1.64 |

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

**(6) 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 interest, taxes, depreciation, and amortization. Based on this evaluation, no impairment was recorded. 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.

Intangible assets with determinable lives are amortized on a straight-line basis over the estimated useful life (between 1 and 10 years). The cost of intangible assets are based on fair values at the date of acquisition. Trademarks with indefinite lives, with a net book value of $63.2 million at fiscal year end 2008, are evaluated for impairment on an annual basis.

The Company assesses the recoverability of its definite-lived intangible assts 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 thousand):

| | Gross Carrying Amount | Accumulated Amortization | Net |
|---|---|---|---|
| **As of February 29, 2008** | | | |
| Amortized intangible assets (in thousands) | | | |
| Tradenames | $ 1,234 | $ 592 | $ 642 |
| Customer lists | 29,908 | 5,648 | 24,260 |
| Noncompete | 500 | 451 | 49 |
| | $ 31,642 | $ 6,691 | $ 24,951 |
| **As of February 28, 2007** | | | |
| Amortized intangible assets (in thousands) | | | |
| Tradenames | $ 1,234 | $ 442 | $ 792 |
| Customer lists | 24,057 | 3,770 | 20,287 |
| Noncompete | 467 | 417 | 50 |
| | $ 25,758 | $ 4,629 | $ 21,129 |

| | Fiscal Years Ended | |
|---|---|---|
| | **2008** | **2007** |
| Non-amortizing intangible assets (in thousands) Trademarks | $ 63,238 | $ 62,260 |

Aggregate amortization expense for fiscal years 2008, 2007 and 2006 was $2,062,000, $1,957,000, and $2,337,000, respectively.

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**ENNIS, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(6) Goodwill and Other Intangible Assets-continued**

The Company s estimated amortization expense for the next five years is as follows:

| | |
|---|---|
| 2009 | $2,344,000 |
| 2010 | 2,329,000 |
| 2011 | 2,323,000 |
| 2012 | 2,317,000 |
| 2013 | 2,273,000 |

The following table represents changes in the carrying amount of goodwill for the fiscal years ended (in thousands):

| | Print Segment Total | Apparel Segment Total | Total |
|---|---|---|---|
| Balance as of March 1, 2006 | $ 40,580 | $ 137,700 | $ 178,280 |
| Goodwill | 34 | | 34 |
| Balance as of March 1, 2007 | 40,614 | 137,700 | 178,314 |
| Goodwill | 74 | | 74 |
| Balance as of February 29, 2008 | $ 40,688 | $ 137,700 | $ 178,388 |

Adjustments of $74,000 and $34,000 during the fiscal year ended February 29, 2008 and February 28, 2007, respectively, were added to goodwill due to revised estimates in accrued expenses from the previous acquisition of Tennessee Business Forms.

**(7) Other Accrued Expenses**

The following table summarizes the components of other accrued expenses for the fiscal years ended (in thousands):

| | February 29, 2008 | February 28, 2007 |
|---|---|---|
| Accrued interest | $ 604 | $ 975 |
| Accrued taxes | 405 | 424 |
| Accrued legal and professional fees | 244 | 267 |
| Accrued utilities | 1,358 | 786 |
| Accrued repairs and maintenance | 274 | 137 |
| Accrued contract labor | 280 | 355 |
| Factored receivables with recourse | 539 | 772 |
| Other accrued expenses | 1,879 | 1,899 |
| | $ 5,583 | $ 5,615 |

**(8) Long-Term Debt**

Long-term debt consisted of the following at fiscal years ended (in thousands):

| | February 29, 2008 | February 28, 2007 |
|---|---|---|

| | | | | |
|---|---|---|---|---|
| Revolving credit facility | $ | 90,500 | $ | 88,500 |
| Capital lease obligations | | 452 | | 784 |
| Note payable to finance companies | | | | 314 |
| Other | | 13 | | 25 |
| | | 90,965 | | 89,623 |
| Less current installments | | 255 | | 652 |
| Long-term debt | $ | 90,710 | $ | 88,971 |

**ENNIS, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(8) Long-Term Debt-continued**

On March 31, 2006, the Company entered into an amended and restated credit agreement with a group of lenders led by LaSalle Bank N.A. (the Facility ). The Facility provides the Company access to $150 million in revolving credit and matures on March 31, 2010. The facility bears interest at the London Interbank Offered Rate ( LIBOR ) plus a spread ranging from .50% to 1.50% (currently LIBOR + .75% or 3.89% at February 29, 2008), depending on the Company s total funded debt to EBITDA ratio, as defined. As of February 29, 2008, the Company had $90.5 million of borrowings under the revolving credit line and $4.5 million outstanding under standby letters of credit arrangements, leaving the Company availability of approximately $55.0 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, as defined. The Company is in compliance with these covenants as of February 29, 2008. The Facility is secured by substantially all of the Company s assets.

Assets under capital leases have a total gross book value of $1,154,000 and $1,092,000 and the related accumulated amortization of $407,000 and $240,000 for fiscal years ended 2008 and 2007, respectively, and are included in property, plant and equipment. Amortization of assets under capital leases is included in depreciation expense.

Capital lease obligations have interest due monthly at 4.82% to 4.96% and principal paid in equal monthly installments. The notes mature at dates ranging from July 2008 through January 2010.

The Company s long-term debt maturities for the years following February 29, 2008 are as follows (in thousands):

| | Debt | Capital Leases | Total |
|---|---|---|---|
| 2009 | $ 13 | $ 259 | $ 272 |
| 2010 | | 215 | 215 |
| 2011 | 90,500 | | 90,500 |
| | 90,513 | 474 | 90,987 |
| Less amount representing interest | | 22 | 22 |
| | $ 90,513 | $ 452 | $ 90,965 |

**(9) Shareholders Equity**

In fiscal year 1999, the Company adopted a Shareholder Rights Plan, which provides that the holders of the Company s common stock receive one preferred share purchase right (a Right) for each share of the Company s common stock they own. Each Right entitles the holder to buy one one-thousandth of a share of Series A Junior Participating Preferred Stock, par value $10.00 per share, at a purchase price of $27.50 per one one-thousandth of a share, subject to adjustment. The Rights are not currently exercisable, but would become exercisable if certain events occurred relating to a person or group acquiring or attempting to acquire 15% or more of the outstanding shares of common stock of the Company (the Event). Under those circumstances, the holders of the Rights would be entitled to buy shares of the Company s common stock or stock of an acquirer of the Company at a 50% discount. The Rights expire on November 4, 2008, unless earlier redeemed by the Company. At any time prior to the Event, the Board of Directors of the Company may redeem the Rights in whole, but not in part, at a price of $0.01 per Right (the Redemption Price). The redemption of the Rights may be made effective at such time and on such basis and conditions as the Board of Directors, in its sole discretion, may establish. Immediately upon any redemption of the Rights, the right to exercise the Rights will terminate and the only right of the holders of Rights will be to receive the Redemption Price. The terms of the Rights may be amended by the Board of Directors of the Company without the consent of the holders of the Rights, except that from and after such time as any person or group of affiliated or associated persons becomes an Acquiring Person, no such amendment may adversely affect the interests of the holders of the Rights.

The Company s revolving credit facility restricts acquisition of treasury shares and distributions to its shareholders.

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**ENNIS, INC. AND SUBSIDIARIES**
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(10) Stock Option Plans and Stock Based Compensation**

The Company has stock options granted to key executives and managerial employees and non-employee directors. At fiscal year ended 2008, the Company has two stock option plans: the 1998 Option and Restricted Stock Plan amended and restated as of June 17, 2004 and the 1991 Incentive Stock Option Plan ( the Plan ). The Company has 801,705 shares of unissued common stock reserved under the stock option plans for issuance to officers and directors, and supervisory employees of the Company and its subsidiaries. The exercise price of each option granted equals the quoted market price of the Company s common stock on the date of grant, and an option s maximum term is ten years. Options may be granted at different times during the year and vest ratably over various periods, from upon grant to five years. The Company uses treasury stock to satisfy option exercises and restricted stock awards.

Prior to the adoption of FAS 123R, all tax benefits resulting from the exercise of stock options were presented as operating cash flows in the Consolidated Statements of Cash Flows. FAS 123R requires that cash flows from the exercise of stock options resulting from tax benefits in excess of recognized cumulative compensation cost (excess tax benefits) be classified as financing cash flows. For fiscal year 2008 and 2007, $385,000 and $169,000, respectively, of such excess tax benefits were classified as financing cash flows.

The Company had the following stock option activity for the three years ended February 29, 2008:

| | **Number of Shares** *(exact quantity)* | **Weighted Average Exercise Price** | **Weighted Average Remaining Contractual Life** *(in years)* | **Aggregate Intrinsic Value(a)** *(in thousands)* |
|---|---|---|---|---|
| Outstanding at March 1, 2005 | 695,575 | $ 9.67 | 4.9 | |
| Granted | 72,700 | 18.51 | | |
| Terminated | (750) | 10.25 | | |
| Exercised | (79,675) | 9.02 | | |
| Outstanding at February 28, 2006 | 687,850 | $10.63 | 4.6 | |
| Granted | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | | 109,091(17) | 2.83 | 1/12/2027 | | | | |
| | | | | | 94,154(18) | 191,133(19) | | |
| Mitchell W. Pratt | 71,274(2) | | 5.09 | 12/9/2018 | | | | |
| | 52,935(3) | | 6.33 | 1/1/2019 | | | | |
| | 40,000(4) | | 14.06 | 10/8/2019 | | | | |
| | 50,000(5) | | 13.49 | 12/1/2020 | | | | |
| | 50,000(6) | | 14.22 | 1/3/2021 | | | | |
| | 75,000(7) | | 13.09 | 12/12/2022 | | | | |
| | | | | | | | 47,500(8) | 96,425(19) |
| | 40,200(10) | 19,800(10) | 6.01 | 2/27/2025 | | | | |
| | | | | | 16,500(11) | 33,495(19) | | |
| | 47,168(13) | 23,232(13) | 5.02 | 11/16/2025 | | | | |
| | | | | | 9,900(14) | 20,097(19) | | |
| | 5,984(15) | 11,616(15) | 3.63 | 1/5/2026 | | | | |
| | | | | | 19,800(16) | 40,194(19) | | |
| | | 90,909(17) | 2.83 | 1/12/2027 | | | | |
| | | | | | 78,462(18) | 159,278(19) | | |
| Peter J. Grace | 18,184(2) | | 5.09 | 12/9/2018 | | | | |
| | 13,747(3) | | 6.33 | 1/1/2019 | | | | |
| | 40,000(10) | | 6.01 | 2/27/2025 | | | | |

| | | | | | | | | |
|---|---|---|---|---|---|---|---|---|
| | 40,000(15) | | 3.63 | 1/5/2026 | | | | |
| | 75,936(17) | | 2.83 | 1/12/2027 | | | | |
| Barclay F. Corbus | 15,008(2) | | 5.09 | 12/9/2018 | | | | |
| | 54,645(3) | | 6.33 | 1/1/2019 | | | | |
| | 40,000(4) | | 14.06 | 10/8/2019 | | | | |
| | 50,000(5) | | 13.49 | 12/1/2020 | | | | |
| | 50,000(6) | | 14.22 | 1/3/2021 | | | | |
| | 75,000(7) | | 13.09 | 12/12/2022 | | | | |
| | | | | | | | 37,500(8) | 76,125(19) |
| | 33,500(10) | 16,500(10) | 6.01 | 2/27/2025 | | | | |
| | | | | | 13,200(11) | 26,796(19) | | |
| | 53,600(13) | 26,400(13) | 5.02 | 11/16/2025 | | | | |
| | | | | | 7,920(14) | 16,078(19) | | |
| | 6,800(15) | 13,200(15) | 3.63 | 1/5/2026 | | | | |
| | | | | | 15,840(16) | 32,155(19) | | |
| | | 75,936(17) | 2.83 | 1/12/2027 | | | | |
| | | | | | 55,385(18) | 112,432(19) | | |

(1) Except as otherwise noted, all option and RSU awards granted before May 2016 were granted under our 2006 Plan and after May 2016 were granted under our 2016 Plan, and all such awards vest as follows: 34% of the shares subject to the award vest on the first anniversary of the date of grant and 33% of the shares subject to the award vest on each subsequent anniversary until all shares are fully vested, subject to continuing service by the named

executive officer on each vesting date. The treatment of these option and RSU awards upon a termination or change of control is described under "Potential Payments Upon Termination or Change in Control" below.

