

FLOW INTERNATIONAL CORP

Form 10-Q

March 02, 2012

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended January 31, 2012

OR

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

For the transition period from _____ to _____

Commission file number 001-34443

FLOW INTERNATIONAL CORPORATION

WASHINGTON

(State or other jurisdiction of
incorporation or organization)

23500 64th Avenue South

Kent, Washington 98032

(253) 850-3500

91-1104842

(I.R.S. Employer
Identification No.)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No .

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company

(Do not check if 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 No

The registrant had 47,859,450 shares of Common Stock, \$0.01 par value per share, outstanding as of February 22, 2012.

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

FLOW INTERNATIONAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except par values)

(unaudited)

| | January 31, 2012 | April 30, 2011 |
|--|---------------------|-------------------|
| ASSETS | | |
| Current Assets: | | |
| Cash and Cash Equivalents | \$ 10,185 | \$ 9,096 |
| Restricted Cash | 1,104 | 1,766 |
| Receivables, net | 47,247 | 47,082 |
| Inventories, net | 34,280 | 28,609 |
| Other Current Assets | 11,367 | 11,539 |
| Total Current Assets | 104,183 | 98,092 |
| Property and Equipment, net | 17,380 | 19,104 |
| Intangible Assets, net | 4,914 | 4,738 |
| Deferred Income Taxes, net | 23,465 | 25,171 |
| Other Long-Term Assets | 5,839 | 5,958 |
| Total Assets | \$ 155,781 | \$ 153,063 |
| LIABILITIES AND SHAREHOLDERS' EQUITY | | |
| Current Liabilities: | | |
| Notes Payable | \$— | \$ 5,500 |
| Current Portion of Long-Term Obligations | 26 | 25 |
| Accounts Payable | 16,669 | 17,363 |
| Accrued Payroll and Related Liabilities | 6,459 | 7,080 |
| Taxes Payable and Other Accrued Taxes | 4,363 | 2,378 |
| Deferred Revenue and Customer Deposits | 13,960 | 13,317 |
| Other Accrued Liabilities | 10,216 | 11,298 |
| Total Current Liabilities | 51,693 | 56,961 |
| Deferred Income Taxes | 5,885 | 5,711 |
| Subordinated Notes | 9,362 | 8,723 |
| Other Long-Term Liabilities | 2,247 | 2,214 |
| Total Liabilities | 69,187 | 73,609 |
| Commitments and Contingencies | | |
| Shareholders' Equity: | | |
| Series A 8% Convertible Preferred Stock, \$.01 par value, 1,000 shares authorized; no shares issued and outstanding | — | — |
| Common Stock, \$.01 par value, 84,000 shares authorized; 47,859 and 47,378 shares issued and outstanding | 474 | 469 |
| Capital in Excess of Par | 163,273 | 161,741 |
| Accumulated Deficit | (72,315) | (79,121) |
| Accumulated Other Comprehensive Income: | | |
| Defined Benefit Plan Obligation, net of income tax | (68) | (68) |

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| | | | |
|---|-----------|-----------|---|
| Cumulative Translation Adjustment, net of income tax | (4,770 |) (3,567 |) |
| Total Shareholders' Equity | 86,594 | 79,454 | |
| Total Liabilities and Shareholders' Equity | \$155,781 | \$153,063 | |
| See Accompanying Notes to Condensed Consolidated Financial Statements | | | |

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CONDENSED CONSOLIDATED INCOME STATEMENTS

(in thousands, except per share amounts)

(unaudited)

| | Three Months Ended | | Nine Months Ended | |
|--|--------------------|----------|-------------------|-----------|
| | January 31, | | January 31, | |
| | 2012 | 2011 | 2012 | 2011 |
| Sales | \$65,808 | \$57,473 | \$190,371 | \$156,988 |
| Cost of Sales | 39,737 | 34,381 | 115,864 | 94,710 |
| Gross Margin | 26,071 | 23,092 | 74,507 | 62,278 |
| Operating Expenses: | | | | |
| Sales and Marketing | 12,028 | 11,568 | 36,806 | 33,049 |
| Research and Engineering | 2,712 | 2,513 | 8,079 | 7,095 |
| General and Administrative | 5,342 | 6,194 | 17,312 | 17,811 |
| Total Operating Expenses | 20,082 | 20,275 | 62,197 | 57,955 |
| Operating Income | 5,989 | 2,817 | 12,310 | 4,323 |
| Interest Income | 12 | 21 | 61 | 86 |
| Interest Expense | (317) | (418) | (937) | (1,268) |
| Other Income (Expense), net | (384) | (81) | (511) | 315 |
| Income Before Taxes | 5,300 | 2,339 | 10,923 | 3,456 |
| Provision for Income Taxes | (2,041) | (1,058) | (4,279) | (2,926) |
| Income from Continuing Operations | 3,259 | 1,281 | 6,644 | 530 |
| Income (Loss) from Discontinued Operations, net of Income Tax of \$0, \$0, \$0 and \$0 | 57 | (40) | 162 | (152) |
| Net Income | \$3,316 | \$1,241 | \$6,806 | \$378 |
| Basic and Diluted Income Per Share: | | | | |
| Income from Continuing Operations | \$0.07 | \$0.03 | \$0.14 | \$0.01 |
| Discontinued Operations | — | — | — | — |
| Net Income | \$0.07 | \$0.03 | \$0.14 | \$0.01 |
| Weighted Average Shares Used in Computing Basic and Diluted Income Per Share: | | | | |
| Basic | 47,857 | 47,301 | 47,730 | 47,168 |
| Diluted | 47,857 | 47,312 | 47,730 | 47,174 |
| See Accompanying Notes to Condensed Consolidated Financial Statements | | | | |

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FLOW INTERNATIONAL CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (in thousands; unaudited)

| | Nine Months Ended | |
|---|-------------------|------------|
| | January 31, | |
| | 2012 | 2011 |
| Cash Flows from Operating Activities: | | |
| Net Income | \$6,806 | \$378 |
| Adjustments to Reconcile Net Income to Cash Provided by Operating Activities: | | |
| Depreciation and Amortization | 4,723 | 4,706 |
| Deferred Income Taxes | 2,437 | 1,585 |
| Provision for Slow Moving and Obsolete Inventory | 391 | 649 |
| Bad Debt Expense | 389 | 346 |
| Warranty Expense | 3,043 | 1,304 |
| Incentive Stock Compensation Expense | 1,783 | 1,855 |
| Unrealized Foreign Exchange Currency Losses (Gains) | 367 | (351) |
| Amortization and Write-off of Deferred Debt Issuance Costs | 28 | 349 |
| Indemnification Charge | (162) |) 152 |
| Interest Accretion on Subordinated Notes | 639 | 568 |
| Other | 9 | 69 |
| Changes in Operating Assets and Liabilities: | | |
| Receivables | (1,883) |) (3,902) |
| Inventories | (7,129) |) (5,990) |
| Other Operating Assets | (944) |) (402) |
| Accounts Payable | (738) |) 348 |
| Accrued Payroll and Related Liabilities | (733) |) 382 |
| Deferred Revenue and Customer Deposits | 1,328 | 2,406 |
| Other Operating Liabilities | (1,062) |) (266) |
| Net Cash Provided by Operating Activities | 9,292 | 4,186 |
| Cash Flows from Investing Activities: | | |
| Expenditures for Property and Equipment | (2,849) |) (2,042) |
| Expenditures for Intangible Assets | (497) |) (658) |
| Proceeds from Sale of Property and Equipment | 36 | 31 |
| Restricted Cash | 502 | (1,663) |
| Net Cash Used in Investing Activities | (2,808) |) (4,332) |
| Cash Flows from Financing Activities: | | |
| Borrowings Under Credit Facility | 45,750 | 35,100 |
| Repayments Under Credit Facility | (51,250) |) (33,550) |
| Borrowings Under Other Financing Arrangements | 37 | 38 |
| Repayments Under Other Financing Arrangements | (10) |) (46) |
| Net Cash (Used in) Provided by Financing Activities | (5,473) |) 1,542 |
| Effect of Changes in Exchange Rates | 78 | 238 |
| Net Change in Cash And Cash Equivalents | 1,089 | 1,634 |
| Cash and Cash Equivalents, Beginning of Period | 9,096 | 6,367 |
| Cash and Cash Equivalents, End of Period | \$10,185 | \$8,001 |
| Supplemental Disclosures of Cash Flow Information: | | |
| Cash Paid during the Period for: | | |
| Interest | 261 | 288 |
| Income Taxes | 588 | 476 |

