

FLOW INTERNATIONAL CORP

Form 10-Q

September 04, 2008

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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 July 31, 2008

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 0-12448**

FLOW INTERNATIONAL CORPORATION

**WASHINGTON
(State or other jurisdiction of
incorporation or organization)**

**91-1104842
(I.R.S. Employer
Identification No.)**

**23500 - 64th Avenue South
Kent, Washington 98032
(253) 850-3500**

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

The registrant had 38,594,083 shares of Common Stock, \$0.01 par value per share, outstanding as of August 22, 2008.

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Explanatory Note:

This Form 10-Q reflects the restatement of the Company's Condensed Consolidated Financial Statements for the quarter ended July 31, 2007 and related Management's Discussion and Analysis of Financial Condition and Results of Operations in Item 2 herein. The restatement is more fully described in Note 16 to the Condensed Consolidated Financial Statements under Item 1, Financial Information herein.

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FLOW INTERNATIONAL CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited; in thousands)

| | July 31, 2008 | April 30, 2008 |
|---|--------------------------|---------------------------|
| <i>ASSETS:</i> | | |
| Current Assets: | | |
| Cash and Cash Equivalents | \$ 24,706 | \$ 29,099 |
| Restricted Cash | 117 | 142 |
| Receivables, net | 33,441 | 33,632 |
| Inventories | 28,555 | 29,339 |
| Deferred Income Taxes | 2,443 | 2,889 |
| Deferred Acquisition Costs | 8,942 | 7,953 |
| Other Current Assets | 8,065 | 6,456 |
| | | |
| Total Current Assets | 106,269 | 109,510 |
| Property and Equipment, net | 19,545 | 18,790 |
| Intangible Assets, net | 4,212 | 4,062 |
| Goodwill | 2,764 | 2,764 |
| Deferred Income Taxes | 14,926 | 15,535 |
| Other Assets | 1,086 | 494 |
| | \$ 148,802 | \$ 151,155 |
| <i>LIABILITIES AND SHAREHOLDERS EQUITY:</i> | | |
| Current Liabilities: | | |
| Notes Payable | \$ 1,113 | \$ 1,118 |
| Current Portion of Long-Term Obligations | 1,208 | 977 |
| Accounts Payable | 14,951 | 19,516 |
| Accrued Payroll and Related Liabilities | 7,993 | 8,189 |
| Taxes Payable and Other Accrued Taxes | 4,207 | 3,617 |
| Deferred Income Taxes | 683 | 686 |
| Deferred Revenue | 3,949 | 4,980 |
| Customer Deposits | 4,648 | 4,549 |
| Other Accrued Liabilities | 9,839 | 9,753 |
| | | |
| Total Current Liabilities | 48,591 | 53,385 |
| Long-Term Obligations, net | 2,344 | 2,333 |
| Deferred Income Taxes | 8,349 | 7,787 |
| Other Long-Term Liabilities | 1,536 | 1,586 |
| | 60,820 | 65,091 |
| Commitments and Contingencies (Note 7) | | |
| Shareholders Equity: | | |
| Series A 8% Convertible Preferred Stock \$0.01 par value, 1,000,000 shares authorized, none issued | 371 | 371 |

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Common Stock \$.01 par value, 49,000,000 shares authorized, 37,593,768 and 37,589,787 shares issued and outstanding at July 31, 2008 and April 30, 2008, respectively

| | | |
|---|------------|------------|
| Capital in Excess of Par | 139,438 | 139,007 |
| Accumulated Deficit | (45,981) | (47,584) |
| Accumulated Other Comprehensive Loss: | | |
| Defined Benefit Plan Obligation, net of income tax of \$93 and \$93 | (280) | (280) |
| Cumulative Translation Adjustment, net of income tax of \$764 and \$764 | (5,566) | (5,450) |
| Total Shareholders' Equity | 87,982 | 86,064 |
| | \$ 148,802 | \$ 151,155 |