(2) Represents an option award granted on December 10, 2008.

(3) Represents an option award granted on January 2, 2009.

(4) Represents an option award granted on October 9, 2009.

(5) Represents an option award granted on December 1, 2010.

(6) Represents an option award granted on January 3, 2011.

(7) Represents an option award granted on December 12, 2012.

(8) Represents a PVU award granted under our 2006 Plan on February 2, 2014 (the "2014 PVU Awards"), which will vest if, between February 2, 2016 and February 1, 2018, the closing price of the Company's common stock equals or exceeds $16.11 for 20 consecutive trading days.

(9) Represents an option award granted on November 4, 2014.

(10) Represents an option award granted on February 27, 2015.

(11) Represents an RSU award granted on February 27, 2015.

(12) Represents an option award granted on May 12, 2015.

(13) Represents an option award granted on November 16, 2015.

(14) Represents an RSU award granted on November 16, 2015.

(15) Represents an option award granted on January 5, 2016.

(16) Represents an RSU award granted on January 5, 2016.

(17) Represents an option award granted on January 13, 2017.

(18) Represents an RSU award granted on January 13, 2017.

(19) Amount determined by multiplying the unvested stock awards by $2.03, the closing price of our common stock on December 29, 2017.

**Option Exercises and Stock Vested**

The following table summarizes exercises of option awards (of which there were none) and vesting of stock awards for each of our named executive officers in 2017:

**Stock Awards**

| | Number of Shares Acquired on Vesting (#)(1) | Value Realized on Vesting ($) |
|---|---|---|
| Andrew J. Littlefair | 503,836(2) | 1,286,437(3) |
| Robert M. Vreeland | 20,100(4) | 52,620(5) |
| Mitchell W. Pratt | 382,002(6) | 975,305(7) |
| Peter J. Grace | 121,785(8) | 307,995(9) |
| Barclay F. Corbus | 297,926(10) | 760,671(11) |

(1) Amounts include (a) the fully vested stock awards granted to certain named executive officers at the closing of the BP Transaction on March 31, 2017, and (b) for Mr. Grace, the RSU awards that were held by Mr. Grace and unvested as of the date of his retirement and whose vesting was accelerated pursuant to the terms of the retirement agreement we entered into with Mr. Grace.

(2) Of the shares acquired upon vesting, as of December 31, 2017, (a) no shares had been sold, and (b) 238,493 shares were withheld by the Company to pay the tax withholding obligations that arose upon the vesting of certain stock awards.

(3) Amount determined by adding (a) 13,600 shares vested on January 5, 2017 multiplied by $3.14, the closing price of our common stock on that date; (b) 16,500 shares vested on February 27, 2017 multiplied by $2.54, the closing price of our common stock on that

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date; (c) 460,536 shares vested on March 31, 2017 multiplied by $2.55, the closing price of our common stock on that date; and (d) 13,200 shares vested on November 16, 2017 multiplied by $2.08, the closing price of our common stock on that date.

(4) Of the shares acquired upon vesting, as of December 31, 2017, no shares had been sold.

(5) Amount determined by adding (a) 10,200 shares vested on January 5, 2017 multiplied by $3.14, the closing price of our common stock on that date; and (b) and 9,900 shares vested on November 16, 2017 multiplied by $2.08, the closing price of our common stock on that date.

(6) Of the shares acquired upon vesting, as of December 31, 2017, (a) 4,572 had been sold to generate proceeds used to satisfy tax withholding obligations that arose upon the vesting of certain stock awards, and (b) 148,250 shares were withheld by the Company to pay the tax withholding obligations that arose upon the vesting of certain stock awards.

(7) Amount determined by adding (a) 10,200 shares vested on January 5, 2017 multiplied by $3.14, the closing price of our common stock on that date; (b) 16,500 shares vested on February 27, 2017 multiplied by $2.54, the closing price of our common stock on that date; (c) 345,402 shares vested on March 31, 2017 multiplied by $2.55, the closing price of our common stock on that date; and (d) 9,900 shares vested on November 16, 2017 multiplied by $2.08, the closing price of our common stock on that date.

(8) Of the shares acquired upon vesting, as of December 31, 2017, 15,000 had been sold to generate proceeds used to satisfy tax withholding obligations that arose upon the vesting of certain stock awards.

(9) Amount determined by adding (a) 13,600 shares vested on January 5, 2017 multiplied by $3.14, the closing price of our common stock on that date; (b) 13,200 shares vested on February 27, 2017 multiplied by $2.54, the closing price of our common stock on that date; and (c) 94,985 shares vested on September 15, 2017 (pursuant to the terms of Mr. Grace's retirement agreement) multiplied by $2.44, the closing price of our common stock on that date.

(10) Of the shares acquired upon vesting, as of December 31, 2017, (a) no shares had been sold, and (b) 105,540 shares were withheld by the Company to pay the tax withholding obligations that arose upon the vesting of certain stock awards.

(11) Amount determined by adding (a) 8,160 shares vested on January 5, 2017 multiplied by $3.14, the closing price of our common stock on that date; (b) 13,200 shares vested on February 27, 2017 multiplied by $2.54, the closing price of our common stock on that date; (c) 268,646 shares vested on March 31, 2017 multiplied by $2.55, the closing price of our common stock on that date; and (d) 7,920 shares vested on November 16, 2017 multiplied by $2.08, the closing price of our common stock on that date.

**Employment Agreements**

On December 31, 2015, we entered into an employment agreement with each of our named executive officers. See the description under "Compensation Discussion and Analysis  Employment Agreements" above for more information. In 2017, salary and discretionary cash bonuses, of which there were none, constituted approximately 30%, 37%, 44%, 15% and 47% of the total compensation of Messrs. Littlefair, Vreeland, Pratt, Grace and Corbus, respectively.

**Pension Benefits, Non-Qualified Defined Contribution and Other Deferred Compensation Plans**

We do not have any plans that provide for payments or other benefits to our named executive officers at, following or in connection with their retirement. We also do not have any non-qualified defined contribution plans or other deferred compensation plans that provide for the deferral of compensation on a basis that is not tax-qualified.

**Potential Payments Upon Termination or Change in Control**

The narrative and tables below describe the amount of compensation to be paid to our named executive officers in the event of a termination of employment or a change in control. The amount of compensation payable to each of our named executive officers upon a voluntary termination, voluntary termination for good reason, involuntary without cause termination, failure by us to renew the named executive officer's employment agreement upon its expiration, for-cause termination, change in control of our Company, termination in connection with a change in control and termination due to disability or death is shown in tabular format. Except as otherwise noted, the amounts shown in these tables assume that each such termination or change in control was effective as of December 31, 2017, and thus are estimates of the amounts that would be paid to our named executive officers upon an actual termination or change in control because actual amounts could only be determined at the time such an actual termination or change in control. The amounts shown in these tables are based on the terms of each named executive officer's employment agreement with us, the terms of agreements relating to each named executive officer's outstanding equity awards, and, for Mr. Grace, the terms of his retirement agreement with us.

***Severance Compensation under Employment Agreements and Grace Retirement Agreement***

Pursuant to the terms of the employment agreement for each named executive officer who remained an executive officer of our Company as of December 31, 2017, if we terminate a named executive officer without "cause" (as such term is defined in the employment agreement), if a named executive officer resigns for "good reason" (as such term is defined in the employment agreement) or if we do not renew the employment agreement before expiration of the term or any renewal term, then the named executive officer would be entitled to (1) a lump-sum payment of an amount equal to the sum of (A) his annual base salary earned through the date of termination and any annual cash bonus earned for the prior year to the extent not previously paid, (B) any compensation previously deferred by the named executive officer (together with any accrued interest or earnings thereon), (C) 150% of one year's then-current annual base salary, (D) 150% of his previous year's annual cash bonus actually earned under our performance-based cash bonus plan, and (E) any vacation pay accrued and not paid as of the date of termination; (2) after the end of the calendar year in which the termination occurs, a lump-sum payment of an amount equal to the annual cash bonus that would be payable to the named executive officer under our performance-based cash bonus plan in respect of such year (based on the criteria applicable for that year) without any pro-rating; and (3) continuing participation, at our expense, for a period of one year from the date of termination in the benefit programs in which the named executive officer was enrolled at the time of termination. In addition, if we terminate any such named executive officer's employment without cause or do not renew his employment agreement within six months before or one year after the date of a "change in control" (as such term is defined in the employment agreement), or if a named executive officer resigns for good reason within six months before or one year after the date of the change in control, then the named executive officer would be entitled to the severance benefits described above, except that the lump-sum payment described in (1) above for all named executive officers except Mr. Littlefair would consist of 225% of his then-current annual base salary, 225% of his previous year's annual cash bonus actually earned under our performance-based cash bonus plan, and the amounts described in (A), (B) and (E); and the lump-sum payment described in (1) above for Mr. Littlefair would consist of 300% of his then-current

annual base salary, 300% of his previous year's annual cash bonus actually earned under our performance-based cash bonus plan, and the amounts described in (A), (B) and (E). Additionally, if any such named executive officer ceases to be an employee due to death or disability, then the named executive officer would be entitled to the amounts described in (1)(A), (B) and (E) and (2) above, except that the amount described in (2) above would be pro-rated based on the number of weeks during the last fiscal year during which the named executive officer was an employee. Further, if, at any time that our common stock is not listed or quoted on a national securities exchange or an over-the-counter quotation system, the employment of either of Messrs. Littlefair or Pratt is terminated for cause, we would be entitled, at our option, to repurchase all or a portion of our stock owned by him, or the employment of either of these named executive officers is terminated due to death or disability, we would be required to repurchase all of our stock owned by him. In consideration of the receipt of any severance benefits under an employment agreement and as a precondition to their receipt, each such named executive officer would be required to execute and deliver, and not revoke, a release in favor of us in the form attached to the employment agreement. For purposes of the tables below, we have assumed that the amounts described in (1)(A) and (B) above have already been paid to the applicable named executive officer or are $0.