Supplemental Disclosures of Noncash Investing Activities:

| | | |
|---|-----|-----|
| Accounts Payable Incurred to Acquire Property and Equipment and Intangible Assets | 338 | 222 |
|---|-----|-----|

See Accompanying Notes to Condensed Consolidated Financial Statements

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FLOW INTERNATIONAL CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY
 AND COMPREHENSIVE INCOME

(in thousands; unaudited)

| | Common Stock | | Capital | | Accumulated | Total |
|---|--------------|-----------|------------------|---------------------|--------------------------|----------------------|
| | Shares | Par Value | In Excess of Par | Accumulated Deficit | Other Comprehensive Loss | Shareholders' Equity |
| Balances, April 30, 2010 | 46,927 | \$465 | \$159,605 | \$(79,887) | \$(4,559) | \$75,624 |
| Components of Comprehensive Income: | | | | | | |
| Net Income | | | | 378 | | 378 |
| Cumulative Translation Adjustment, Net of Income Tax of \$16 | | | | | 922 | 922 |
| Total Comprehensive Income | | | | | | 1,300 |
| Stock Compensation | 404 | 4 | 1,742 | | | 1,746 |
| Balances, January 31, 2011 | 47,331 | \$469 | \$161,347 | \$(79,509) | \$(3,637) | \$78,670 |
| Balances, April 30, 2011 | 47,378 | \$469 | \$161,741 | \$(79,121) | \$(3,635) | \$79,454 |
| Components of Comprehensive Income: | | | | | | |
| Net Income | | | | 6,806 | | 6,806 |
| Cumulative Translation Adjustment, Net of Income Tax of \$(153) | | | | | (1,203) | (1,203) |
| Total Comprehensive Income | | | | | | 5,603 |
| Stock Compensation | 481 | 5 | 1,532 | | | 1,537 |
| Balances, January 31, 2012 | 47,859 | \$474 | \$163,273 | \$(72,315) | \$(4,838) | \$86,594 |

See Accompanying Notes to Condensed Consolidated Financial Statements

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FLOW INTERNATIONAL CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(All tabular dollar amounts in thousands, except per share amounts)
(Unaudited)

Note 1: Basis of Presentation

In the opinion of the management of Flow International Corporation (the “Company”), the accompanying unaudited condensed consolidated financial statements (“financial statements”) are prepared in accordance with Generally Accepted Accounting Principles (“GAAP”) for interim financial information and rules and regulations of the Securities and Exchange Commission. Accordingly, certain information and footnote disclosures usually found in financial statements prepared in accordance with GAAP have been condensed or omitted. The unaudited financial statements reflect all adjustments, which in the opinion of management are necessary to fairly state the financial position, results of operations and cash flows for the interim periods presented. These financial statements should be read in conjunction with the audited consolidated financial statements and related notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended April 30, 2011.

The preparation of these interim condensed consolidated financial statements requires management to make estimates and judgments that affect the reported amount of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities at the date of the Company’s financial statements. Operating results for the three and nine months ended January 31, 2012 may not be indicative of future results.

Recent Accounting Pronouncements Not Yet Adopted

In June 2011, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update No. 2011-05, Comprehensive Income (“or ASU 2011-05”). The new guidance eliminates the current option to report other comprehensive income and its components in the statement of shareholders' equity. Instead, an entity will be required to present either a continuous statement of net income and other comprehensive income or two separate but consecutive statements. In December 2011, the FASB issued ASU 2011-12, Comprehensive Income, which supersedes certain pending paragraphs in ASU 2011-05. ASU 2011-12 indefinitely defers the presentation of reclassification adjustments for each component of accumulated other comprehensive income in both other comprehensive income and net income on the face of the financial statements. The new guidance provided in both ASU 2011-05 and ASU 2011-12 will be effective for the Company beginning in the first quarter of fiscal year 2013. However, the Company has elected early adoption of the new guidance for fourth quarter of the current fiscal year since the impacts of the new guidance are to be applied retrospectively. Adoption of the new guidance by the Company will not change the components that are currently reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income, it will only revise the manner in which comprehensive income is presented in the Company's financial statements.

In May 2011, the FASB issued ASU No. 2011-04, Fair Value Measurement. The FASB issued the new guidance to achieve common fair value measurement and disclosure requirements between U.S. GAAP and International Financial Reporting Standards. This ASU clarifies existing fair value measurement and disclosure requirements, amends certain fair value measurement principles and requires additional disclosures about fair value measurements. This new guidance will be effective for the Company beginning in the fourth quarter of the current fiscal year. Other than requiring additional disclosures, the Company does not anticipate the adoption of this new guidance to have a material impact on the financial statements.

Fair Value of Financial Instruments

The carrying value of the Company’s current assets and liabilities approximate fair values due to the short-term maturity of these assets and liabilities. Nonfinancial assets and liabilities measured on a nonrecurring basis that are included in the Company’s Condensed Consolidated Balance Sheets consist of long-lived assets and a cost-method investment. Certain of the Company's nonfinancial assets are measured at fair value when impairment indicators exist. Due to significant unobservable inputs, the fair value measures used to evaluate impairment and to calculate a

prevailing market interest rate are Level 3 inputs. The carrying amount of these nonfinancial assets measured on a nonrecurring basis approximates fair value unless otherwise disclosed in these financial statements.

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Note 2: Receivables, Net

Net receivables as of January 31, 2012 and April 30, 2011 consisted of the following:

| | January 31, 2012 | April 30, 2011 |
|---------------------------------------|---------------------|----------------|
| Trade Accounts Receivable | \$35,836 | \$37,521 |
| Unbilled Revenues | 12,515 | 10,865 |
| | 48,351 | 48,386 |
| Less: Allowance for Doubtful Accounts | (1,104) | (1,304) |
| Receivables, net | \$47,247 | \$47,082 |

Unbilled revenues do not contain any amounts which are expected to be collected after one year.

Note 3: Inventories

Inventories as of January 31, 2012 and April 30, 2011 consisted of the following:

| | January 31, 2012 | April 30, 2011 |
|-------------------------|---------------------|----------------|
| Raw Materials and Parts | \$22,691 | \$18,134 |
| Work in Process | 3,083 | 1,945 |
| Finished Goods | 8,506 | 8,530 |
| Inventories, net | \$34,280 | \$28,609 |

Note 4: Notes Payable

Notes payable as of January 31, 2012 and April 30, 2011 consisted of the following:

| | January 31, 2012 | April 30, 2011 |
|-----------------|---------------------|----------------|
| Credit Facility | \$— | \$5,500 |

The Company has a \$25.0 million Credit Facility that matures March 2, 2014. The agreement requires the Company to maintain the following financial covenants:

| | |
|--|---|
| Maximum Consolidated Leverage Ratio (i) | Minimum Fixed Charge Coverage Ratio (ii) |
| 2.75x | 1.75x |

Defined as the ratio of consolidated indebtedness, excluding the subordinated notes, to consolidated adjusted (i) Earnings Before Interest, Taxes, Depreciation and Amortization (“Adjusted EBITDA”) for the most recent four fiscal quarters.

Defined as the ratio of Adjusted EBITDA, less income taxes and maintenance capital expenditures, during the (ii) most recent four quarters, to the sum of interest charges during the most recent four quarters and scheduled debt repayments in the next four quarters.

A violation of any of the covenants above would result in an event of default and accelerate the repayment of all unpaid principal and interest and the termination of any letters of credit. The Company was in compliance with all its financial covenants as of January 31, 2012. All of the Company's domestic assets and certain interests in some foreign subsidiaries are pledged as collateral under the three-year Credit Facility Agreement. In addition, the terms of the Credit Facility Agreement limit the Company's ability to pay dividends.