See Accompanying Notes to
Condensed Consolidated Financial Statements

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FLOW INTERNATIONAL CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF INCOME
(unaudited; in thousands, except per share amounts)

| | Three Months Ended July 31, 2007 (Restated, see Note 16) | |
|---|---|-----------|
| | 2008 | |
| Sales | \$ 57,065 | \$ 57,860 |
| Cost of Sales | 30,934 | 34,476 |
| Gross Margin | 26,131 | 23,384 |
| Expenses: | | |
| Sales and Marketing | 10,098 | 10,394 |
| Research and Engineering | 2,250 | 2,280 |
| General and Administrative | 8,590 | 12,346 |
| Restructuring Charges | 1,436 | |
| | 22,374 | 25,020 |
| Operating Income (Loss) | 3,757 | (1,636) |
| Interest Income | 179 | 191 |
| Interest Expense | (130) | (83) |
| Other Income, Net | 391 | 246 |
| Income (Loss) Before Provision for Income Taxes | 4,197 | (1,282) |
| Income Tax (Provision) Benefit | (2,664) | 1,630 |
| Income From Continuing Operations | 1,533 | 348 |
| Income from Operations of Discontinued Operations, Net of Income Tax of \$37 and \$45 | 70 | 87 |
| Net Income | \$ 1,603 | \$ 435 |
| Basic Income Per Share: | | |
| Income From Continuing Operations | \$.04 | \$.01 |
| Income from Operations of Discontinued Operations | .00 | .00 |
| Net Income | \$.04 | \$.01 |
| Diluted Income Per Share: | | |
| Income From Continuing Operations | \$.04 | \$.01 |
| Income from Operations of Discontinued Operations | .00 | .00 |
| Net Income | \$.04 | \$.01 |

Weighted Average Shares Used in Computing Basic and Diluted Income Per

Share:

| | | |
|---------|--------|--------|
| Basic | 37,591 | 37,303 |
| Diluted | 38,101 | 37,906 |

See Accompanying Notes to
Condensed Consolidated Financial Statements

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

| | Three Months Ended | |
|---|---------------------------|--------------|
| | July 31, | |
| | 2007 | |
| | (Restated, | |
| | see | |
| | Note 16) | |
| | 2008 | |
| Cash Flows from Operating Activities: | | |
| Net Income | \$ 1,603 | \$ 435 |
| Adjustments to Reconcile Net Income to Cash Provided by Operating Activities: | | |
| Depreciation and Amortization | 1,050 | 733 |
| Deferred Income Taxes | 1,612 | (2,317) |
| Provision for Slow Moving and Obsolete Inventory | 107 | 399 |
| Bad Debt Expense | 66 | 203 |
| Warranty Expense | 646 | 942 |
| Incentive Stock Compensation Expense | 521 | 605 |
| Unrealized Foreign Currency (Gains), net | (21) | (377) |
| Other | (81) | 263 |
| Changes in Operating Assets and Liabilities: | | |
| Receivables | 84 | 534 |
| Inventories | 849 | (2,225) |
| Other Operating Assets | (2,132) | 864 |
| Accounts Payable | (5,463) | (1,314) |
| Accrued Payroll and Payroll Related Liabilities | (247) | 2,342 |
| Deferred Revenue | (1,041) | (244) |
| Customer Deposits | 186 | 354 |
| Other Operating Liabilities | (777) | (450) |
| Cash Provided by Operating Activities | (3,038) | 747 |
| Cash Flows From Investing Activities: | | |
| Expenditures for Property and Equipment and Intangible Assets | (1,300) | (1,395) |
| Proceeds from Sale of Short-term Investments | | 550 |
| Proceeds from Sale of Property and Equipment | 321 | |
| Payments for Pending Acquisition | (424) | |
| Restricted Cash | 32 | 169 |
| Cash Used in Investing Activities | (1,371) | (676) |
| Cash Flows from Financing Activities: | | |
| Repayments of Notes Payable | | (5,384) |
| Borrowings Under Financing Arrangements | 723 | |
| Payments of Capital Lease Obligations | (35) | |
| Payments of Long-Term Obligations | (434) | (406) |
| Proceeds from Exercise of Stock Options | | 424 |

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| | | |
|--|-----------|-----------|
| Cash Provided by (Used in) Financing Activities | 254 | (5,366) |
| Effect of Changes in Exchange Rates | (238) | 376 |
| Increase (Decrease) in Cash And Cash Equivalents | (4,393) | (4,919) |
| Cash and Cash Equivalents at Beginning of Period | 29,099 | 38,288 |
| Cash and Cash Equivalents at End of Period | \$ 24,706 | \$ 33,369 |