For purposes of each such named executive officer's employment agreement, (1) "cause" means (A) the named executive officer committing a material act of dishonesty against us, (B) the named executive officer being convicted of a felony involving moral turpitude or (C) the named executive officer committing a material breach of his confidentiality, trade secret, non-solicitation or invention assignment obligations under his employment agreement; (2) "good reason" means the named executive officer resigning from his employment after we (A) have materially diminished the named executive officer's duties, authority, responsibility, annual base salary or annual incentive compensation opportunity, (B) materially breach the employment agreement; (C) change the person to whom the named executive officer reports, or (D) change the location of the named executive officer's principal place of employment; and (3) "change in control" means (A) any "person" (as defined or referred to in Section 3(a)(9) and/or 13(d)(1), et seq. of the Exchange Act and the associated rules of the SEC promulgated thereunder), other than an existing stockholder of the Company as of January 1, 2006, is or becomes the "beneficial owner" (as defined in Rule 13d-3 under the Exchange Act), directly or indirectly, of securities of the Company representing 40% or more of the combined voting power of our then-outstanding securities, or (B) a merger or consolidation of the Company in which its voting securities immediately before the merger or consolidation do not represent, or are not converted into securities that represent, a majority of the combined voting power of all voting securities of the surviving entity immediately after the merger or consolidation, or (C) a sale, lease, exchange or other transfer (in one transaction or a series of related transactions) of all or substantially all of the assets of the Company or a liquidation or dissolution of the Company, or (D) individuals who, as of the date of the employment agreement, constitute the Company's board of directors (the "Incumbent Board") cease for any reason to constitute at least a majority of the Company's board of directors; provided that, other than in connection with an actual or threatened proxy contest, any individual who becomes a director subsequent to the date of the employment agreement whose election, or nomination for election by the stockholders of the Company, was approved by the vote of at least a majority of the directors then in office shall be deemed a member of the Incumbent Board.

Pursuant to the terms of the retirement agreement we entered into with Peter J. Grace, upon Mr. Grace's voluntary retirement, we agreed (1) to pay to Mr. Grace retirement compensation consisting of (a) a cash payment totaling $675,000, equal to 150% of Mr. Grace's annual base salary as of the effective date of his retirement; plus $540,000, equal to 150% of Mr. Grace's annual performance bonus for 2016, on the effective date of his retirement; and (b) a cash payment of $204,196, equal to Mr. Grace's bonus under our 2017 performance-based cash bonus plan, in early 2018 consistent with customary practice for payouts under this bonus plan; (2) to transfer to Mr. Grace title to the CNG vehicle we had furnished to Mr. Grace during the term of his employment on the effective

date of his retirement; (3) to pay the expenses of Mr. Grace's continuing participation, for a period of one year from the effective date of his retirement or, if shorter, until Mr. Grace's eligibility for coverage with a subsequent employer, in the medical and dental benefit programs in which Mr. Grace was enrolled at the effective date of his retirement, and (4) to pay to Mr. Grace any vacation pay accrued and not paid as of the effective date of his retirement. In consideration of Mr. Grace's receipt of these and the other retirement benefits described below and as a precondition to their receipt, Mr. Grace was required to execute and deliver, and not revoke, a release in favor of us in the form attached to the retirement agreement and agree to comply with certain non-disparagement, confidentiality and other similar covenants.

***Vesting of PVUs***

The terms of the PVUs granted to our named executive officers are subject to the following provisions regarding changes in the employment status of a named executive officer: (i) the PVU award will be forfeited in full if the named executive officer's employment with the Company is terminated for cause (as defined in his employment agreement) or voluntarily by the named executive officer before the fourth anniversary of the PVU's grant date ("Termination Date"); (ii) if the named executive officer's employment is terminated by the Company without cause (as defined in his employment agreement) and the Stock Price Hurdle is subsequently satisfied before the Termination Date, the Time-Vested Percentage (as defined in the PVU award agreement) of the PVUs will vest on the date the Stock Price Hurdle is satisfied; (iii) if the named executive officer ceases to be an employee due to death or disability, the Time-Vested Percentage of the PVUs will immediately vest; and (iv) if the Company experiences a "change in control," as defined in the 2006 Plan or the 2016 Plan, as applicable, before the Termination Date, 100% of the PVUs will vest if the per share consideration received by holders of common stock in connection with such change in control equals or exceeds the Stock Price Hurdle. For purposes of the PVU award agreements, "Time-Vested Percentage" means (1) the quotient of (A) the number of full months that have elapsed from the PVU's grant date up to the date of the holder's termination of service, divided by (B) forty-eight, multiplied by (2) one hundred, provided that the Time-Vested Percentage shall never exceed one hundred.

As of December 31, 2017, the only outstanding PVUs granted to our named executive officers were the 2014 PVUs. In light of the closing price of our common stock on December 31, 2017, we have assumed for purposes of the tables below that, had a change in control occurred as of such date, the per share consideration received by holders of our common stock in connection with such change in control would not have exceeded the Stock Price Hurdle for the 2014 PVUs, which is $16.11.

***Vesting of Option and RSU Awards***

The terms of the option awards granted to our named executive officers provide that all unvested options will be forfeited if the named executive officer's employment with the Company is terminated for any reason, and that all vested options will generally continue to be exercisable for three months after the date of any such termination. The terms of the RSU awards granted to our named executive officers provide that all unvested RSUs will be forfeited if the named executive officer's employment with the Company is terminated by the Company for cause (as defined in his employment agreement) or voluntarily by the named executive officer before their vesting date, and that all unvested RSUs will vest in full if the named executive officer's employment is terminated by the Company without cause (as defined in his employment agreement) or if the named executive officer ceases to be an employee due to death or disability before their vesting date.

Notwithstanding the above, pursuant to the terms of Mr. Grace's retirement agreement, we agreed, upon Mr. Grace's voluntary retirement, (1) to accelerate the vesting of all of Mr. Grace's RSUs that were outstanding and unvested as of the effective date of his retirement, covering 94,985 shares of our common stock; and (2) to accelerate the vesting of certain of Mr. Grace's options that were

outstanding and unvested as of the effective date of his retirement, totaling options to purchase up to 187,867 shares of our common stock at exercise prices ranging from $2.83 to $6.33 per share, and extend the post-termination exercise period for these options to the original termination date for each such option.

If the Company experiences a "change in control," as defined in the 2006 Plan or the 2016 Plan, as applicable, then (1) the option and RSU awards granted before November 2014 to each named executive officer who remained an executive officer of our Company as of December 31, 2017 and that are outstanding on the date that immediately precedes the change in control will immediately vest in full and, if applicable, become fully exercisable on that date, and (2) each such named executive officer's option and RSU awards granted after November 2014 that are outstanding on the date that immediately precedes the change in control will (A) if such awards are not assumed or replaced by the successor company in the change in control, immediately vest in full and, if applicable, become fully exercisable on the date of the change in control, or (B) if such awards are assumed or replaced by the successor company in the change in control but the named executive officer's employment is terminated by the successor company without cause or by the named executive officer for good reason within 12 months following the change in control (based on the definitions of "cause" and "good reason" in his employment agreement with us), immediately vest in full and, if applicable, become fully exercisable on the date of such termination. For purposes of the tables below, except as otherwise noted for Mr. Grace, no amounts are shown for the vesting of outstanding option awards because all unvested options as of December 31, 2017 had exercise prices that exceeded $2.03 per share, which was the closing price of our common stock on December 29, 2017.

***Potential Payments to Each Named Executive Officer***

*Andrew J. Littlefair*

The following table shows the potential cash payments or other benefits to be provided to our President and Chief Executive Officer, Andrew J. Littlefair, had a termination and/or a change in control occurred as of December 31, 2017:

| **Benefit and Payments** | **Voluntary Termination** | **Voluntary Termination for Good Reason** | **Involuntary Without Cause Termination** | **Failure to Renew Employment Agreement** | **For-Cause Termination** | **Change in Control** | **Voluntary Termination for Good Reason in connection with a Change in Control** | **Involuntary Without Cause Termination in connection with a Change in Control** | **Termination Due to Disability** | **Termination Due to Death** |
|---|---|---|---|---|---|---|---|---|---|---|
| Cash Severance Payment | | $ 3,031,951 | $ 3,031,951 | $ 3,031,951 | | | $ 5,551,411 | $ 5,551,411 | | |
| Continuation of Medical/Welfare Benefits (present value) | | $ 19,334 | $ 19,334 | $ 19,334 | | | $ 19,334 | $ 19,334 | | |
| Vacation Pay | $ 82,548 | $ 82,548 | $ 82,548 | $ 82,548 | $ 82,548 | | $ 82,548 | $ 82,548 | $ 82,548 | $ 82,548 |
| PVU Vesting(1) | | | | | | | | | $ 145,906 | $ 145,906 |
| RSU Vesting(2) | | | $ 571,102 | $ 571,102 | | | $ 571,102 | $ 571,102 | $ 571,102 | $ 571,102 |
| Total: | $ 82,548 | $ 3,133,833 | $ 3,704,935 | $ 3,704,935 | $ 82,548 | | $ 6,224,395 | $ 6,224,395 | $ 2,979,443 | $ 2,979,443 |

(1) At December 31, 2017, the Time-Vested Percentage of the 2014 PVUs was 95.83%, or 145,906 shares. The amounts in this row were determined by multiplying the 71,875 shares by $2.03, the closing price of our common stock on December 29, 2017.

(2) At December 31, 2017, Mr. Littlefair held 281,331 RSUs that had not vested, all of which were granted after November 2014. The amounts in this row were determined by multiplying the unvested RSUs by $2.03, the closing price of our common stock on December 29, 2017.

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*Robert M. Vreeland*

The following table shows the potential cash payments or other benefits to be provided to our Chief Financial Officer, Robert M. Vreeland, had a termination and/or a change in control occurred as of December 31, 2017:

| Benefit and Payments | Voluntary Termination | Voluntary Termination for Good Reason | Involuntary Without Cause Termination | Failure to Renew Employment Agreement | For-Cause Termination | Change in Control | Voluntary Termination for Good Reason in connection with a Change in Control | Involuntary Without Cause Termination in connection with a Change in Control | Termination Due to Disability | Termination Due to Death |
|---|---|---|---|---|---|---|---|---|---|---|
| Cash Severance Payment | | $ 1,157,718 | $ 1,157,718 | $ 1,157,718 | | | $ 1,650,815 | $ 1,650,815 | | |
| Continuation of Medical/Welfare Benefits (present value) | | $ 7,115 | $ 7,115 | $ 7,115 | | | $ 7,115 | $ 7,115 | | |
| Vacation Pay | $ 40,361 | $ 40,361 | $ 40,361 | $ 40,361 | $ 40,361 | | $ 40,361 | $ 40,361 | $ 40,361 | $ 40,361 |
| RSU Vesting(1) | | | $ 251,424 | $ 251,424 | | | $ 251,424 | $ 251,424 | $ 251,424 | $ 251,424 |
| Total: | $ 40,361 | $ 1,205,194 | $ 1,456,618 | $ 1,456,618 | $ 40,361 | | $ 1,949,715 | $ 1,949,715 | $ 291,785 | $ 291,785 |

(1) At December 31, 2017, Mr. Vreeland held 123,854 RSUs that had not vested, all which were granted after November 2014. The amounts in this row were determined by multiplying the unvested RSUs by $2.03, the closing price of our common stock on December 29, 2017.