Interest on the Credit Facility is based on the bank's prime rate or LIBOR rate plus a percentage spread between 0.00% and 2.25% depending on whether it uses the bank's prime rate or LIBOR rate and based on the Company's current leverage ratio. The Company also pays an annual letter of credit fee ranging from 1.25% to 2.25% of the amount available to be drawn under each outstanding stand-by letter of credit. The annual letter of credit fee is payable quarterly in arrears and varies depending on the Company's leverage ratio.

As of January 31, 2012, the Company had \$22.2 million available under its Credit Facility, net of \$2.8 million in outstanding letters of credit. There were no outstanding balances under the Company's Credit Facility as of January 31, 2012.

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Revolving Credit Facilities in Taiwan

The Company has two unsecured credit facilities in Taiwan of \$1.3 million and \$1.7 million bearing interest at 2.5% and 3.0% per annum, respectively. There were no outstanding balances under the Company's unsecured Taiwan credit facilities as of January 31, 2012.

Note 5: Commitments and Contingencies

Warranty Obligations

The Company believes that its warranty accrual as of January 31, 2012, which is included in the Other Accrued Liabilities line item in the Condensed Consolidated Balance Sheets, is sufficient to cover expected warranty costs. The following table presents the fiscal year 2012 year-to-date activity for the Company's warranty obligations:

| | | |
|--|---------|---|
| Warranty liability as of April 30, 2011 | \$2,804 | |
| Increase in warranty liability on fiscal year 2012 sales | 3,043 | |
| Reduction in warranty liability for claims in fiscal year 2012 | (2,884 |) |
| Warranty liability as of January 31, 2012 | \$2,963 | |

Legal Proceedings

At any time, the Company may be involved in legal proceedings arising in the normal course of conducting business. The Company's policy is to routinely assess the likelihood of any adverse judgments or outcomes related to legal matters, as well as ranges of probable losses. A determination of the amount of the reserves required, if any, for these contingencies is based on historical experience and after analysis of each known issue. The Company records reserves related to legal matters for which it is probable that a loss has been incurred and the range of such loss can be estimated. With respect to other matters, management has concluded that a loss is only reasonably possible or remote and, therefore, no liability is recorded. Management discloses the facts regarding material matters assessed as reasonably possible and potential exposure, if determinable. Costs incurred defending claims are expensed as incurred. Other than those described below, the Company does not believe that the resolution of any such matters will have a material adverse effect on its consolidated financial position, results of operations or cash flows.

In litigation arising out of a June 2002 incident at a Crucible Metals' ("Crucible") facility, the Company's excess insurance carrier is contesting its obligation to provide coverage for property damage. The suits over insurance coverage, Flow Autoclave Systems, Inc., Flow Pressure Systems, ABB Pressure Systems, Avure Technologies AB and Avure Technologies, Inc. v. Lumbermens Mutual Casualty and Kemper Insurance Co., and Lumbermens Mutual Casualty Company v. Flow International Corporation, Flow Autoclave Systems, Inc., Flow Pressure Systems, ABB Pressure Systems, Avure Technologies AB and Avure Technologies, Inc., were originally filed in Supreme Court of the State of New York, County of Onondaga, Index No. 2005-2126 in 2005, and sought a declaratory judgment of the rights of the parties under the insurance policy issued by the carrier. The carrier, Lumbermens Mutual Casualty Company, has settled the claims relating to this incident for a total of approximately \$3.4 million and is now seeking a declaratory judgment that it was not obligated to pay the claim, Lumbermens Mutual Casualty Company v. Flow International Corporation, Flow Autoclave Systems, Inc., Flow Pressure Systems, ABB Pressure Systems, Avure Technologies AB, Avure Technologies, Inc., Travelers Property Casualty Company of America and Zurich American Insurance Company as subrogees of Crucible Materials Corporation, and Crucible Materials Corporation, filed in United States District Court for the Northern District of New York on August 13, 2008, case number 08-CV-865. The Company intends to vigorously contest the carrier's claim; however, the ultimate outcome or likelihood of this specific claim cannot be determined at this time and an unfavorable outcome ranging from \$0 to \$3.4 million is reasonably possible.

Other Claims or Assessments

In fiscal year 2009, the Company was notified by the purchaser of its Avure business (reported as a discontinued operation for the year ended April 30, 2006), that the Swedish Tax Authority was conducting an audit which included

periods when the Company had owned the business. In the sale agreements, the Company made commitments to indemnify the purchaser for certain claims, including tax matters relating to the periods when it owned the business. The Swedish tax authority concluded its audit and issued a final report in November 2009 initially asserting that Avure owes 19.5 million Swedish Krona in additional taxes, penalties and fines. In April 2010, the Company, on behalf of Avure, filed an appeal to contest the Swedish tax authority's assertion. Since the filing of the Company's appeal, there has been further correspondence with the Swedish tax authorities as the Company continues to contest the findings, and there has been a hearing before the Swedish district court regarding the appeal, but there has been no decision in the matter. A charge was recorded in the first quarter of fiscal year 2010 related to the periods when the Company owned Avure. This charge was accounted for as an adjustment to the loss on the disposal of the Avure business and is reported as a charge to discontinued operations in the Company's Consolidated Statements

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of Operations. As of January 31, 2012, the Company has accrued \$1.3 million related to the Avure matter. The balance of the accrued liability will fluctuate period over period with changes in foreign currency rates until such time as the matter is ultimately resolved.

Note 6: Stock-Based Compensation

The Company maintains a stock-based compensation plan (the "2005 Plan") which was adopted to attract and retain talented employees and promote the growth and success of the business by aligning long-term interests of employees with those of shareholders. Shares are issuable in the form of common stock, restricted stock, performance stock units, stock options, stock appreciation rights, or cash awards.

Stock Options

The following table summarizes stock option activities for the nine months ended January 31, 2012:

| | Number of Options | Weighted-Average Exercise Price | Aggregate Intrinsic Value | Weighted-Average Remaining Contractual Term (Years) |
|--|----------------------|------------------------------------|------------------------------|--|
| Outstanding at April 30, 2011 | 489,438 | \$ 10.37 | \$— | 5.2 |
| Granted | — | — | | |
| Exercised | — | — | | |
| Expired or forfeited | (61,270 |) 9.82 | | |
| Outstanding at January 31, 2012 | 428,168 | \$ 10.45 | \$— | 5.1 |
| Vested and Exercisable at January 31, 2012 | 384,413 | \$ 10.53 | \$— | 5.0 |

There were no options granted or exercised for the respective nine months ended January 31, 2012 and 2011.

For the respective nine months ended January 31, 2012 and 2011, the Company recognized compensation expense related to stock options of \$0.2 million and \$0.4 million. As of January 31, 2012, total unrecognized compensation cost related to nonvested stock options was \$0.1 million, which is expected to be recognized within the current fiscal year.

Service and Performance-Based Stock Awards

The Company grants stock awards to employees of the Company with service and/or performance conditions, and it also grants stock awards to non-employee directors. Each non-employee director is eligible to receive and is granted fully vested common stock worth \$40,000 annually. The compensation cost of the common stock or restricted stock units are based on their fair value at the grant date and recognized ratably over the service or performance period.

The following table summarizes the service and performance-based stock award activities for employees for the nine months ended January 31, 2012:

| | Number of Shares | Weighted-Average Grant-date Fair Value |
|-------------------------------|---------------------|--|
| Nonvested at April 30, 2011 | 1,634,778 | \$ 2.90 |
| Granted | 720,028 | 3.42 |
| Vested | (381,711 |) 3.01 |
| Forfeited | (32,263 |) 3.04 |
| Nonvested at January 31, 2012 | 1,940,832 | \$ 3.07 |

For the respective nine months ended January 31, 2012 and 2011, the Company recognized compensation expense related to service and performance-based stock awards of \$1.5 million in each period. As of January 31, 2012, total unrecognized compensation cost related to service and performance-based stock awards of \$3.7 million is expected to be recognized over a weighted average period of 2.3 years.