Supplemental Disclosures of Noncash Investing and Financing Activities

| | | |
|--|-------|-------|
| Accounts Payable incurred to acquire Property and Equipment, and Intangible Assets | 966 | 1,091 |
| Accrued Liabilities Incurred for Pending Acquisition | 1,010 | |
| Operating Assets Transferred to Property and Equipment | | 243 |

See Accompanying Notes to
Condensed Consolidated Financial Statements

Table of Contents**FLOW INTERNATIONAL CORPORATION****CONDENSED CONSOLIDATED STATEMENT OF SHAREHOLDERS EQUITY
AND COMPREHENSIVE INCOME**

(unaudited, in thousands)

| | Common Stock Shares | Par Value | Capital In Excess of Par | Accumulated Deficit | Accumulated Other Comprehensive Loss | Total Shareholders Equity |
|---|--------------------------------|----------------------|---|--------------------------------|---|--|
| Balances, April 30, 2007 | 37,268 | \$ 367 | \$ 139,207 | \$ (69,395) | \$ (8,955) | \$ 61,224 |
| Components of Comprehensive Income: | | | | | | |
| Net Income (restated, see Note 16) | | | | 435 | | 435 |
| Cumulative Translation Adjustment, Net of Income Tax of \$0 | | | | | 522 | 522 |
| Total Comprehensive Income (restated, see Note 16) | | | | | | 957 |
| Cumulative effect upon adoption of FIN 48 (Note 7) | | | | (543) | | (543) |
| Exercise of Options | 41 | 1 | 423 | | | 424 |
| Stock Compensation | 15 | 0 | 73 | | | 73 |
| Balances, July 31, 2007 (restated, see Note 16) | 37,324 | \$ 368 | \$ 139,703 | \$ (69,503) | \$ (8,433) | \$ 62,135 |
| Balances, April 30, 2008 | 37,590 | \$ 371 | \$ 139,007 | \$ (47,584) | \$ (5,730) | \$ 86,064 |
| Components of Comprehensive Income: | | | | | | |
| Net Income | | | | 1,603 | | 1,603 |
| Cumulative Translation Adjustment, Net of Income Tax of \$0 | | | | | (116) | (116) |
| Total Comprehensive Income | | | | | | 1,487 |
| Stock Compensation | 4 | 0 | 431 | | | 431 |
| Balances, July 31, 2008 | 37,594 | \$ 371 | \$ 139,438 | \$ (45,981) | \$ (5,846) | \$ 87,982 |

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 contain all adjustments, consisting of normal recurring items and accruals necessary to fairly present the financial position, results of operations and cash flows of the Company. The financial information as of April 30, 2008 is derived from the Company's audited consolidated financial statements and notes for the fiscal year ended April 30, 2008 included in Item 8 in the fiscal year 2008 Annual Report on Form 10-K (10-K). These interim financial statements do not include all information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States, and should be read in conjunction with the Company's fiscal year 2008 Form 10-K. The preparation of these 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. Actual results may differ from these estimates. Operating results for the three months ended July 31, 2008 may not be indicative of future results.