*Mitchell W. Pratt*

The following table shows the potential cash payments or other benefits to be provided to our Chief Operating Officer and Corporate Secretary, Mitchell W. Pratt, had a termination and/or a change in control occurred as of December 31, 2017:

| Benefit and Payments | Voluntary Termination | Voluntary Termination for Good Reason | Involuntary Without Cause Termination | Failure to Renew Employment Agreement | For-Cause Termination | Change in Control | Voluntary Termination for Good Reason in connection with a Change in Control | Involuntary Without Cause Termination in connection with a Change in Control | Termination Due to Disability | Termination Due to Death |
|---|---|---|---|---|---|---|---|---|---|---|
| Cash Severance Payment | | $ 1,517,808 | $ 1,517,808 | $ 1,517,808 | | | $ 2,167,519 | $ 2,167,519 | | |
| Continuation of Medical/Welfare Benefits (present value) | | $ 14,536 | $ 14,536 | $ 14,536 | | | $ 14,536 | $ 14,536 | | |
| Vacation Pay | $ 56,688 | $ 56,688 | $ 56,688 | $ 56,688 | $ 56,688 | | $ 56,688 | $ 56,688 | $ 56,688 | $ 56,688 |
| PVU Vesting(1) | | | | | | | | | $ 92,408 | $ 92,408 |
| RSU Vesting(2) | | | $ 253,064 | $ 253,064 | | | $ 253,064 | $ 253,064 | $ 253,064 | $ 253,064 |
| Total: | $ 56,688 | $ 1,589,032 | $ 1,842,096 | $ 1,842,096 | $ 56,688 | | $ 2,491,807 | $ 2,491,807 | $ 1,297,366 | $ 1,297,366 |

(1)

At December 31, 2017, the Time-Vested Percentage of the 2014 PVUs was 95.83%, or 92,407 shares. The amounts in this row were determined by multiplying the 45,521 shares by $2.03, the closing price of our common stock on December 29, 2017.

(2) At December 31, 2017, Mr. Pratt held 124,662 RSUs that had not vested, all which were granted after November 2014. The amounts in this row were determined by multiplying the unvested RSUs by $2.03, the closing price of our common stock on December 29, 2017.

*Peter J. Grace*

Mr. Grace voluntarily retired from his employment with our Company effective September 15, 2017. In connection with such retirement and pursuant to the terms of the retirement agreement we

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entered into with Mr. Grace, we paid or provided to Mr. Grace the following cash payments or other benefits:

| Benefit and Payments under Retirement Agreement | Voluntary Retirement |
|---|---|
| Cash Severance Payment | $ 1,215,000 |
| Non-Equity Incentive Plan Compensation | $ 204,196 |
| CNG Vehicle(1) | $ 15,598 |
| Option Vesting(2) | $ 145,193 |
| RSU Vesting(2) | $ 3,284 |
| Continuation of Medical/Welfare Benefits | $ 8,994 |
| Vacation Pay | $ 51,923 |
| Total: | $ 1,644,188 |

(1) Reflects the fair value of the CNG vehicle whose title we transferred to Mr. Grace upon his retirement.

(2) Reflects the aggregate incremental fair value of Mr. Grace's modified option and RSU awards as a result of the acceleration of the vesting of all such awards that were unvested as of the effective date of his retirement and the extension of the post-termination exercise period of all such option awards. Such awards consist of (A) an RSU award granted on February 27, 2015 for 43,500 shares of common stock, 13,200 of which were unvested as of the effective date of his retirement; (B) an RSU award granted on January 5, 2016 for 40,000 shares of our common stock, 26,400 of which were unvested as of the effective date of his retirement; (C) an RSU award granted on January 13, 2017 for 55,385 shares of our common stock, all of which were unvested as of the effective date of his retirement; (D) an option award granted on December 10, 2008 for 18,184 shares of common stock, none of which were unvested as of the effective date of his retirement; (E) an option award granted on January 2, 2009 for 13,747 shares of common stock, none of which were unvested as of the effective date of his retirement; (F) an option award granted on February 27, 2015 for 40,000 shares of common stock, 13,200 of which were unvested as of the effective date of his retirement; (G) an option award granted on January 5, 2016 for 40,000 shares of common stock, 26,400 of which were unvested as of the effective date of his retirement; and (H) an option award granted on January 13, 2017 for 75,936 shares of common stock, all of which were unvested as of the effective date of his retirement. In accordance with FASB ASC 718, the incremental fair value of each such award is calculated as the fair value of the modified award at the date of the modification, less the fair value of the original award at the date of the modification.

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*Barclay F. Corbus*

The following table shows the potential cash payments or other benefits to be provided to our Senior Vice President, Strategic Development, Barclay F. Corbus, had a termination and/or a change in control occurred as of December 31, 2017:

| Benefit and Payments | Voluntary Termination | Voluntary Termination for Good Reason | Involuntary Without Cause Termination | Failure to Renew Employment Agreement | For-Cause Termination | Change in Control | Voluntary Termination for Good Reason in connection with a Change in Control | Involuntary Without Cause Termination in connection with a Change in Control | Termination Due to Disability | Termination Due to Death |
|---|---|---|---|---|---|---|---|---|---|---|
| Cash Severance Payment | $ 0 | $ 1,398,429 | $ 1,398,429 | $ 1,398,429 | | | $ 1,997,039 | $ 1,997,039 | | |
| Continuation of Medical/Welfare Benefits (present value) | $ 0 | $ 19,334 | $ 19,334 | $ 19,334 | | | $ 19,334 | $ 19,334 | | |
| Vacation Pay | $ 52,229 | $ 52,229 | $ 52,229 | $ 52,229 | $ 52,229 | | $ 52,229 | $ 52,229 | $ 52,229 | $ 52,229 |
| PVU Vesting(1) | $ 0 | $ 0 | $ 0 | | | | | | $ 72,954 | $ 72,954 |
| RSU Vesting(2) | $ 0 | $ 0 | $ 187,460 | $ 187,460 | | | $ 187,460 | $ 187,460 | $ 187,460 | $ 187,460 |
| Total: | $ 52,229 | $ 1,469,992 | $ 1,657,452 | $ 1,657,452 | $ 52,229 | | $ 2,256,062 | $ 2,256,062 | $ 312,643 | $ 312,643 |

(1) At December 31, 2017, the Time-Vested Percentage of the 2014 PVUs was 95.83%, or 72,953 shares. The amounts in this row were determined by multiplying the 35,938 shares by $2.03, the closing price of our common stock on December 29, 2017.

(2) At December 31, 2017, Mr. Corbus held 92,345 RSUs that had not vested, all which were granted after November 2014. The amounts in this row were determined by multiplying the unvested RSUs by $2.03, the closing price of our common stock on December 29, 2017.

**Pay Ratio**

We are required by applicable SEC rules to disclose the annual total compensation of our Chief Executive Officer, the median annual total compensation of all of our other employees, and the ratio of these two amounts.

In determining the median annual total compensation of our employees other than our Chief Executive Officer, we started by preparing a list of all such employees as of December 31, 2017 and each such employee's taxable earnings for 2017 as reflected in our payroll records, which generally consists of salary; regular, hourly, and overtime wages; commissions; bonuses and other miscellaneous earnings. This list includes all of our employees on such date (except solely for our Chief Executive Officer), whether employed on a full-time, part-time, seasonal or temporary basis and wherever located, resulting in 411 employees who are all located in the United States. For any such employees who are permanently employed (in other words, who are not employed on a seasonal or temporary basis) and who joined the Company after January 1, 2017, this list reflects 2017 taxable earnings on an annualized basis. We then ordered the employees in this list based on the amounts of their 2017 taxable earnings, selected the single employee at the midpoint of the re-ordered list, and calculated the amount of this single midpoint employee's annual total compensation using the methodology required by SEC rules for calculating the total compensation of our named executive officers as reported in the Summary Compensation Table above. In order to determine whether the single midpoint employee's compensation had any anomalous characteristics, we then calculated the amount of the annual total compensation, also using the methodology required by SEC rules for calculating the total compensation of our named executive officers as reported in the Summary Compensation Table above, for the six other employees nearest to the single midpoint employee in the re-ordered list, and compared the annual total compensation of all seven of these employees. Based on this comparison, we determined that the single midpoint employee's annual total compensation is not anomalous to other employees with similar compensation levels, and as a result, the amount of the single midpoint employee's annual total compensation, which is $98,100, is considered the median annual total compensation of all of our employees other than our Chief Executive Officer for 2017. Utilizing this amount, as well as the annual total compensation of our Chief Executive Officer for 2017 of $2,307,533 as shown in the Summary

Compensation Table above, we estimate the ratio of the annual total compensation of our Chief Executive Officer to the median annual total compensation of all of our other employees is 23 to 1.

This pay ratio is a reasonable estimate calculated in a manner consistent with applicable SEC rules. In light of the many different methodologies, exclusions, estimates and assumptions companies are permitted to use in determining an estimate of their respective pay ratios, as well as the differing employment and compensation practices and industry standards that impact these ratios, our estimated pay ratio information may not be comparable to the pay ratio information reported by other companies and we discourage the use of this information as a basis for comparison between companies. Neither our compensation committee nor our management used our pay ratio information in making compensation decisions for 2017 or 2018.

**Risks Related to Compensation Policies and Practices**

The compensation committee regularly monitors and considers whether our overall compensation programs, including our executive compensation program, creates incentives for employees to take excessive or unreasonable risks that could materially harm our Company. Although risk-taking is a necessary part of any business, the compensation committee focuses on aligning the Company's compensation policies with the long-term interests of the Company and its stockholders and avoiding short-term rewards for management decisions that could pose long-term risks to the Company. Although a portion of our executive compensation plan is performance-based, which could motivate risk-taking, we do not believe our overall compensation structure encourages excessive or unnecessary risk-taking. We believe our approach to goal-setting, the mix of different types of compensation, payouts at multiple levels of performance, evaluation of performance results, and allowance for compensation committee discretion in determining award types, levels and payouts assist in mitigating these risks, as follows:

- Our compensation structure includes a combination of compensation vehicles, including a competitive base salary and benefits generally available to our employees, equity awards to incentivize long-term performance and align the interests of our employees with those of our stockholders, annual cash bonuses to reward executives for achieving Company objectives, and change in control and post-termination severance benefits to encourage retention of our key executives.