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Note 7: Basic and Diluted Income per Share

Basic income per share is calculated by dividing income from continuing operations by the weighted average number of common shares outstanding during the period. Diluted income per share is calculated by dividing income from continuing operations by the weighted average number of common shares and potential common shares outstanding during the period. Potential common shares include the dilutive effects of outstanding stock options and non-vested stock units except where their inclusion would be antidilutive.

The following table sets forth the computation of basic and diluted income from continuing operations per share for the respective three and nine months ended January 31, 2012 and 2011:

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|---------|-------------------|--------|
| | January 31, | | January 31, | |
| | 2012 | 2011 | 2012 | 2011 |
| Income from Continuing Operations | \$3,259 | \$1,281 | \$6,644 | \$530 |
| Weighted average shares used in computing basic income per share | 47,857 | 47,301 | 47,730 | 47,168 |
| Dilutive potential common shares from employee stock options and restricted stock units | — | 11 | — | 6 |
| Weighted average shares used in computing diluted income per share | 47,857 | 47,312 | 47,730 | 47,174 |
| Basic and diluted income from continuing operations per share | \$0.07 | \$0.03 | \$0.14 | \$0.01 |

There were 2.4 million and 2.2 million potentially dilutive common shares from employee stock options and restricted stock units which were excluded from the diluted weighted average per share calculation for the respective three and nine months ended January 31, 2012 and 2011, as their effect would be antidilutive.

Note 8: Other Income (Expense), Net

The following table sets forth the detail of Other Income (Expense), net:

| | Three Months Ended | | Nine Months Ended | |
|---|--------------------|----------|-------------------|---------|
| | January 31, | | January 31, | |
| | 2012 | 2011 | 2012 | 2011 |
| Realized Foreign Exchange (Losses), net | \$(456 |) \$(133 |) \$(109 |) \$(44 |
| Unrealized Foreign Exchange Gains (Losses), net | 116 | 59 | (367 |) 351 |
| Other | (44 |) (7 |) (35 |) 8 |
| Other Income (Expense), net | \$(384 |) \$(81 |) \$(511 |) \$315 |

Note 9: Income Taxes

For the three and nine months ended January 31, 2012, the Company recorded income tax expense of \$2.0 million and \$4.3 million compared to income tax expense of \$1.1 million and \$2.9 million, respectively in the same periods last year. For the nine months ended January 31, 2011, the relationship between income tax expense and income before taxes was not customary as the Company recorded the impact of a \$1.9 million repatriation treated as a dividend for income tax purposes and the tax impact of losses from subsidiaries for which a full valuation allowance is maintained. The Company anticipates generating sufficient future taxable income to realize the benefits of its U.S. and certain of its foreign deferred tax assets while continuing to provide a full valuation allowance against its net operating losses and other net deferred tax assets in certain other foreign tax jurisdictions. The Company's valuation allowance, which was \$9.0 million at January 31, 2012 and \$9.7 million April 30, 2011, is mainly attributable to foreign net operating losses. Most of the foreign losses can be carried forward indefinitely, with certain amounts expiring between fiscal years 2014 and 2017.

As of January 31, 2012, the Company has not made a provision for U.S. or additional foreign withholding taxes for the excess of the financial reporting carrying value over the tax basis of investments in foreign subsidiaries with the exception of its subsidiaries in Taiwan, Japan, and Switzerland for which it provides deferred taxes.

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Note 10: Segment Information

The following table sets forth the revenue and gross margin of operations by reportable segment:

| | Three Months Ended | | Nine Months Ended | | |
|-------------------|--------------------|--------|-------------------|---------|---|
| | January 31, | | January 31, | | |
| | 2012 | 2011 | 2012 | 2011 | |
| Standard Segment: | | | | | |
| Sales | 59,076 | 49,916 | 171,267 | 135,619 | |
| Gross Margin | 24,244 | 21,017 | 70,093 | 57,093 | |
| | 41 | % 42 | % 41 | % 42 | % |
| Advanced Segment: | | | | | |
| Sales | 6,732 | 7,557 | 19,104 | 21,369 | |
| Gross Margin | 1,827 | 2,075 | 4,414 | 5,185 | |
| | 27 | % 27 | % 23 | % 24 | % |
| Total: | | | | | |
| Sales | 65,808 | 57,473 | 190,371 | 156,988 | |
| Gross Margin | 26,071 | 23,092 | 74,507 | 62,278 | |
| | 40 | % 40 | % 39 | % 40 | % |

Note 11: Subsequent Event

On February 6, 2012, the Company amended its existing lease agreement for its Kent, Washington headquarters, which was set to expire on December 31, 2012. The amended agreement extends the term of the lease for the Company's headquarters through January 31, 2020 and includes an extension option. The terms of the amendment do not result in materially different annual rent expense for the Company.

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FLOW INTERNATIONAL CORPORATION
MANAGEMENT'S DISCUSSION AND ANALYSIS OF
FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Forward-looking Statements

Forward-looking statements in this report, including without limitation, statements relating to our plans, strategies, objectives, expectations, intentions, and adequacy of resources, are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. The words "may," "expect," "believe," "anticipate," "estimate," "plan" and similar expressions are intended to identify forward-looking statements. These statements are no guarantee of future performance and involve certain risks, assumptions, and uncertainties that are difficult to predict. Therefore, actual outcome and results may differ materially from what is expressed or forecasted in such forward-looking statements.

We make forward-looking statements of our expectations which include but are not limited to the following examples:

• statements regarding the effects of global financial and economic conditions, credit and equity market volatility and continued fluctuations in the global economy and the impact this may have on our business and financial condition;

• statements regarding our technological leadership position and our belief that our technological capabilities for developing products with superior characteristics provide us potential growth opportunities as well as a competitive advantage;

• statements regarding our continued investments in lead generation, product enhancements, new product development and in our employees which we believe are critical to achieving our strategic objectives;

• statements regarding our belief that our continued efforts to streamline our manufacturing process will ensure that we optimize the most cost efficient sources of labor while maintaining a high level of quality;

• statements regarding our ability to mitigate the risk of higher commodity and fuel prices;

• statements regarding our belief that our channels of distribution are unparalleled in our industry;

• statements regarding our belief that Advanced segment gross margins have returned to normalized levels;

• statements regarding our use of cash, cash needs, generation of cash through operations, and ability to raise capital and/or use our Credit Facility;

• statements regarding our belief that our existing cash and cash equivalents, along with the expected proceeds from our operations and available amounts under our Credit Facility Agreement, will provide adequate liquidity to fund our operations through at least the next twelve months;

• statements regarding our ability to fund future capital spending through cash from operations and/or from external financing;

• statements regarding our ability to meet our debt covenants in future periods;

• statements regarding anticipated results of potential or actual litigation; and

• statements regarding the realizability of our deferred tax assets and our expectation that our unrecognized tax benefits will not change significantly within the next twelve months.

Certain other statements in Management's Discussion and Analysis are forward-looking as defined in the Private Securities Litigation Reform Act of 1995. Our ability to fully implement our strategies and achieve our objective may be influenced by a variety of factors, many of which are beyond our control. For a detailed discussion of risk factors affecting our business and operations, see Item 1A, Risk Factors in our fiscal year 2011 Form 10-K. We undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. These forward-looking statements should not be relied on as representing our estimates or views as of any subsequent date.

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In this discussion and analysis, we discuss and explain our financial condition and results of operations, including:

- Factors which might affect comparability of our results;
- Our earnings and costs in the periods presented;
- Changes in earnings and costs between periods;
- Impact of these factors on our overall financial condition;
- Expected future expenditures for capital projects; and
- Expected sources of cash for future operations and capital expenditures.