Note 2 Recently Issued Accounting Pronouncements

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 Defining Fair Value Measurement (SFAS 157) which defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS 157 became effective for the Company as of May 1, 2008. In February 2008, the FASB issued FSP 157-2 Partial Deferral of the Effective Date of Statement 157 (FSP 157-2). FSP 157-2 delays the effective date of SFAS 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) to fiscal years beginning after November 15, 2008. The Company therefore adopted SFAS 157 solely as it applies to its financial assets and liabilities. This adoption at May 1, 2008 did not have a material impact on the financial statements of the Company. See Note 15 Fair Value of Financial Instruments for additional disclosure on the adoption of SFAS 157. The Company is currently evaluating the impact of adopting SFAS 157 for its nonfinancial assets and nonfinancial liabilities on its Consolidated Financial Statements at the beginning of its fiscal year 2010.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115 (SFAS 159). SFAS 159 was effective for the Company in the first quarter of its fiscal year 2009. SFAS 159 provides entities the option to choose to measure eligible items at fair value at specified election dates. If elected, an entity must report unrealized gains and losses on the item in earnings at each subsequent reporting date. The fair value option may be applied instrument by instrument, and with a few exceptions, such as investments otherwise accounted for by the equity method, is irrevocable (unless a new election date occurs); and is applied only to entire instruments and not to portions of instruments. The Company did not elect to apply the fair value option to any of its financial instruments.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141 (revised 2007), Business Combinations (SFAS 141R) and Statement of Financial Accounting Standards No. 160, Noncontrolling Interests in Consolidated Financial Statements, an Amendment of ARB No. 51 (SFAS 160). These new standards are the U.S. GAAP outcome of a joint project with the International Accounting Standards Board. SFAS 141R applies prospectively to business combinations for which the acquisition date is on or after the beginning of the first annual reporting period beginning on or after December 15, 2008 and will significantly change the accounting for business combinations in a number of areas, including the treatment of contingent consideration, acquisition costs, intellectual property, research and development, and restructuring costs. SFAS 160 establishes reporting requirements that clearly identify and distinguish between the interests of the parent and the interests of the non-controlling owners. The Company is currently evaluating the impact of adopting SFAS 141R and SFAS 160 on its Consolidated Financial Statements at the beginning of its fiscal year 2010.

In March 2008, the FASB issued Statement of Financial Accounting Standards No. 161, Disclosures about Derivative Instruments and Hedging Activities, an amendment of FASB Statement No. 133 (SFAS 161), which requires enhanced disclosures about a company's derivative and hedging activities. The Company currently is evaluating the impact of the adoption of the enhanced disclosures required by SFAS 161 at the beginning of its fiscal year 2010.

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In May 2008, the FASB issued Statement of Financial Accounting Standards No. 162, The Hierarchy of Generally Accepted Accounting Principles (SFAS 162). The new standard is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements that are presented in conformity with generally accepted accounting principles (GAAP) for nongovernmental entities in the United States. SFAS 162 is effective 60 days following SEC approval of the Public Company Accounting Oversight Board Auditing amendments to AU Section 411, The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles. The Company is currently evaluating the impact, if any, of adopting SFAS 162, on its Consolidated Financial Statements.

Note 3 Receivables, Net

Receivables, Net at July 31, 2008 and April 30, 2008 consisted of the following:

| | July 31, 2008 | April 30, 2008 |
|---------------------------------------|--------------------------|---------------------------|
| Trade Accounts Receivable | \$ 31,559 | \$ 32,410 |
| Unbilled Revenues | 4,999 | 4,589 |
| | 36,558 | 36,999 |
| Less: Allowance for Doubtful Accounts | (3,117) | (3,367) |
| | \$ 33,441 | \$ 33,632 |

Note 4 Inventories

Inventories at July 31, 2008 and April 30, 2008 consisted of the following:

| | July 31, 2008 | April 30, 2008 |
|-------------------------|--------------------------|---------------------------|
| Raw Materials and Parts | \$ 18,573 | \$ 19,671 |
| Work in Process | 3,617 | 3,215 |
| Finished Goods | 6,365 | 6,453 |
| | \$ 28,555 | \$ 29,339 |

Table of Contents**Note 5 Accrued Liabilities**

The Company's accrued liabilities consist of warranty obligations, restructuring liabilities, professional fee accruals, and other items.

Warranty Obligations

The Company provides for the estimated costs of product warranties at the time the product revenue is recognized. The provisions are based upon historical costs incurred for such obligations adjusted, as necessary, for current conditions and factors. Due to the significant uncertainties and judgments involved in estimating the Company's warranty obligations, including changing product designs and specifications, the ultimate amount incurred for warranty costs could change in the near term from the current estimate. The Company believes that the warranty accrual as of July 31, 2008 is sufficient to cover expected warranty costs.