- To discourage excessive or unnecessary risk-taking, for 2017, payouts to each named executive officer under our performance-based cash bonus plan were based on four distinct performance metrics, each with material weighting, as follows: 33% was based on our adjusted EBITDA; 33% was based on the volume of GGEs of natural gas we delivered; 22% was based on the achievement of certain specified strategic initiatives; and 20% was based on our volume margin. Additionally, the compensation committee retains the discretion to increase or decrease payouts under this bonus plan as it deems appropriate.

- To help mitigate risks of overpayment due to fraudulent, intentional or grossly negligent errors, our clawback policy permits us, under certain circumstances, to recover certain cash compensation in the event of a restatement of our financial statements or excess payments of performance-based compensation in the event of a restatement or other adjustment of the performance measures on which the payments are based.

We further believe that our internal legal and financial controls appropriately mitigate the probability and potential impact of an individual employee committing our Company to a harmful long-term business transaction in exchange for a short-term compensation benefit.

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## DIRECTOR COMPENSATION

### Overview

We use cash and equity compensation to attract and retain qualified candidates to serve on our Board. In setting non-employee director compensation, we consider the significant amount of time that our directors spend in fulfilling their duties to our Company, as well as the level of experience and skill required of the members of the Board. We have also awarded compensation to individual non-employee directors or directors serving in certain positions on our Board or its committees in recognition of outstanding service or efforts on the Company's behalf. Further, in setting director compensation, our compensation committee considers that a director's independence may be jeopardized if director compensation and perquisites exceed customary levels, if the Company makes charitable or political contributions to organizations with which a director is affiliated or if the Company enters into consulting contracts with (or provides other indirect forms of compensation to) a director or an organization with which a director is affiliated. Directors who are our employees receive no additional compensation for their services as directors.

In November 2016, the compensation committee conducted a review of our non-employee director compensation. In the course of such review, the committee considered, among other things, a comparative market analysis prepared for the committee by Semler Brossy. As a result of this review, the committee approved the non-employee director compensation program described below for 2017 compensation.

***Cash***

For 2017, our non-employee directors received the following cash compensation:

- All of our non-employee directors receive base cash compensation of $60,000 per year;
- Audit committee members (other than the Chairman) receive an additional $2,500 in cash compensation per year in recognition of their additional responsibilities;
- The Chairman of the audit committee receives an additional $10,000 per year in recognition of his additional responsibilities; and
- The Chairman of the Board receives an additional $60,000 per year in recognition of his additional responsibilities.

***Equity***

For 2017, each non-employee director received, on the date of the Company's annual meeting of stockholders, a stock award for a number of shares equal to a grant date fair value of approximately $100,000, all of which were fully vested upon grant.

**Director Compensation Table**

The following table summarizes the compensation we paid to directors who are not employees of our Company for 2017:

| Name(1) | Fees Earned or Paid in Cash ($) | Stock Awards(2) ($) | Total ($) |
|---|---|---|---|
| Warren I. Mitchell(3) | 120,000 | 99,998 | 219,998 |
| John S. Herrington(4) | 61,875 | 99,998 | 161,873 |
| James C. Miller III(5) | 70,000 | 99,998 | 169,998 |
| T. Boone Pickens(6) | 60,000 | 99,998 | 159,998 |
| Kenneth M. Socha(7) | 60,000 | 99,998 | 159,998 |
| Vincent C. Taormina(8) | 61,875 | 99,998 | 161,873 |
| James E. O'Connor(9) | 60,000 | 99,998 | 159,998 |
| Stephen A. Scully(10) | 61,875 | 99,998 | 161,873 |

(1) Andrew J. Littlefair, our President and Chief Executive Officer, is not included in this table because he is an employee of the Company and thus receives no additional compensation for his services as a director. The compensation received by Mr. Littlefair as an employee of the Company is shown in the Summary Compensation Table above.

(2) On May 24, 2017, each of our non-employee directors was granted an RSU award for 41,493 shares of common stock. The amounts shown in this column represent the grant date fair value of these RSU awards calculated in accordance with FASB ASC 718 (for a discussion regarding the valuation model and assumptions used to calculate the fair value of these awards, see note 12 to the consolidated financial statements included in the Annual Report).

(3) As of December 31, 2017, Mr. Mitchell had fully vested and outstanding options to purchase the following: 25,977 shares at an exercise price of $5.09; 19,638 shares at an exercise price of $6.33; 20,000 shares at an exercise price of $14.06; 20,000 shares at an exercise price of $13.49; 20,000 shares at an exercise price of $14.22; 25,000 shares at an exercise price of $15.11; 20,000 shares at an exercise price of $13.09; 20,000 shares at an exercise price of $11.93; and 20,000 shares at an exercise price of $5.54. As of December 31, 2017, Mr. Mitchell had fully vested stock awards of 89,118 shares.

(4) As of December 31, 2017, Mr. Herrington had fully vested and outstanding options to purchase the following: 25,977 shares at an exercise price of $5.09; 19,638 shares at an exercise price of $6.33; 20,000 shares at an exercise price of $14.06; 20,000 shares at an exercise price of $13.49; 20,000 shares at an exercise price of $14.22; 25,000 shares at an exercise price of $15.11; 20,000 shares at an exercise price of $13.09; 20,000 shares at an exercise price of $11.93; and 20,000 shares at an exercise price of $5.54. As of December 31, 2017, Mr. Herrington had fully vested stock awards of 89,118 shares.

(5) As of December 31, 2017, Mr. Miller had fully vested and outstanding options to purchase the following: 17,145 shares at an exercise price of $5.09; 12,961 shares at an exercise price of $6.33; 20,000 shares at an exercise price of $14.06; 20,000 shares at an exercise price of $13.49; 20,000 shares at an exercise price of $14.22; 25,000 shares at an exercise price of $15.11; 20,000 shares at an exercise price of $13.09; 20,000 shares at an exercise price of $11.93; and 20,000 shares at an exercise price of $5.54. As of December 31, 2017, Mr. Miller had fully vested stock awards of 89,118 shares.

(6) As of December 31, 2017, Mr. Pickens had fully vested and outstanding options to purchase the following: 113,897 shares at an exercise price of $5.09; 86,103 shares at an exercise price of $6.33; 400,000 shares at an exercise price of $14.06; 20,000 shares at an exercise price of $13.49; 20,000 shares at an exercise price of $14.22; 25,000 shares at an exercise price of $15.11; 20,000 shares at an exercise price of $13.09; 20,000 shares at an exercise price of $11.93; and 20,000 shares at an exercise price of $5.54. As of December 31, 2017, Mr. Pickens had fully vested stock awards of 89,118 shares.

(7) As of December 31, 2017, Mr. Socha had fully vested and outstanding options to purchase the following: 10,000 shares at an exercise price of $5.09; 19,638 shares at an exercise price of $6.33; 20,000 shares at an exercise price of $14.06; 20,000 shares at an exercise price of $13.49; 20,000 shares at an exercise price of $14.22; 25,000 shares at an exercise price of $15.11; 20,000 shares at an exercise price of $13.09; 20,000 shares at an exercise price of $11.93; and 20,000 shares at an exercise price of $5.54. As of December 31, 2017, Mr. Socha had fully vested stock awards of 89,118 shares.

(8) As of December 31, 2017, Mr. Taormina had fully vested and outstanding options to purchase the following: 25,000 shares at an exercise price of $14.43; 25,977 shares at an exercise price of $5.09; 19,638 shares at an exercise price of $6.33; 20,000 shares at an exercise price of $14.06; 20,000 shares at an exercise price of $13.49; 20,000 shares at an exercise price of $14.22; 25,000 shares at an exercise price of $15.11; 20,000 shares at an exercise price of $13.09; 20,000 shares at an exercise price of $11.93; and 20,000 shares at an exercise price of $5.54. As of December 31, 2017, Mr. Taormina had fully vested stock awards of 89,118 shares.

(9) As of December 31, 2017, Mr. O'Connor had fully vested and outstanding options to purchase the following: 25,000 shares at an exercise price of $15.11; 20,000 shares at an exercise price of $13.09; 20,000 shares at an exercise price of $11.93; and 20,000 shares at an exercise price of $5.54. As of December 31, 2017, Mr. O'Connor had fully vested stock awards of 89,118 shares.

(10) As of December 31, 2017, Mr. Scully had fully vested and outstanding options to purchase the following: 20,000 shares at an exercise price of $11.93; and 20,000 shares at an exercise price of $5.54. As of December 31, 2017, Mr. Scully had fully vested stock awards of 89,118 shares.

## EQUITY COMPENSATION PLANS

The Company currently maintains, or has in the past maintained, the following three equity compensation plans: the 2006 Plan, the 2016 Plan and the ESPP, each of which is described below.

***2006 Plan***

Our 2006 Plan was initially adopted by our Board and approved by our stockholders in December 2006. Upon the approval by our stockholders of the 2016 Plan in May 2016, the share reserve that was then available for grant under the 2006 Plan was cancelled and all grants of awards since then have been made under the 2016 Plan. If any outstanding award under the 2006 Plan expires or is cancelled, the shares allocable to the unexercised or unsettled portion of that award will be added to the share reserve under the 2016 Plan and will be available for grant under the 2016 Plan. The terms of the 2016 Plan are described under "2016 Plan" below.

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*Share Limit*

No participant in the 2006 Plan can receive option grants, stock appreciation rights or stock awards for more than 2,000,000 shares total in any calendar year, or for more than 4,000,000 shares total in connection with the participant's initial service.

*Administration*

The 2006 Plan is to be administered by our Board or the compensation committee of the Board. In the case of options intended to qualify as "performance-based compensation" within the meaning of Section 162(m), the administrator of the plan will consist of two or more outside directors within the meaning of Section 162(m). The administrator has the authority, in its sole discretion:

To select the recipients to whom options, stock awards, stock appreciation rights and cash awards may, from time to time, be granted under the 2006 Plan,

To determine whether and to what extent options, stock awards, stock appreciation rights and cash awards are granted under the 2006 Plan,

To determine the number of shares that are covered by options, stock awards, and stock appreciation rights and the terms of the related agreements,

To determine the terms and conditions of any options, stock awards and stock appreciation rights, including exercise price, the method of payment of the exercise price, term, vesting and whether an option is a non-statutory stock option or an incentive stock option, and

To construe and interpret the terms of the 2006 Plan and agreements and other documentation related to the 2006 Plan.

*Eligibility*

The 2006 Plan provides for the grant of options to purchase shares of common stock, stock awards, stock appreciation rights and cash awards. Incentive stock options may be granted only to employees. Non-statutory stock options and other stock-based awards may be granted to employees, non-employee directors, advisors and consultants.

*Vesting*

Although the 2006 Plan provides the administrator with the discretion to determine the vesting schedule, options (other than the initial option grants) and stock awards (other than initial stock awards) granted under the 2006 Plan generally vest over three years, at a rate of 34%, 33%, and 33% per year, respectively, if the grantee is then in service to the Company.

*Adjustments Upon Change in Control*

The 2006 Plan provides that in the event of a "change in control," as defined in the 2006 Plan, all awards outstanding on the date that immediately precedes the change in control will become immediately exercisable on that date, unless otherwise expressly provided in the award agreement.