As you read this discussion and analysis, refer to our Condensed Consolidated Statements of Operations included in Item 1 - Condensed Consolidated Financial Statements, which presents the results of our operations for the respective three and nine months ended January 31, 2012 and 2011. We analyze and explain the differences between the periods in the specific line items of our Condensed Consolidated Statements of Operations. This discussion and analysis has been organized as follows:

- Executive Summary, including overview and future outlook;
- Significant matters affecting comparability that are important to understanding the results of our operations and financial condition;
- Results of operations beginning with an overview of our results, followed by a detailed review of those results by reporting segment;
- Financial condition addressing liquidity position, sources and uses of cash, capital resources and requirements, commitments, and off-balance sheet arrangements; and
- Critical accounting policies which require management's most difficult, subjective or complex judgment.

Executive Summary

Overview

Flow is a global technology-based manufacturing company committed to providing a world class customer experience. We offer technology leadership and exceptional waterjet performance to a wide-ranging customer base. Our versatile technology benefits many cutting and cleaning applications, delivering profitable waterjet solutions and dynamic business growth to our customers.

Third Quarter 2012 Highlights

During the third quarter of fiscal year 2012:

- Our Standard segment systems sales grew by 23% to \$40.1 million for the three months ended January 31, 2012 compared to the year-ago quarter with strong growth across all regions;
- We continued to experience strong demand for consumable parts across most of our markets with sales increasing by 9% to \$19.0 million;
- As anticipated, our Advanced segment system sales were \$6.7 million for the three months ended January 31, 2012, an 11% decrease versus the year-ago quarter primarily due to the timing of contract awards, timing of project design and manufacturing schedule, and the timing of shipments to customers;
- Overall revenues for the three months ended January 31, 2012 totaled \$65.8 million, a 15% increase compared to the year-ago quarter and also represents a new quarterly record for Flow;
- Quarter-over-quarter, our overall gross margins remained constant;
- Our operating income was \$6.0 million or 9.1% of sales during the three months ended January 31, 2012 compared to operating income of \$2.8 million or 4.9% of sales in the year-ago quarter;
- We generated net income of \$3.3 million or earnings per share of \$0.07 per share which compares to a net income of \$1.2 million or \$0.03 per share in the comparative prior period;
- Our consolidated adjusted earnings before interest, tax and depreciation ("Adjusted EBITDA") increased from \$4.9 million in the year-ago quarter to \$8.1 million for the quarter ended January 31, 2012. A reconciliation of Adjusted EBITDA to net income, which is the GAAP financial measure that is most directly comparable to our non-GAAP financial measure, is provided herein;

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We maintained a strong balance sheet with a net cash position of \$10.2 million as of January 31, 2012, a current ratio of 2.0 and a long-term debt to equity ratio of 0.1. Total cash generated by operating activities as defined in our cash flow statement was \$3.3 million during the three months ended January 31, 2012. We continue to maintain sufficient liquidity for our expected future operations and had \$2.8 million in outstanding letters of credit against our \$25.0 million Credit Facility. We believe that future cash flow from operations and our borrowing capacity should provide adequate capital for planned growth.

Looking Ahead

Although other factors will likely impact us, including some that we do not foresee, we believe that our performance for the remainder of fiscal year 2012 may be affected by the following:

Economic Climate. The current economic environment continues to affect our business in a number of direct and indirect ways including: consumer demand for our products, differences in customer demand in the different geographic regions in which we operate; profit margins subject to pricing in the different geographic regions, sales mix due to differing products; changes in currency exchange rates; lack of credit availability; inflation; and business disruptions due to difficulties experienced by suppliers and customers.

Operations and Manufacturing. We anticipate that commodity price pressure will continue in the near term. Mitigating the risk of higher commodity and fuel prices continues to be an area of focus. We intend to continue to pursue opportunities for streamlining of distribution, logistics and manufacturing operations, focus on inventory management, optimizing transportation costs, and providing a high level of service to our customers.

New Products. We continue to make strategic investments in research and development for existing and new products, and to invest in research and development of advanced and innovative technologies for future application. We believe that delivering innovative and high-value solutions is critical to meeting customer needs and achieving our future growth. We remain positive with regard to our recently introduced Mach 4 and Mach 2 series products and expect limited contributions in fiscal year 2012 with stronger contributions in fiscal year 2013 and beyond.

Distribution Channels. We intend to continue making significant investments to expand our access to potential customers by continued development of both our direct and indirect distribution channels, which are unparalleled in the industry.

Management remains focused on creating long-term shareholder value. We believe that Adjusted EBITDA, which we define as net income (loss), as determined in accordance with accounting principles generally accepted in the United States of America ("GAAP"), excluding the effects of income taxes, depreciation, amortization of intangible assets, interest expense, and other non-cash charges, which includes such items as stock-based compensation expense, foreign currency gains or losses, and other allowable add backs pursuant to our Credit Facility Agreement, is a good measure of our core performance in creating this value. The following table reconciles our Adjusted EBITDA for the three and nine months ended January 31, 2012:

Reconciliation of Adjusted EBITDA to Net Income:
(in 000s)

| | Three Months Ended | | Nine Months Ended | |
|-------------------------------|---------------------|---------|---------------------|----------|
| | January 31, 2012 | 2011 | January 31, 2012 | 2011 |
| Net Income | \$3,316 | \$1,241 | \$6,806 | \$378 |
| Add Back: | | | | |
| Depreciation and Amortization | 1,572 | 1,522 | 4,723 | 4,706 |
| Income Tax Provision | 2,041 | 1,058 | 4,279 | 2,926 |
| Interest Charges | 317 | 418 | 937 | 1,268 |
| Non-Cash Charges (i) | 868 | 687 | 2,092 | 1,700 |
| Adjusted EBITDA | \$8,114 | \$4,926 | \$18,837 | \$10,978 |

(i) Allowable Add backs Pursuant to Credit Facility Agreement

Adjusted EBITDA is a non-GAAP financial measure and the presentation of this non-GAAP financial measure is not intended to be considered in isolation or as a substitute for the financial information presented in accordance with GAAP. The items excluded from this non-GAAP financial measure are significant components of our financial statements and must be considered in performing a comprehensive analysis of our overall financial results. We use this measure, together with our

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GAAP financial metrics, to assess our financial performance, allocate resources, evaluate our overall progress towards meeting our long-term financial objectives, and to assess compliance with our debt covenants. We believe that this non-GAAP financial measure is useful to investors and analysts in allowing for greater transparency with respect to the supplemental information used by us in our financial and operational decision making. Our calculation of Adjusted EBITDA may not be consistent with calculations of similar measures used by other companies.

Matters Affecting Comparability

The following events occurred in the respective three and nine months ended January 31, 2012 and 2011, which impact the comparability of our results of operations:

Investments in Business

We believe that continued investment in lead generation, product enhancements, new product development and in our employees is critical to achieving our strategic objectives in fiscal 2012 and beyond. Comparable period-over-period operating expenses will differ depending on the timing and magnitude of these investments. We expect that we will be able to leverage our overall operating expenses in future periods as our business continues to grow.

Currency Translation

The volatility in the global economic environment continues to result in significant volatility in the global currency markets. Since the majority of our international operations are conducted in currencies other than the U.S. dollar, currency fluctuations can have a significant impact on the translation of our international revenues and earnings into U.S. dollar amounts. During the first half of fiscal year 2012, the U.S. dollar weakened against these currencies versus the comparable prior year period, positively impacting the translation of our international revenues and earnings during the current period. In the third quarter of fiscal year 2012, we experienced a strengthening of the U.S. dollar against the Euro which is anticipated to continue and, to the extent it does, we expect it will have a negative impact in the translation of our revenue and earnings in that region.

In addition, some of our transactions that occur in our international locations are denominated in U.S. dollars, exposing them to exchange rate fluctuations when converted to their local currencies. These transactions include U.S. dollar denominated purchases of inventory and intercompany liabilities. Fluctuations in exchange rates can impact the profitability of our foreign operations and reported earnings and are largely dependent on the transaction timing and magnitude during the period that the currency fluctuates.