The following table shows the fiscal year 2009 year-to-date activity for the Company's warranty obligations:

| | |
|---|----------|
| Accrued warranty balance as of April 30, 2008 | \$ 3,101 |
| Accruals for warranties of fiscal year 2009 sales | 646 |
| Warranty costs incurred in fiscal year 2009 | (764) |
| Accrued warranty balance as of July 31, 2008 | \$ 2,983 |

Restructuring Charges

On June 2, 2008, the Company committed to a plan to establish a single facility for designing and building its advanced waterjet systems at its Jeffersonville, Indiana facility and to close its manufacturing facility in Burlington, Ontario, Canada. The Company recorded charges of \$1.5 million associated with this facility closure, of which \$1.1 million was paid during the current fiscal quarter. These charges included employee severance and termination benefits and an inventory write-down. Facility shut down costs have been included in Restructuring Charges in the Condensed Consolidated Statements of Income, except for the inventory write-down which has been included as part of Cost of Sales. The following table summarizes the Company's restructuring charges for the quarter ended July 31, 2008:

| | Three Months Ended July 31, 2008 | |
|------------------------------------|---|-------|
| Severance and termination benefits | \$ | 1,436 |
| Inventory write-down | | 108 |
| | \$ | 1,544 |

The Company expects to recognize future additional costs totaling approximately \$895,000 in connection with actions to complete the shutdown of this facility. As of July 31, 2008, the restructuring liability balance of \$256,000 is included in Other Accrued Liabilities. There was no restructuring liability balance as of April 30, 2008.

Note 6 Long-Term Obligations and Notes Payable

The Company's long-term obligations consist of the following:

| | July 31, 2008 | April 30, 2008 |
|------------------------------|--------------------------|---------------------------|
| Long-term loan | \$ 2,486 | \$ 2,914 |
| Other Financing Arrangements | 1,066 | 396 |
| | 3,552 | 3,310 |
| Less current maturities | (1,208) | (977) |

| | | | | |
|-----------------------|----|-------|----|-------|
| Long-term obligations | \$ | 2,344 | \$ | 2,333 |
|-----------------------|----|-------|----|-------|

The long-term loan is a collateralized long-term variable rate loan that bears interest at the current annual rate of 3.67% at July 31, 2008 and matures in 2011. The loan is collateralized by the Company's manufacturing facility in Taiwan. As of July 31, 2008, \$828,000 of the loan balance is current.

The Company leases certain office equipment under agreements that are classified as capital leases and are included in the accompanying balance sheet under property and equipment, of which \$146,000 is current.

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Notes payable consist of the following:

| | July 31, 2008 | April 30, 2008 |
|---------------------------------------|--------------------------|---------------------------|
| Revolving credit facilities in Taiwan | \$ 1,113 | \$ 1,118 |

The revolving credit facilities consist of four unsecured credit facilities in Taiwan with a commitment totaling \$4.3 million at July 31, 2008, bearing interest at 2.80% per annum. The balances outstanding on these credit facilities at July 31, 2008, will mature within one year and may be extended for one-year periods at the bank's option.

New Senior Credit Facility

On June 9, 2008, the Company secured a new five-year senior secured credit facility with an aggregate principal amount of \$100 million, which includes a \$65 million revolving credit facility and a \$35 million term loan that the Company may draw upon for the pending merger with Omax which is detailed in Note 14: *Pending Omax Transaction*. This line of credit has a maturity date of June 9, 2013 and is collateralized by a general lien on certain assets of the Company, as defined within the credit agreement. Borrowings on the credit facility, if any, will be based on the bank's prime rate or LIBOR rate, at the Company's option, plus a percentage spread between 1.25% and 2.00% depending on the Company's leverage ratios. The credit agreement associated with the new credit facility places debt covenant restrictions on the Company which will require it to maintain financial ratios as defined by the credit agreement. The Company also pays an annual letter of credit fee equal to 1.25% of the amount available to be drawn under each outstanding 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 July 31, 2008, the Company had \$97.6 million of domestic unused line of credit available, net of \$2.4 million in outstanding letters of credit. The Company was in compliance with all financial covenants as of July 31, 2008.

Note 7 Commitments and Contingencies

At any time, the Company may be involved in legal proceedings in addition to the Omax, Crucible, and Collins and Aikman matters described below. 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 made after thoughtful analysis of each known issue and an analysis of historical experience in accordance with Statement of Financial Accounting Standards No. 5, *Accounting for Contingencies*, and related pronouncements. 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.