*Amendment and Termination*

The 2006 Plan terminates 10 years after its initial adoption, unless earlier terminated by the Board. The Board or the compensation committee may amend or terminate the plan at any time, subject to stockholder approval where required by applicable law. Any amendment or termination may not impair the rights of holders of outstanding awards without their consent.

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***2016 Plan***

The 2016 Plan was adopted by our Board in February 2016 and approved by our stockholders in May 2016. Under the 2016 Plan, at December 31, 2017, 10,607,640 shares of common stock were authorized for issuance and 4,823,956 shares were available for grants of future awards.

*Authorized Shares; Limits on Awards.*

The maximum number of shares of the Company's common stock that may be issued or transferred pursuant to awards under the 2016 Plan equals the sum of: (1) 6,050,000 shares, plus (2) the number of any shares subject to stock options granted under our predecessor equity incentive plans, including the 2006 Plan, and outstanding as of the date of adoption of the 2016 Plan and that expire, or for any reason are cancelled or terminated, after such date without being exercised, plus (3) the number of any shares subject to restricted stock and restricted stock unit awards granted under our predecessor equity incentive plans, including the 2006 Plan, that are outstanding and unvested as of the date of adoption of the 2016 Plan and that are forfeited, terminated, cancelled, or otherwise reacquired after such date without having become vested (such total number of shares, the "Share Limit"). As of April 10, 2018, approximately 7,773,963 shares were subject to awards then outstanding under our predecessor equity incentive plans. As noted above, no additional awards have been or will be granted under the 2006 Plan or any other predecessor equity incentive plans following the date of adoption of the 2016 Plan.

Shares issued in respect of any "full-value" award granted under the 2016 Plan will be counted against the Share Limit as 1.5 shares for every one share actually issued in connection with the award. For example, if the Company granted a bonus of 100 shares of its common stock under the 2016 Plan, 150 shares would be counted against the Share Limit with respect to that award. For this purpose, a "full-value" award generally means any award granted under the 2016 Plan other than a stock option or stock appreciation right ("SAR").

The following other limits are also contained in the 2016 Plan:

- The maximum number of shares that may be delivered pursuant to options qualified as incentive stock options granted under the plan is 6,050,000 shares;

- The maximum number of shares subject to those options and SARs that are granted under the plan during any one calendar year to any one individual is 2,000,000 shares;

- The maximum number of shares subject to all awards that are granted under the plan during any one calendar year to any one individual is 2,000,000 shares;

- The maximum grant date fair value for awards granted to a non-employee director under the 2016 Plan during any one calendar year is $400,000, except that this limit will be $600,000 as to (1) a non-employee independent director who is serving as the Chairman of the Board or the lead independent director (if there is one) at the time the applicable grant is made or (2) any new non-employee director for the calendar year in which the non-employee director is first elected or appointed to the Board. For purposes of this limit, the "grant date fair value" of an award means the value of the award on the date of grant of the award determined using the equity award valuation principles applied in the Company's financial reporting. This limit does not apply to, and will be determined without taking into account, any award granted to an individual who, on the grant date of the award, is an officer or employee of the Company or one of its subsidiaries. This limit applies on an individual basis and not on an aggregate basis to all non-employee directors as a group; and

- The maximum number of shares subject to awards granted with performance-based vesting requirements and intended to qualify as performance-based awards within the meaning of

Section 162(m) ("Qualified Performance-Based Awards") granted during any one calendar year to any one participant (including Qualified Performance-Based Awards payable in shares and Qualified Performance-Based Awards payable in cash upon or following vesting of the award where the amount of such payment is determined with reference to the fair market value of a share at such time) is 2,000,000 shares (counting such shares on a one-for-one basis for this purpose). The maximum amount that may be paid to any one participant in respect of all Qualified Performance-Based Awards payable only in cash (other than the cash awards referred to in the preceding sentence) and granted to that participant in any one calendar year is $3,000,000.

For purposes of determining the Share Limit, the 2016 Plan provides as follows:

Except as described below, shares that are subject to or underlie awards which expire or for any reason are cancelled or terminated, are forfeited, fail to vest, or for any other reason are not paid or delivered under the 2016 Plan will not be counted against the Share Limit and will again be available for subsequent awards under the 2016 Plan;

Shares that are exchanged by a participant or withheld by the Company as full or partial payment in connection with any award under the 2016 Plan (whether a stock option, SAR or other "full-value" award), as well as any shares exchanged by a participant or withheld by the Company or one of its subsidiaries to satisfy the tax withholding obligations related to any award (whether a stock option, SAR or other "full-value" award), will be counted against the Share Limit and will not be available for subsequent awards under the 2016 Plan;

Any shares repurchased with the proceeds of any option exercise price shall not be available for awards under the 2016 Plan;

To the extent that shares are delivered pursuant to the exercise of a stock appreciation right granted under the 2016 Plan, the number of underlying shares as to which the exercise related will be counted against the Share Limit (for purposes of clarity, if a stock appreciation right relates to 100,000 shares and is exercised at a time when the payment due to the participant is 15,000 shares, 100,000 shares will be charged against the Share Limit with respect to such exercise);

Shares that are exchanged by a participant or withheld by the Company after the date of adoption of the 2016 Plan as full or partial payment in connection with any award granted under our predecessor equity incentive plans, as well as any shares exchanged by a participant or withheld by the Company after the date of adoption of the 2016 Plan to satisfy the tax withholding obligations related to any award granted under our predecessor equity incentive plans, will not be available for new awards under the 2016 Plan;

To the extent that an award is settled in cash or a form other than shares, the shares that would have been delivered had there been no such cash or other settlement will not be counted against the Share Limit and will again be available for subsequent awards under the 2016 Plan;

In the event that shares are delivered in respect of a dividend equivalent right, the actual number of shares delivered with respect to the award will be counted against the Share Limit (for purposes of clarity, if 1,000 dividend equivalent rights are granted and outstanding when the Company pays a dividend, and 50 shares are delivered in payment of those rights with respect to that dividend, 75 shares (after giving effect to the "full-value" award premium counting rules) will be counted against the Share Limit);

Except as otherwise provided by the administrator of the 2016 Plan, shares delivered in respect of dividend equivalent rights will not count against any individual award limit under the 2016 Plan other than the aggregate Share Limit;

Shares issued in connection with awards that are granted by or become obligations of the Company through the assumption of awards (or in substitution for awards) in connection with an acquisition of another company will not count against the shares available for issuance under the 2016 Plan; and

The Company may not increase the applicable share limits of the 2016 Plan by repurchasing shares of common stock on the market (by using cash received through the exercise of stock options or otherwise).

*Administration*

Our Board has delegated general administrative authority for the 2016 Plan to the compensation committee. The committee may delegate some or all of its authority with respect to the 2016 Plan to another committee of directors, and certain limited authority to grant awards to employees may be delegated to one or more officers of the Company.

The administrator has broad authority under the 2016 Plan, including, without limitation, the authority:

To select eligible participants and determine the type(s) of award(s) that they are to receive;

To grant awards and determine the terms and conditions of awards, including the price (if any) to be paid for the shares or the award and, in the case of share-based awards, the number of shares to be offered or awarded;

Subject to the minimum vesting requirements set forth below, to determine any applicable vesting and exercise conditions for awards (including any applicable performance-based vesting or exercisability conditions), and the extent to which such conditions have been satisfied, or determine that no delayed vesting or exercise is required, and to accelerate or extend the vesting or exercisability or extend the term of any or all outstanding awards;

To cancel, modify, or waive the Company's rights with respect to, or modify, discontinue, suspend, or terminate any or all outstanding awards, subject to any required consents;

Subject to the other provisions of the 2016 Plan, to make certain adjustments to an outstanding award and to authorize the conversion, succession or substitution of an award;

To determine the method of payment of any purchase price for an award or shares of the Company's common stock delivered under the 2016 Plan, as well as any tax-related items with respect to an award, which may be in the form of cash, check, or electronic funds transfer, by the delivery of already-owned shares of the Company's common stock or by a reduction of the number of shares deliverable pursuant to the award, by services rendered by the recipient of the award, by notice and third party payment or cashless exercise on such terms as the administrator may authorize, or any other form permitted by law;

To modify the terms and conditions of any award, establish sub-plans and agreements and determine different terms and conditions that the administrator deems necessary or advisable to comply with laws in the countries where the Company or one of its subsidiaries operates or where one or more eligible participants reside or provide services;

To approve the form of any award agreements used under the 2016 Plan; and

To construe and interpret the 2016 Plan, make rules for the administration of the 2016 Plan, and make all other determinations necessary or advisable for the administration of the 2016 Plan.

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*Eligibility*

Persons eligible to receive awards under the 2016 Plan include officers or other employees of the Company or any of its subsidiaries, directors of the Company, and certain consultants and advisors to the Company or any of its subsidiaries. As of December 31, 2017, 431 officers and other employees of the Company and its subsidiaries (including all of the Company's named executive officers), and each of the Company's eight non-employee directors, are considered eligible under the 2016 Plan.

*Vesting*

All awards granted under the 2016 Plan are generally subject to a minimum vesting requirement of one year and no portion of any award may vest earlier than the first anniversary of the grant date of the award. This minimum vesting requirement does not apply to 5% of the total number of shares under the 2016 Plan and does not limit or restrict the administrator's discretion to accelerate the vesting of any award in circumstances it determines to be appropriate. Although the 2016 Plan provides the administrator with the discretion to determine vesting conditions, we expect that options (other than the initial option grants) and stock awards (other than initial stock awards) granted under the 2016 Plan will generally vest over three years, at a rate of 34%, 33%, and 33% per year, respectively, if the grantee is then in service to the Company.

*Assumption or Adjustments Upon Change in Control*

If an event occurs in which the Company does not survive (or does not survive as a public company in respect of its common stock), including, without limitation, a dissolution, merger, combination, consolidation, conversion, exchange of securities, or other reorganization, or a sale of all or substantially all of the business, stock or assets of the Company, awards then-outstanding under the 2016 Plan will not automatically become fully vested pursuant to the provisions of the 2016 Plan so long as such awards are assumed, substituted for or otherwise continued. However, if awards then-outstanding under the 2016 Plan are to be terminated in such circumstances (without being assumed or substituted for), such awards would generally become fully vested, subject to any exceptions that the administrator may provide for in an applicable award agreement (such as for awards subject to performance-based vesting requirements). The administrator also has the discretion to establish other change in control provisions with respect to awards granted under the 2016 Plan. For example, the Administrator could provide for the acceleration of vesting or payment of an award in connection with a corporate event or in connection with a termination of the award holder's employment.

*Amendment and Termination*

The Board may amend or terminate the 2016 Plan at any time and in any manner. Stockholder approval for an amendment will be required only to the extent then required by applicable law or deemed necessary or advisable by the Board. Unless terminated earlier by the Board and subject to any extension that may be approved by stockholders, the authority to grant new awards under the 2016 Plan will terminate on February 15, 2026. Outstanding awards, as well as the administrator's authority with respect thereto, generally will continue following the expiration or termination of the plan. Generally speaking, outstanding awards may be amended by the administrator (except for a repricing), but the consent of the award holder is required if the amendment (or any plan amendment) materially and adversely affects the holder.