Reinstatement of Previously Reduced Wages and Suspended Employee Benefits

As the global recession set in during fiscal years 2008 and 2009, we responded by implementing permanent and temporary changes to adjust our operating costs. Some of these changes included a temporary reduction in wages or hours worked for a majority of our employees and suspension of certain employee benefits. While these temporary wage reductions and benefit suspensions helped us through the economic downturn, they did not fit into our long-term strategy of attracting and retaining skilled and knowledgeable people. We therefore initiated the reinstatement of these wages and employee benefits using a phased in approach starting in the third quarter of fiscal year 2010. As a result of these reinstatements, our comparable year-over-year operating expenses are higher in the current comparative period.

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Results of Operations

(Tabular amounts in thousands)

Summary Consolidated Results

| | Three Months Ended | | | | | Nine Months Ended | | | | |
|--|--------------------|----------|---------------------|-------|---------|-------------------|-----------|---------------------|-------|------|
| | January 31, | | Increase (Decrease) | | | January 31, | | Increase (Decrease) | | |
| | 2012 | 2011 | \$ | % | | 2012 | 2011 | \$ | % | |
| Sales | \$65,808 | \$57,473 | \$8,335 | 15 | % | \$190,371 | \$156,988 | \$33,383 | 21 | % |
| Gross Margin | 26,071 | 23,092 | 2,979 | 13 | % | 74,507 | 62,278 | 12,229 | 20 | % |
| Selling, General, and Administrative Expenses | 20,082 | 20,275 | (193) | (1) | % | 62,197 | 57,955 | 4,242 | 7 | % |
| Operating Income | 5,989 | 2,817 | 3,172 | NM | | 12,310 | 4,323 | 7,987 | NM | |
| Expressed as a % of Sales: | | | | | | | | | | |
| Gross Margin | 40 | % 40 | % | — | bpts 39 | % 40 | % | | (100) | bpts |
| Selling, General, and Administrative Expenses | 31 | % 35 | % | (400) | bpts 33 | % 37 | % | | (400) | bpts |
| Operating Income | 9 | % 5 | % | 400 | bpts 6 | % 3 | % | | 300 | bpts |

bpts = basis points

NM = not meaningful

Consolidated Sales by Category

| | Three Months Ended | | | | | Nine Months Ended | | | | |
|------------------------|--------------------|----------|---------------------|----|---|-------------------|-----------|---------------------|----|---|
| | January 31, | | Increase (Decrease) | | | January 31, | | Increase (Decrease) | | |
| | 2012 | 2011 | \$ | % | | 2012 | 2011 | \$ | % | |
| System Sales | \$46,780 | \$39,987 | \$6,793 | 17 | % | \$130,913 | \$105,429 | \$25,484 | 24 | % |
| Consumable Parts Sales | 19,028 | 17,486 | 1,542 | 9 | % | 59,458 | 51,559 | 7,899 | 15 | % |
| | \$65,808 | \$57,473 | \$8,335 | 15 | % | \$190,371 | \$156,988 | \$33,383 | 21 | % |

Segment Results of Operations

We report our operating results to the chief operating decision maker based on market segments which are consistent with management's long-term growth strategy. Our reportable segments are Standard and Advanced. The Standard segment includes sales and cost of sales related to our cutting, surface preparation and cleaning systems using ultrahigh-pressure water pumps as well as parts and services to sustain these installed systems. Systems included in this segment do not require significant custom configuration. The Advanced segment includes sales and cost of sales related to our complex aerospace and automation systems which require specific custom configuration and advanced features to match unique customer applications. Segment results are measured based on revenue growth and gross margin.

This section provides a comparison of sales and gross margin for each of our reportable segments for the respective three and nine months ended January 31, 2012 and 2011.

Standard Segment

Three Months Ended

Nine Months Ended

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| | January 31, | | Increase (Decrease) | | January 31, | | Increase (Decrease) | | | |
|-------------------------------|-------------|----------|------------------------|------|-------------|-----------|---------------------|----------|------|--------|
| | 2012 | 2011 | \$ | % | 2012 | 2011 | \$ | % | | |
| Sales | \$59,076 | \$49,916 | \$9,160 | 18 | % | \$171,267 | \$135,619 | \$35,648 | 26 | % |
| % of total company sales | 90 | % 87 | % NM | 300 | bpts | 90 | % 86 | % NM | 400 | bpts |
| Gross Margin | 24,244 | 21,017 | 3,227 | 15 | % | 70,093 | 57,093 | 13,000 | 23 | % |
| Gross Margin as % of sales | 41 | % 42 | % NM | (100 |) bpts | 41 | % 42 | % NM | (100 |) bpts |

bpts = basis points
 NM = not meaningful

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For the three and nine months ended January 31, 2012:

Sales in our standard segment increased \$9.2 million or 18%, and \$35.6 million or 26% over the prior year comparative periods. Excluding the impact of foreign currency changes, sales in the Standard segment increased \$9.6 million or 19% and \$32.0 million or 24% for the respective three and nine months ended January 31, 2012 when compared to the prior year comparative periods. The quarter-to-date and year-to-date increases were primarily due to the following:

- Continued double-digit growth in system sales in nearly all geographies on higher system sales volume for an aggregate growth of \$7.6 million or 23% and \$27.7 million or 33% over the prior year comparative periods.
- Consumable parts sales for this segment also increased \$1.5 million or 9% and \$7.9 million or 15% over the prior year comparative periods based on higher system utilization by our customers and increased system sales volumes.

Gross margin for the three and nine months ended January 31, 2012 amounted to \$24.2 million or 41% and \$70.1 million or 41% of sales compared to \$21.0 million or 42%, and \$57.1 million or 42% of sales in the prior year comparative periods. Generally, comparison of gross margin rates will vary period over period based on changes in our product sales mix and prices, geographic mix and levels of production volume.

Advanced Segment

| | Three Months Ended | | | Increase (Decrease) | | | Nine Months Ended | | | Increase (Decrease) | | |
|----------------------------|--------------------|---------|---------|---------------------|---|--------|-------------------|----------|-------------|---------------------|--|-------------|
| | January 31, | | | January 31, | | | January 31, | | January 31, | | | January 31, |
| | 2012 | 2011 | | \$ | % | | \$ | % | \$ | % | | \$ |
| Sales | \$6,732 | \$7,557 | \$(825) | (11) | |)% | \$19,104 | \$21,369 | \$(2,265) | (11) | |)% |
| % of total company sales | 10 | % 13 | % NM | (300) | |) bpts | 10 | % 14 | % NM | (400) | |) bpts |
| Gross Margin | 1,827 | 2,075 | (248) | (12) | |)% | 4,414 | 5,185 | (771) | (15) | |)% |
| Gross Margin as % of sales | 27 | % 27 | % NM | — | | bpts | 23 | % 24 | % NM | (100) | |) bpts |

bpts = basis points

NM = not meaningful

Sales in the Advanced segment vary period over period for various reasons, such as the timing of contract awards, timing of project design and manufacturing schedules, the timing of shipments to customers, and timing of installation at customer sites.

For the respective three and nine months ended January 31, 2012, sales in our Advanced segment decreased by \$0.8 million or 11% and \$2.3 million or 11% over the prior year comparative periods. The decrease in sales was anticipated and primarily driven by the timing of our Advanced contracts and completion of certain aerospace contracts in the current fiscal year.

Gross margin for the three and nine months ended January 31, 2012 amounted to \$1.8 million or 27% and \$4.4 million or 23% of sales as compared to \$2.1 million and 27% and \$5.2 million and 24% of sales in the prior year comparative periods. Gross margin as a percentage of sales in the Advanced segment returned to more normalized levels for the three months ended January 31, 2012 based on the type of projects and the stages of the projects. Advanced segment gross margins will vary period over period based on changes in product mix, geographic mix and levels of production.