Omax Corporation (*Omax*) filed suit against the Company on November 18, 2004. The case, *Omax Corporation v. Flow International Corporation*, United States District Court, Western Division at Seattle, Case No. CV04-2334, was filed in federal court in Seattle, Washington. The suit alleges that the Company's products infringe Omax's Patent Nos. 5,508,596 entitled *Motion Control with Precomputation* and 5,892,345 entitled *Motion Control for Quality in Jet Cutting*. The suit also seeks to have the Company's Patent No. 6,766,216 entitled *Method and System for Automated Software Control of Waterjet Orientation Parameters* declared invalid, unenforceable and not infringed. The Company has brought claims against Omax alleging certain of their products infringe its Patent No. 6,766,216. Omax manufactures waterjet equipment that competes with the Company's equipment. Both Omax's and the Company's patents are directed at the software that controls operation of the waterjet equipment. Although the Omax suit seeks damages of over \$100 million, the Company believes Omax's claims are without merit and the Company intends not only to contest Omax's allegations of infringement but also to vigorously pursue its claims against Omax with regard to its own patent. Proceedings in the case have been stayed as the parties negotiate the possible purchase of Omax by the Company. The outcome of this case is uncertain and an unfavorable outcome ranging from \$0 to \$100 million is reasonably possible. The Company has not provided any loss accrual related to the Omax lawsuit as of July 31, 2008. The Company has spent, and could continue to spend considerable amounts on this case except as discussed in Note

14: *Pending Omax Transaction.*

In litigation arising out of a June 2002 incident at a Crucible Metals (Crucible) facility, the Company's excess insurance carrier notified the Company in December 2006 that it would contest its obligation to provide coverage for the property damage. The Company believes the carrier's position is without merit, and following the commencement of a declaratory judgment action, the carrier agreed to provide the Company a defense. The carrier recently resumed its contest coverage. The unresolved claims relating to this incident total approximately \$7 million, and the Company may spend substantial amounts if the carrier chooses, at a future date, to withdraw its defense or contest coverage.

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In June 2007, the Company received a claim seeking the return of amounts paid by Collins and Aikman Corporation, a customer, as preference payments. The amount sought is approximately \$1 million. The Company intends to vigorously contest this 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 \$1 million is reasonably possible.

Other Legal Proceedings For matters other than Omax, Crucible, and Collins and Aikman described above, the Company does not believe these proceedings will have a material adverse effect on its consolidated financial position, results of operations or cash flows.

Note 8 Stock-based Compensation

The Company recognizes share-based compensation expense under the provisions of Statement of Financial Accounting Standard No. 123(R), Share-Based Payments (SFAS 123(R)) which requires the measurement and recognition of compensation expense for all share-based payment awards to employees and directors, including employee stock options, based on fair value. The Company maintains a stock-based compensation plan (the 2005 Plan) which was adopted in September 2005 to attract and retain the most talented employees and promote the growth and success of the business by aligning long-term interests of employees with those of shareholders. The 2005 Plan provides for the award of up to 2.5 million shares by the Company in the form of stock, stock units, stock options, stock appreciation rights, or cash awards.

Stock Options

The Company grants stock options to employees of the Company with service and/or performance conditions. The compensation cost of service condition stock options is based on their fair value at the grant date and recognized ratably over the service period. Compensation cost of stock options with performance conditions is based upon current performance projections and the percentage of the requisite service that has been rendered. All options become exercisable upon a change in control of the Company unless the surviving company assumes the outstanding options or substitutes similar awards for the outstanding awards of the 2005 Plan. Options are granted with an exercise price equal to the fair market value of the Company's common stock on the date of grant. The maximum term of options is 10 years from the date of grant.

The following tables summarize the stock option activities for the three months ended July 31, 2008:

| | Number of Options | Weighted- Average Exercise Price | Aggregate Intrinsic Value | Weighted- Average Remaining Contractual Term (Years) |
|--|-------------------------|---|--|--|
| Outstanding at April 30, 2008 | 773,500 | \$ 10.53 | \$ 195,801 | 3.98 |
| Granted during the period | 236,210 | 9.77 | | |
| Exercised during the period | | | | |
| Expired or forfeited during the period | (18,000) | 11.13 | | |
| Outstanding at July 31, 2008 | 991,710 | \$ 10.34 | \$ 12,483 | 5.23 |
| Exercisable at July 31, 2008 | 605,500 | \$ 10.30 | \$ 12,483 | 2.53 |
| Vested or expected to vest at July 31, 2008 | 605,500 | 10.30 | 12,483 | 2.53 |
| | | | Three Months ended July 31, | |
| | | | 2008 | 2007 |
| Total intrinsic value of options exercised | | | \$ | \$ 105 |
| Total fair value of options vested | | | \$ 345 | \$ |
| Cash received from exercise of share options | | | \$ | \$ 424 |