***Employee Stock Purchase Plan***

The ESPP was adopted by the Board in February 2013 and approved by our stockholders in May 2013. Under the ESPP, eligible employees may authorize payroll deductions of eligible compensation for the purchase of common stock during each purchase period.

*Administration*

The compensation committee serves as the administrator of the ESPP, and as such has full authority to adopt such rules and procedures as it may deem necessary for proper plan administration and to interpret the provisions of the ESPP.

*Shares Available Under the ESPP*

A total of 2,500,000 shares of common stock are authorized for purchase over the term of the ESPP, subject to adjustment in the event of a stock split, stock dividend, combination or reclassification or similar event.

*Offering Periods*

The ESPP is implemented through two offering periods per calendar year, with each offering period lasting six months. The administrator of the ESPP may alter the duration of future offering periods in advance without stockholder approval. Each participant is granted a separate purchase right to purchase shares of common stock for each offering period in which he or she participates. Purchase rights under the ESPP are granted on the start date of each offering period in which the participant participates and are automatically exercised on the last day of the offering period. Each purchase right entitles the participant to purchase the whole number of shares of common stock obtained by dividing the participant's payroll deductions for the offering period by the purchase price in effect for such period.

*Eligibility*

Except as described in this paragraph with respect to certain foreign employees, all employees of the Company and its subsidiaries are eligible to participate in the ESPP, except that the ESPP administrator may exclude from an offering period any individual who is regularly expected to work less than twenty hours per week or less than five months per calendar year in the employ of the Company or any subsidiary, or has not been employed for such continuous period as the ESPP administrator may require (not to exceed two years). An eligible employee may only join an offering period on the start date of that period. Subsidiaries include any subsidiary corporation of the Company, whether now existing or hereafter organized, which elects, with the approval of the ESPP administrator, to extend the benefits of the ESPP to their eligible employees. Employees who are citizens or residents of a non-U.S. jurisdiction (without regard to whether he or she is also a citizen of the United States or a resident alien (within the meaning of Section 7701(b)(1)(A) of the Code) are ineligible to participate in the ESPP if his or her participation is prohibited under the laws of the applicable non-U.S. jurisdiction or if complying with the laws of the applicable non-U.S. jurisdiction would cause the ESPP or an offering to violate Section 423 of the Code.

*Purchase Provisions*

Each participant in the ESPP may authorize periodic payroll deductions that may not exceed the lesser of (i) 10% of his or her compensation, which is defined in the ESPP to include his or her regular base salary in effect at the beginning of the offering period, exclusive of any payments for overtime, bonuses, annual awards, other incentive payments, reimbursements of expense allowances, fringe benefits (cash or non-cash), moving expenses, deferred compensation, or contributions (other than contributions under a 401(k) or cafeteria plan) and (ii) such lesser amount determined by the administrator of the ESPP per offering period. A participant may increase or reduce his or her rate of payroll deductions during an offering period. On the last day of each offering period, the accumulated payroll deductions of each participant are automatically applied to the purchase of shares of common stock at the purchase price in effect for that period.

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*Purchase Price*

The purchase price per share at which common stock is purchased on the participant's behalf for each offering period is equal to 85% of the fair market value per share of the common stock on the last day of the offering period.

*Valuation*

The fair market value of the common stock on a given date is the closing sales price of the common stock on the Nasdaq Global Select Market as of such date.

*Special Limitations*

The ESPP imposes certain limitations on a participant's right to acquire common stock, including the following limitations:

- No purchase right may be granted to any individual who owns stock (including stock purchasable under any outstanding options or purchase rights) possessing 5% or more of the total combined voting power or value of all classes of stock of the Company or any of its affiliates.

- No purchase right granted to a participant may permit such individual to purchase common stock at a rate greater than $25,000 worth of such common stock (valued at the time such purchase right is granted) for each calendar year.

*Termination of Purchase Rights*

A participant's purchase right immediately terminates upon such participant's loss of eligible employee status, and his or her accumulated payroll deductions for the offering period in which the purchase right terminates are refunded. A participant may withdraw from an offering period by giving advance notice before the end of that period and his or her accumulated payroll for the offering period in which withdrawal occurs shall be refunded.

*Assignability*

The purchase rights are not assignable or transferable (other than by will or the laws of descent and distribution) and are exercisable only by the participant.

*Corporate Transaction*

In the event of the proposed dissolution or liquidation of the Company, the then-current offering period will terminate immediately before the consummation of such dissolution or liquidation, unless otherwise provided by the ESPP administrator. In the event of "corporate transaction," as defined in the ESPP, during an offering period, all outstanding purchase rights shall be assumed by the successor corporation (or a parent or subsidiary thereof), unless the ESPP administrator determines, in its sole discretion, to shorten the offering period then in-effect to a new purchase date. If the ESPP administrator shortens the offering period then in progress to a new purchase date, the ESPP administrator will provide notice to each participant that (i) his or her purchase right will be automatically exercised on the new purchase date or (ii) the Company will pay to him or her, on the new purchase date, cash, cash equivalents, or property as determined by the ESPP administrator that is equal to the difference in the fair market value of the shares of common stock covered by his or her purchase right and the purchase price due had the purchase right been automatically exercised on the new purchase date.

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*Changes in Capitalization*

In the event any change is made to the outstanding shares of common stock by reason of any stock split, stock dividend, recapitalization, combination of shares, exchange of shares or other change in corporate structure effected without the Company's receipt of consideration, appropriate adjustments will be made to (i) the maximum number of securities issuable under the ESPP, including the maximum number of securities issuable per participant on any one purchase date and (ii) the number of securities subject to each outstanding purchase right and the purchase price payable per share thereunder.

*Amendment and Termination*

The administrator of the ESPP may at any time terminate or amend the ESPP. To the extent necessary to comply with Section 423 of the Code (or any successor rule or provision or any other applicable law), the Company shall obtain stockholder approval in such a manner and to such a degree as may be required. The ESPP will terminate upon the earlier to occur of (i) 10 years following the date of the original adoption of the ESPP or (ii) the date on which all purchase rights are exercised in connection with a Corporate Transaction.

***Securities Authorized for Issuance Under Equity Compensation Plans***

The following table summarizes information about compensation plans under which our equity securities are authorized for issuance as of December 31, 2017:

| | Equity Compensation Plan Information | | |
|---|---|---|---|
| **Plan Category** | **Number of Securities to be Issued upon Exercise of Outstanding Options, Warrants and Rights** | **Weighted-Average Exercise Price of Outstanding Options, Warrants and Rights** | **Number of Securities Remaining Available for Future Issuance under Equity Compensation Plans** |
| Equity compensation plans approved by security holders | 10,446,466(1) | $ 9.62(2) | 7,004,496(3) |
| Equity compensation plans not approved by security holders | | | |
| Total | 10,446,466 | $ 9.62 | 7,004,496 |

(1) Of these shares, 7,519,982 were subject to options then outstanding under the 2006 Plan, 869,626 were subject to RSUs then outstanding under the 2006 Plan, 1,093,872 were subject to options then outstanding under the 2016 Plan, and 962,986 were subject to RSUs then outstanding under the 2016 Plan. The Company's authority to grant new awards under the 2006 Plan terminated upon the adoption of the 2016 Plan in May 2016.

This total includes 334,500 shares subject to performance-based vesting requirements based on achieving the maximum level of performance. The actual number of shares to be issued with respect to these performance-based awards will vary depending on the applicable level of performance achieved, with such number ranging from zero to the maximum level indicated.

(2) This weighted-average exercise price does not reflect 2,314,105 shares that will be issued upon the settlement of outstanding RSUs.

(3) Represents (a) 4,823,956 shares available for future issuance under the 2016 Plan as of December 31, 2017, and (b) 2,180,540 shares available for future issuance under the ESPP, excluding 119,576 shares that were subject to purchase under the ESPP during the purchase period ended December 31, 2017. Shares available under the 2016 Plan may be used for any type of award authorized in that plan, as described under "2016 Plan" above.

## CERTAIN RELATIONSHIPS AND RELATED PARTY TRANSACTIONS

### 2017 Related Party Transactions

Except as described below, since January 1, 2017, there has not been, nor is there currently proposed, any transaction or series of similar transactions in which were or are to be a participant, in which the amount involved exceeds $120,000 and in which any of our directors, executive officers, holders of more than 5% of our common stock or any immediate family member of any of the foregoing had or will have a direct or indirect material interest. This does not include employment compensation or compensation for Board service, which are described elsewhere in this Proxy Statement.

In November 2014, we entered into a sublease with Mr. Pickens ("Sublease"), pursuant to which we occupy, as the sublessee under the Sublease, 3,769 square feet of office space located in Dallas, Texas and leased by Mr. Pickens. The Sublease terminates in November 2019 and provides that we will pay the following approximate amounts for rent, operating expenses and electric utilities in each remaining year of such term: $142,000 from November 2016 to November 2017; $145,000 from November 2017 to November 2018 and $147,000 from November 2018 to November 2019. In May 2016, we agreed to sublease an additional 3,162 square feet of adjacent space from Mr. Pickens (the "Sublease Amendment"). We pay approximately $99,000 per year for rent, operating expenses and electric utilities for the space subject to the Sublease Amendment.

In February 2017, we signed and closed a negotiated note repurchase agreement with Mr. Pickens, pursuant to which we purchased from Mr. Pickens the 7.5% convertible note due July 2018 having an outstanding principal amount of $25.0 million we had previously issued to Mr. Pickens (the "Note"). We paid to Mr. Pickens a cash purchase price of $21.75 million for the Note, reflecting a 13% discount on the outstanding principal amount of the Note (the "Note Repurchase"). We offered to purchase the other outstanding 7.5% Convertible Notes due July 2018, which have an aggregate outstanding principal amount of $25.0 million, from the holders of such notes on the same terms and for the same purchase price, but such holders declined to participate in the note repurchase transaction.

In November 2017, Mr. Pickens transferred to third parties all remaining $40.0 million in principal amount of his 7.5% convertible notes due July 2019 and June 2020 (the "Notes Transfer"). We participated in the Notes Transfer for the sole purpose of consenting to the transfer.

### Policies and Procedures for Related Party Transactions

Our audit committee charter requires that all related party transactions, as defined in applicable SEC rules, be reviewed and approved by our audit committee, in accordance with applicable Nasdaq rules. When evaluating any such transaction, our audit committee focuses on whether the terms of the transaction are at least as favorable to us as terms we would receive on an arm's-length basis from an unaffiliated third party. These policies and procedures for approving related party transactions are set forth in our written audit committee charter, which was adopted in September 2006 and most recently re-approved by our audit committee in October 2017. The Sublease, Sublease Amendment and the Note Repurchase were each reviewed and approved by the audit committee due to the involvement of one of our directors, Mr. T. Boone Pickens.