Selling, General, and Administrative Expenses

| | Three Months Ended | | | Increase (Decrease) | | | Nine Months Ended | | | Increase (Decrease) | | |
|----------------------------|--------------------|----------|-------|---------------------|---|----|-------------------|----------|-------------|---------------------|--|-------------|
| | January 31, | | | January 31, | | | January 31, | | January 31, | | | January 31, |
| | 2012 | 2011 | | \$ | % | | \$ | % | \$ | % | | \$ |
| Sales and Marketing | \$12,028 | \$11,568 | 460 | 4 | | % | \$36,806 | \$33,049 | 3,757 | 11 | | % |
| Research and Engineering | 2,712 | 2,513 | 199 | 8 | | % | 8,079 | 7,095 | 984 | 14 | | % |
| General and Administrative | 5,342 | 6,194 | (852) | (14) | |)% | 17,312 | 17,811 | (499) | (3) | |)% |

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Total Operating Expenses \$20,082 \$20,275 (193) (1)% \$62,197 \$57,955 4,242 7 %

Consolidated operating expenses decreased for the three months ended January 31, 2012 over the prior year comparative period and increased for the nine months ended January 31, 2012 as compared to the prior period, respectively. The movement was primarily the result of the following:

• higher commission expense of \$0.8 million and \$2.8 million, respectively, based on comparatively higher sales volume and increased sales through our indirect channel;

• decreased marketing and related support expenses by \$0.4 million for the three months ended January 31, 2012 versus

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the prior year comparative period and increased marketing and support expense of \$0.2 million for the nine months ended January 31, 2012 as compared to the prior year period due to the timing and activity of customer lead generation;

labor and compensation related costs were \$0.2 million lower for the three months ended January 31, 2012 versus the prior year comparative period. For the nine months ended January 31, 2012, the reinstatement of previously reduced wages and suspended employee benefits, as well as incremental investment in personnel compensation and other labor related costs, increased operating expenses by \$1.5 million;

lower investment in new product development and technology infrastructure for the three months ended January 31, 2012 which decreased \$0.2 million over the prior year comparative period. Investment in new product development and technology infrastructure for the nine months ended January 31, 2012 was consistent with the prior year comparative period; and

other general cost reductions of \$0.2 million and \$0.3 million over the prior year comparative periods due in part to the timing of internal projects, and also to management and operational efficiencies.

Interest Income (Expense), net

| | Three Months Ended | | | Nine Months Ended | | | | |
|----------------------|--------------------|---------|---------------------|-------------------|-------------|-----------|---------------------|-------|
| | January 31, | | Increase (Decrease) | | January 31, | | Increase (Decrease) | |
| | 2012 | 2011 | \$ | % | 2012 | 2011 | \$ | % |
| Interest Income | \$12 | \$21 | \$(9) | (43)% | \$61 | \$86 | \$(25) | (29)% |
| Interest Expense | (317) | (418) | (101) | (24)% | (937) | (1,268) | (331) | (26)% |
| Net Interest Expense | \$(305) | \$(397) | \$(92) | (23)% | \$(876) | \$(1,182) | \$(306) | (26)% |

Our net interest expense was \$0.3 million and \$0.9 million for the three and nine months ended January 31, 2012, compared to net interest expense of \$0.4 million and \$1.2 million in the prior year comparative periods. Our interest expense primarily consists of imputed interest on two subordinated notes that carry a below market interest rate, amortization of deferred debt financing fees and interest charges on the used and unused portion of our Credit Facility as well as outstanding letters of credit.

Other Income (Expense), net

| | Three Months Ended | | | Nine Months Ended | | | | |
|---|--------------------|---------|---------------------|-------------------|-------------|--------|---------------------|----|
| | January 31, | | Increase (Decrease) | | January 31, | | Increase (Decrease) | |
| | 2012 | 2011 | \$ | % | 2012 | 2011 | \$ | % |
| Realized Foreign Exchange (Losses), net | \$(456) | \$(133) | \$(323) | NM | \$(109) | \$(44) | \$(65) | NM |
| Unrealized Foreign Exchange Gains (Losses), net | 116 | 59 | 57 | 97% | (367) | 351 | (718) | NM |
| Other | (44) | (7) | (37) | NM | (35) | 8 | (43) | NM |
| Other Income (Expense), net | \$(384) | \$(81) | \$(303) | NM | \$(511) | \$315 | \$(826) | NM |

NM = not meaningful

During the three months ended January 31, 2012 net Other Expense was \$0.4 million compared to negligible net Other Expense for the three months ended January 31, 2011. For the nine months ended January 31, 2012 we recorded net Other Expense of \$0.5 million compared to net Other Income of \$0.3 million in the prior year comparative period. In general, changes in this balance result from the fluctuation in realized and unrealized foreign exchange gains and losses on revaluation of third party and intercompany settled and unsettled balances for which payment is anticipated in the foreseeable future.

Income Taxes

Our provision for income taxes for the respective three and nine months ended January 31, 2012 and 2011 consisted of:

| | Three Months Ended | | | Nine Months Ended | | | | |
|--|--------------------|------|---------------------|-------------------|-------------|------|---------------------|---|
| | January 31, | | Increase (Decrease) | | January 31, | | Increase (Decrease) | |
| | 2012 | 2011 | \$ | % | 2012 | 2011 | \$ | % |

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| | | | | | | | | | | |
|----------------------|---------|---------|-------|----|---|---------|---------|---------|----|---|
| Current Tax Expense | \$808 | \$425 | \$383 | 90 | % | \$1,754 | \$1,447 | \$307 | 21 | % |
| Deferred Tax Expense | 1,233 | 633 | 600 | 95 | % | 2,525 | 1,479 | 1,046 | 71 | % |
| Total Tax Expense | \$2,041 | \$1,058 | \$983 | 93 | % | \$4,279 | \$2,926 | \$1,353 | 46 | % |

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For the three and nine months ended January 31, 2012, we recorded income tax expense of \$2.0 million and \$4.3 million compared to income tax expense of \$1.1 million and \$2.9 million, respectively in the comparative prior year. For the nine months ended January 31, 2011, the relationship between income tax expense and income before taxes was not customary as we recorded the impact of a \$1.9 million repatriation treated as a dividend for income tax purposes and the tax impact of losses from subsidiaries for which a full valuation allowance is maintained.

We anticipate generating sufficient future taxable income to realize the benefits of our U.S. and certain of our foreign deferred tax assets while continuing to provide a full valuation allowance against our net operating losses and other net deferred tax assets in certain other foreign tax jurisdictions. Our valuation allowance, which was \$9.0 million at January 31, 2012 and \$9.7 million April 30, 2011, is mainly attributable to foreign net operating losses. Most of the foreign losses can be carried forward indefinitely, with certain amounts expiring between fiscal years 2014 and 2017. As of January 31, 2012, we have not made a provision for U.S. or additional foreign withholding taxes for the excess of the financial reporting carrying value over the tax basis of investments in foreign subsidiaries with the exception of our subsidiaries in Taiwan, Japan, and Switzerland for which we provide deferred taxes.

Liquidity and Capital Resources

Sources of Cash

Historically, our most significant sources of financing have been funds generated by operating activities, available cash and cash equivalents and available lines of credit. From time to time, we have raised funds through the sale of common stock.

Cash Generated by Operating Activities

Cash generated by operating activities was \$9.3 million for nine months ended January 31, 2012, compared to cash generated by operations of \$4.2 million for the nine months ended January 31, 2011. The improvement in cash generated by operating activities versus the prior year comparative period was driven by comparatively stronger earnings for the nine months ended January 31, 2012.

Available Cash and Cash Equivalents

At January 31, 2012, we had total cash and cash equivalents of \$10.2 million, of which \$8.2 million was held by our foreign subsidiaries. To the extent that our cash needs in the U.S. exceed our cash reserves and availability under our Credit Facility Agreement, we may repatriate cash from certain of our foreign subsidiaries; however, this is not our current intent and could be limited by our ability to repatriate such cash in a tax efficient manner. We believe that our existing cash and cash equivalents as of January 31, 2012, anticipated funds generated from our operations, and financing available under our existing credit facilities will be sufficient to fund our operations for at least the next twelve months. However, in the event that there are changes in our expectations or circumstances, we may need to raise additional funds through public or private debt or sale of equity to fund our operations. Cash balances which are not available for general corporate purposes are classified as restricted cash and are primarily related to cash which collateralizes commercial letters of credit.