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| | Three Months ended July 31, | |
|---|------------------------------------|-------------|
| | 2008 | 2007 |
| Options granted | 236,210 | 200,000 |
| Weighted average grant-date fair value of stock options granted | \$ 5.67 | \$ 6.90 |
| Assumptions: | | |
| Weighted average expected volatility | 60% | 62.02% |
| Risk-free interest rate | 3.09% | 4.98% |
| Weighted average expected term (in years) | 6 | 6 |
| Expected dividend yield | | |

The Company uses historical volatility in estimating expected volatility and historical employee exercise and option expiration data to estimate the expected term assumption for the Black-Scholes grant-date valuation. The risk-free interest rate assumption is based on U.S. Treasury constant maturity interest rate whose terms are consistent with the expected term of the Company's stock options. The Company has not declared or paid any cash dividends on its Common Stock and does not anticipate that any dividends will be paid in the foreseeable future.

For the three months ended July 31, 2008 and 2007, the Company recognized compensation expense related to stock options of \$169,000 and \$14,000, respectively. As of July 31, 2008, total unrecognized compensation cost related to nonvested stock options was \$2.3 million which is expected to be recognized over a weighted average period of 3.46 years.

Service-Based Stock Awards

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

The following table summarizes the service-based stock award activities for employees for the three months ended July 31, 2008:

| | Number of Shares | Weighted- Average Grant-date Fair Value |
|-----------------------------|-----------------------------|--|
| Nonvested at April 30, 2008 | 325,449 | \$ 8.06 |
| Granted during the period | 192,143 | 9.77 |
| Forfeited during the period | (7,682) | 8.67 |
| Vested during the period | (5,379) | 6.03 |
| Nonvested at July 31, 2008 | 504,531 | \$ 8.67 |

For the three months ended July 31, 2008 and 2007, the Company recognized compensation expense related to service-based stock awards of \$351,000 and \$185,000, respectively. As of July 31, 2008, total unrecognized compensation cost related to such awards of \$3.8 million is expected to be recognized over a weighted average period of 3.76 years.

Performance-Based Stock Awards

In fiscal year 2007, the Company adopted a Long-Term Incentive Plans (the "LTIP") under which the executive officers are to receive stock awards based on certain performance targets which were to be measured over three-year performance period. Awards to be granted will vary based on the degree to which the Company's performance meets or exceeds these predetermined thresholds at the end of the performance period. No payout will occur unless the Company exceeds certain minimum threshold performance targets. Compensation expense is based upon current performance projections for the three-year period and the percentage of the requisite service that has been rendered.

Compensation cost for the unvested portion of the LTIP awards is based on its grant-date fair value. The LTIP permits employees to elect to net-settle a portion of the award paid in stock to meet the employee's share of minimum withholding requirements, which the Company accounts for as equity.

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The following table summarizes the LTIP's activities for the three month period ended July 31, 2008:

| | Number of Shares | Weighted- Average Grant-date Fair Value |
|-----------------------------|-----------------------------|--|
| Nonvested at April 30, 2008 | 74,500 | \$ 13.50 |
| Granted during the period | | |
| Forfeited during the period | (4,000) | 13.50 |
| Vested during the period | | |
| Nonvested at July 31, 2008 | 70,500 | \$ 13.50 |

For the three months ended July 31, 2008 and 2007, the Company did not recognize any compensation expense related to LTIPs as the performance objectives have not been deemed probable.

Note 9 Basic and Diluted Income per Share

Basic income per share represents income available to common shareholders divided by the weighted average number of shares outstanding during the period. Diluted income per share represents income available to common shareholders divided by the weighted average number of shares outstanding including the potentially dilutive impact of stock options and warrants, where appropriate. Potential common share equivalents of stock options and warrants are computed by the treasury stock method and are included in the denominator for computation of earnings per share if such equivalents are dilutive.