**AUDIT COMMITTEE REPORT**

The audit committee is responsible for overseeing our accounting, auditing and financial reporting practices on behalf of the Board. Management is responsible for the preparation and presentation of our consolidated financial statements, including establishing accounting and financial reporting principles and designing systems of internal control over financial reporting. Our independent registered public accounting firm is responsible for expressing an opinion on our consolidated financial statements and an opinion on our internal control over financial reporting.

In performing its responsibilities, the audit committee has reviewed and discussed, with management and KPMG LLP, our independent registered public accounting firm, the audited consolidated financial statements included in the Annual Report. The audit committee has also discussed with KPMG LLP the matters required to be discussed by Auditing Standards No. 16, "Communications with Audit Committees."

Additionally, the audit committee has received the written disclosures and the letter from KPMG LLP required by applicable requirements of the Public Company Accounting Oversight Board (United States) regarding KPMG LLP's communication with the audit committee concerning independence, and has discussed with KPMG LLP its independence.

Based on the reviews and discussions referred to above, the audit committee recommended to the Board that the audited consolidated financial statements of Clean Energy Fuels Corp. be included in our annual report on Form 10-K for the year ended December 31, 2017 for filing with the SEC.

Audit Committee:
James C. Miller III, *Chairman*
John S. Herrington
Stephen A. Scully
Vincent C. Taormina

*This audit committee report shall not be deemed to be "soliciting material," or to be "filed" with the SEC or subject to Regulation 14A or 14C under the Exchange Act, other than as provided by applicable SEC rules, or to the liabilities of Section 18 of the Exchange Act, except to the extent that we specifically request that the information be treated as soliciting material or specifically incorporate it by reference into a document filed under the Securities Act or the Exchange Act. This audit committee report will not be deemed to be incorporated by reference into any filing under the Securities Act or the Exchange Act, except to the extent that we specifically incorporate it by reference.*

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## OTHER MATTERS

### Section 16(a) Beneficial Ownership Reporting Compliance

Section 16(a) of the Exchange Act requires our directors, executive officers and beneficial owners of more than 10% of our common stock to file reports of ownership of our common stock and changes in such ownership with the SEC. Based solely on a review of these reports furnished to us and written representations that no other reports were required, we believe these persons complied with all applicable Section 16(a) filing requirements in 2017, except that Mr. Miller filed one late report on Form 4 with respect to a purchase of shares of our common stock in November 2017.

### Stockholder Proposals for 2019 Annual Meeting

***Stockholder Proposals to be Considered for Inclusion in Our Proxy Materials***

Stockholder proposals submitted pursuant to Rule 14a-8 under the Exchange Act and intended to be presented at our 2019 annual meeting of stockholders and considered for inclusion in our proxy materials for that meeting must be received by us no later than December 15, 2018 if our 2019 annual meeting is held between April 30, 2019 and June 29, 2019 or, if our 2019 annual meeting is not held within these dates, a reasonable time before we begin to print and send our proxy materials for the meeting. Additionally, our amended and restated bylaws provide that a stockholder must have given timely written notice to us of any proposal that is sought to be considered for inclusion in our proxy materials. To be timely for our 2019 annual meeting of stockholders, a stockholder's written notice must be delivered to or mailed and received by our Corporate Secretary at the address of our principal executive offices no earlier than October 22, 2018 and no later than December 21, 2018 if our 2019 annual meeting is held between April 30, 2019 and June 29, 2019 or, if our 2019 annual meeting is not held within these dates, no later than the close of business on the later of (1) the $90^{th}$ day before the date of our 2019 annual meeting or (2) the $10^{th}$ day following the date on which we first make public announcement of the date of our 2019 annual meeting. A stockholder's notice to us must also comply with all other requirements of Rule 14a-8 in all respects, including delivery of proof of ownership of our common stock in accordance with Rule 14a-8(b)(2), and must set forth, as to each proposal the stockholders seeks to bring before the meeting, all of the information required by our amended and restated bylaws.

***Director Nominations or Stockholder Proposals to be Brought Before an Annual Meeting But Not Included in Our Proxy Materials***

Our amended and restated bylaws provide that, for stockholder nominations of directors or other proposals to be considered at an annual meeting but not sought to be included in our proxy materials for the meeting, the stockholder must have given timely written notice of the nomination or proposal to us. To be timely for our 2019 annual meeting of stockholders, a stockholder's notice must be delivered to or mailed and received by our Corporate Secretary at our principal executive offices between March 1, 2019 and March 31, 2019 if our 2019 annual meeting is held between April 30, 2019 and June 29, 2019 or, if our 2019 annual meeting is not held within these dates, between the $60^{th}$ day and the $90^{th}$ day before the date the meeting is held or, if we first publicly announce the date of the meeting less than 70 days before the date of the meeting, no later than the $10^{th}$ day following the date on which such public announcement is made. A stockholder's notice to the Company must set forth, as to each director nominee or other proposal the stockholder proposes to bring before our 2019 annual meeting, all of the information required by our amended and restated bylaws, as described under "Corporate Governance  Director Nominations" above. We will not entertain any director nominations or other proposals at the Annual Meeting or at our 2019 annual meeting that do not meet the requirements set forth in our amended and restated bylaws. If we comply and the stockholder does not comply with the requirements of Rule 14a-4(c)(2) under the Exchange Act, we may exercise

discretionary voting authority under proxies we solicit to vote in accordance with our best judgment on any such director nomination or other stockholder proposal.

**Other Business at the Annual Meeting**

We know of no other matters to be submitted at the Annual Meeting. If any other matters are properly brought before the Annual Meeting, the individuals we have designated as proxies for the Annual Meeting will have discretionary authority to vote for or against any such matter. It is the intention of such individuals to vote the shares represented by proxy at the Annual Meeting in accordance with their judgment.

**More Information About the Company**

For more information about the Company, please refer to our Annual Report, which accompanies this Proxy Statement. Our annual report on Form 10-K for the year ended December 31, 2017, which is a part of the Annual Report, was filed with the SEC on March 13, 2018, and is accessible on our website at *http://investors.cleanenergyfuels.com/financial-information/annual-reports*. You may also obtain a copy of the Annual Report by sending a written request to the attention of Investor Relations at the address of our principal executive offices.

By order of the Board,

MITCHELL W. PRATT
*Corporate Secretary*

***CLEAN ENERGY FUELS CORP.***

***4675 MACARTHUR COURT, SUITE 800***

***NEWPORT BEACH, CA 92660***

**VOTE BY INTERNET**

*Before The Meeting* - Go to **www.proxyvote.com**

Use the Internet to transmit your voting instructions and for electronic delivery of information up until 11:59 P.M. Eastern Time the day before the meeting date. Have this proxy card in hand when you access the web site and then follow the instructions to obtain your records and to create an electronic voting instruction form.

*During The Meeting* - Go to
**www.virtualshareholdermeeting.com/CLNE2018**

You may attend the meeting via the Internet and vote during the meeting. Have the information that is printed in the box marked by the arrow available and follow the instructions.

**VOTE BY PHONE - 1-800-690-6903**

Use any touch-tone telephone to transmit your voting instructions up until 11:59 P.M. Eastern Time the day before the meeting date. Have this proxy card in hand when you call and then follow the instructions.

**VOTE BY MAIL**

Mark, sign and date this proxy card and return it in the postage-paid envelope we have provided or return it to Vote Processing, c/o Broadridge, 51 Mercedes Way, Edgewood, NY 11717.

TO VOTE, MARK BLOCKS BELOW IN BLUE OR BLACK INK AS FOLLOWS:

E43001-P06424

KEEP THIS PORTION FOR YOUR RECORDS

DETACH AND RETURN THIS PORTION ONLY

**THIS PROXY CARD IS VALID ONLY WHEN SIGNED AND DATED.**

| **CLEAN ENERGY FUELS CORP.** | **For All** | **Withhold All** | **For All Except** | To withhold authority to vote for any individual nominee(s), mark "For All Except" and write the number(s) of the nominee(s) on the line below. |
|---|---|---|---|---|
| **The Board of Directors recommends you vote FOR ALL of the director nominees in proposal 1.** | | | | |
| 1. Election of Directors | o | o | o | |
| **Nominees:** | | | | |

| | |
|---|---|
| 01) Andrew J. Littlefair | 06) T. Boone Pickens |
| 02) Warren I. Mitchell | 07) Stephen A. Scully |
| 03) John S. Herrington | 08) Kenneth M. Socha |
| 04) James C. Miller III | 09) Vincent C. Taormina |
| 05) James E. O'Connor | |

| **The Board of Directors recommends you vote FOR proposals 2 and 3.** | **For** | **Against** | **Abstain** |
|---|---|---|---|
| 2. Ratification of the appointment of KPMG LLP as our independent registered public accounting firm for the fiscal year ending December 31, 2018. | o | o | o |
| 3. Approval, on an advisory, non-binding basis, of our executive compensation. | o | o | o |

**NOTE:** To transact any other business that may properly come before the meeting or any adjournment or postponement of the meeting.

Authorized Signatures. This section must be completed for your vote to be counted. Date and sign below. Please sign exactly as name(s) appear(s) hereon. Joint owners should each sign. When signing as attorney, executor, administrator, corporate officer, trustee, guardian, or custodian, please give full title.

| Signature [PLEASE SIGN WITHIN BOX] | Date | | Signature (Joint Owners) | Date |
|---|---|---|---|---|

**Important Notice Regarding the Availability of Proxy Materials for the Annual Meeting:**

The Notice, Proxy Statement and Annual Report are available at www.proxyvote.com.

E43002-P06424

**2018 Proxy - Clean Energy Fuels Corp.**

**THIS PROXY IS SOLICITED ON BEHALF OF THE BOARD OF DIRECTORS**

I hereby appoint Stephen A. Scully and Andrew J. Littlefair, or either of them, as proxies, with power of substitution to each, to vote all shares of common stock that I am entitled to vote at the Annual Meeting of Stockholders of Clean Energy Fuels Corp. to be held on Wednesday, May 30, 2018 at 9:00 a.m. PDT, or at any adjournment or postponement thereof, in accordance with the instructions on the reverse side of this card and with the same effect as though I were present at the Annual Meeting and voting such shares. My appointed proxies are authorized in their discretion to vote upon such other business as may properly come before the Annual Meeting or any adjournment or postponement thereof.

UNLESS A CONTRARY DIRECTION IS INDICATED, THIS PROXY WILL BE VOTED "FOR ALL" NOMINEES FOR DIRECTOR LISTED IN PROPOSAL 1, "FOR" PROPOSALS 2 AND 3, AND IN THE DISCRETION OF THE APPOINTED PROXIES UPON SUCH OTHER BUSINESS AS MAY PROPERLY COME BEFORE THE ANNUAL MEETING. IF SPECIFIC INSTRUCTIONS ARE INDICATED, THIS PROXY WILL BE VOTED IN ACCORDANCE THEREWITH.

If you vote by phone or Internet, please do not mail your proxy card.

Thank You For Voting

**(CONTINUED AND TO BE SIGNED AND DATED ON REVERSE SIDE)**