Credit Facilities

We have a \$25.0 million Credit Facility that matures March 2, 2014. The agreement requires us to maintain the following financial covenants:

| | |
|----------------------|----------------------|
| Maximum Consolidated | Minimum Fixed Charge |
| Leverage Ratio (i) | Coverage Ratio (ii) |
| 2.75x | 1.75x |

Defined as the ratio of consolidated indebtedness, excluding the subordinated notes issued to OMAX, to (i) consolidated adjusted Earnings Before Interest, Taxes, Depreciation and Amortization (“Adjusted EBITDA”) for the most recent four fiscal quarters.

Defined as the ratio of Adjusted EBITDA, less income taxes and maintenance capital expenditures, during the (ii) most recent four quarters to the sum of interest charges during the most recent four quarters and scheduled debt repayments in the next four quarters.

The financial covenants are measured on a quarterly basis. Our leverage ratio and fixed charge coverage ratio were 0.13

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and 34.3, respectively, as of January 31, 2012. Our calculations of these financial ratios are reported in Exhibit No. 99.1 of this Quarterly Report on Form 10-Q. A violation of any of the covenants above would result in an event of default and accelerate the repayment of all unpaid principal and interest and the termination of any letters of credit. All of our domestic assets and certain interests in some foreign subsidiaries are pledged as collateral under the three-year Credit Facility Agreement. We were in compliance with all our financial covenants as of January 31, 2012.

Interest on the Credit Facility is based on the bank's prime rate or LIBOR rate plus a percentage spread between 0.00% and 2.25% depending on whether it uses the bank's prime rate or LIBOR rate and based on our current leverage ratio. We also pay an annual letter of credit fee ranging from 1.25% to 2.25% of the amount available to be drawn under each outstanding stand-by letter of credit. The annual letter of credit fee is payable quarterly in arrears and varies depending on our leverage ratio.

We expect to be in compliance with our covenants pursuant to the Credit Facility Agreement for at least the next twelve months. However, in the event that there is a possibility of default, we may institute cost reductions; raise additional funds through public or private debt or sale of equity; possibly seek further amendments to our Credit Facility Agreement or a combination of these items. Refer to Part I, Item 1A - Risk Factors in our Annual Report on Form 10-K for the fiscal year ended April 30, 2011 for discussion of the risks and uncertainties pertaining to our business and industry.

As of January 31, 2012, we had \$22.2 million available under our Credit Facility, net of \$2.8 million in outstanding letters of credit. There were no outstanding balances under our Credit Facility as of January 31, 2012.

We have two unsecured credit facilities in Taiwan of \$1.3 million and \$1.7 million bearing interest at 2.5% and 3.0% per annum, respectively. There were no outstanding balances under our unsecured Taiwan credit facilities as of January 31, 2012.

Subordinated Notes

We have subordinated notes with an aggregate value of \$10.0 million, accruing interest at 2% annually, all of which are due August 2013. We expect to pay the subordinated notes, and related interest, using cash generated from our operations or from our existing credit facilities.

Uses of Cash

Capital Expenditures

Our capital spending plans currently provide for outlays ranging from approximately \$6 million to \$8 million over the next twelve months, primarily related to investments in machinery and equipment to support manufacturing, the continued implementation of our ERP system and other information technology related projects, as well as patent and trademark maintenance. It is expected that funds necessary for these expenditures will be generated internally or from available financing. To the extent that sufficient funds cannot be generated through operations or we are unable to obtain financing on reasonable terms, we may reduce our capital expenditures accordingly. Our capital spending for the nine months ended January 31, 2012 and 2011 was \$3.3 million and \$2.7 million, respectively.

Repayment of Debt, Capital Leases and Notes Payable

Our total net repayments of debt and notes payable were \$5.5 million for the nine months ended January 31, 2012 as compared to net borrowings of debt and notes payable of \$1.5 million for the nine months ended January 31, 2011.

Off-Balance Sheet Arrangements

As of January 31, 2012, the Company had letter-of-credit reimbursement agreements totaling \$2.8 million compared to \$2.3 million as of April 30, 2011. These letter-of-credit agreements relate to performance on contracts with our customers and vendors.

Contractual Obligations

During the nine months ended January 31, 2012, there were no material changes outside the ordinary course of business in our contractual obligations and minimum commercial commitments as reported in our Annual Report on Form 10-K for the fiscal year ended April 30, 2011.

Critical Accounting Estimates and Judgments

There are no material changes in our critical accounting estimates as disclosed in our Annual Report on Form 10-K for the

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fiscal year ended April 30, 2011.

Recently Issued Accounting Pronouncements

Refer to Note 1 to the Condensed Consolidated Financial Statements found in Item 1 of Part I of this quarterly report on Form 10-Q for a discussion of recently issued accounting pronouncements.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have not been any material changes in our market risk during the nine months ended January 31, 2012. For additional information, refer to Management's Discussion and Analysis of Financial Condition and Results of Operations as presented in our Annual Report on Form 10-K for the fiscal year ended April 30, 2011.

Item 4. Controls and Procedures

(a) Evaluation of Disclosure Controls and Procedures

The Company's management evaluated, with the participation of our principal executive officer and principal financial officer, the effectiveness of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as of the end of the period covered by this report. Based on this evaluation, our principal executive officer and principal financial officer have concluded that, as of the end of the period covered by this report, our disclosure controls and procedures were effective to ensure that information we are required to disclose in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms relating to the Company, including our consolidated subsidiaries, and was accumulated and communicated to the Company's management, including the principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Controls

During the third quarter of fiscal year 2012, we completed the implementation of our new enterprise resource planning ("ERP") system in another of our geographic locations, continuing with the implementation that was launched in the second quarter of fiscal year 2010. We expect to continue this implementation in succeeding phases over the course of the next twelve to eighteen months in the rest of our global operations. The implementation of this ERP system has and will continue to affect our internal controls over financial reporting by, among other things, improving user access security and automating a number of accounting, back office and reporting processes and activities. Management will continue to evaluate the operating effectiveness of related key controls during subsequent periods.

With the exception of the implementation of the ERP system in another of our geographic locations as described above, there were no other changes identified in our internal control over financial reporting that occurred during the fiscal quarter ended January 31, 2012 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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PART II—OTHER INFORMATION

Item 1. Legal Proceedings

Refer to Note 5 of the Condensed Consolidated Financial Statements found in Item 1 of Part I of this quarterly report on Form 10-Q for a discussion of the Company's legal proceedings.

Item 1A. Risk Factors

Our business is subject to certain risks and events that, if they occur, could adversely affect our financial condition and results of operations and the trading price of our common stock. For a discussion of these risks, please refer to the "Risk Factors" sections of our Annual Report on Form 10-K for the fiscal year ended April 30, 2011, filed by us with the United States Securities and Exchange Commission on June 23, 2011. There have been no material changes in the risk factors set forth in our Annual Report on Form 10-K for the fiscal year ended April 30, 2011.

Items 2, 3, 4, and 5 are None and have been omitted.

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Item 6. Exhibits

| | |
|----------|---|
| 31.1 | Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 | Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1 | Certifications of Principal Executive Officer and Principal Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 99.1 | Debt Covenant Compliance as of January 31, 2012 |
| 101. INS | XBRL Instance Document |
| 101. SCH | XBRL Taxonomy Extension Schema Document |
| 101. CAL | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101. DEF | XBRL Taxonomy Extension Definition Linkbase Document |
| 101. LAB | XBRL Taxonomy Extension Label Linkbase Document |
| 101. PRE | XBRL Taxonomy Extension Presentation Linkbase Document |

The XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q shall not be deemed “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, or otherwise subject to liability of that section and shall not be incorporated by reference into any filing or other document pursuant to the Securities Act of 1933, as amended, except as shall be expressly set forth by specific reference in such filing or document.

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SIGNATURES

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

FLOW INTERNATIONAL CORPORATION

Date: March 1, 2012

/s/ Charles M. Brown
Charles M. Brown
President and Chief Executive Officer
(Principal Executive Officer)

Date: March 1, 2012

/s/ Allen M. Hsieh
Allen M. Hsieh
Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)