The following table sets forth the computation of basic and diluted income from continuing operations per share for the three months ended July 31, 2008 and 2007:

| | Three Months Ended July 31, | |
|--|--|-------------|
| | 2008 | 2007 |
| Numerator: | | |
| Income from continuing operations | \$ 1,533 | \$ 348 |
| Denominator: | | |
| Denominator for basic income per share weighted average shares outstanding | 37,591 | 37,303 |
| Dilutive potential common shares from employee stock options | 5 | 273 |
| Dilutive potential common shares from warrants | | 268 |
| Dilutive potential common shares from service and performance based stock awards | 505 | 62 |
| Denominator for diluted income weighted average shares outstanding and assumed conversions | 38,101 | 37,906 |
| Basic and diluted income from continuing operations per share | \$.04 | \$.01 |

There were 978,570 and 221,250 potentially dilutive common shares from employee stock options which have been excluded from the diluted weighted average share denominator for the three months ended July 31, 2008 and 2007 as their effect would be antidilutive.

Note 10 Other Income (Expense), Net

The Company's subsidiaries have adopted the local currency of the country in which they operate as the functional currency. All assets and liabilities of these foreign subsidiaries are translated at period-end rates. Income and expense accounts of the foreign subsidiaries are translated at the average rates in effect during the period. Assets and liabilities (including inter-company accounts that are transactional in nature) of the Company which are denominated in currencies other than the functional currency of the entity are translated based on current exchange rates and gains or

losses are included in the Condensed Consolidated Statements of Income.

The Company selectively utilizes forward exchange rate contracts to hedge its exposure to adverse exchange rate fluctuations on foreign currency denominated accounts receivable and accounts payable (both trade and inter-company). These forward contracts have not been designated as hedges under Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (SFAS 133). At the end of each month, the Company marks the outstanding forward contracts to market and records an unrealized foreign exchange gain or loss for the

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mark-to-market valuation. For the three months ended July 31, 2008, the Company recorded an unrealized foreign exchange gain of \$51,000.

The following table shows the detail of Other Income (Expense), Net, in the accompanying Condensed Consolidated Statements of Income:

| | Three Months Ended July 31, | |
|---|--|---------------|
| | 2008 | 2007 |
| Realized Foreign Exchange Gains (Losses), Net | \$ 335 | \$ (58) |
| Unrealized Foreign Exchange Gains (Losses), Net | 21 | 377 |
| Other | 35 | (73) |
| | \$ 391 | \$ 246 |

Note 11 Income Taxes

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48), effective May 1, 2007 and has analyzed its filing positions in all of the federal, state, and international jurisdictions where it, or its wholly-owned subsidiaries, are required to file income tax returns for all open tax years in these jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for years before 2002. Furthermore, no open tax years are currently under audit, and as of July 31, 2008, no significant adjustments have been proposed relative to the Company's tax positions.

The adoption of FIN 48 resulted in a \$543,000 increase in the Company's liability for unrecognized tax benefits, which was accounted for as a reduction to the May 1, 2007 retained earnings balance. As of July 31, 2008, the balance of unrecognized tax benefits was \$9.2 million, which, if recognized, would reduce the Company's effective tax rate. There have been no significant changes to these amounts during the quarter ended July 31, 2008. In accordance with FIN 48, the Company has recognized immaterial interest related to unrecognized tax benefits as a component of interest expense. The Company does not expect that unrecognized tax benefits will significantly change within the next twelve months.

The Company continues to provide a full valuation allowance against its net operating losses and other net deferred tax assets, arising in certain tax jurisdictions, mainly in Canada, because the realization of such assets is not more likely than not. For the three months ended July 31, 2008 and 2007, the valuation allowance increased by \$0.9 million, and decreased by \$0.5 million, respectively. The change is mainly attributable to an increase in net operating losses in Canada for the current quarter. Most of the foreign net operating losses can be carried forward indefinitely, with certain amounts expiring between fiscal years 2014 and 2017.

For the three months ended July 31, 2008, the foreign tax provision consists of current and deferred tax expense. The United States tax provision consists primarily of deferred tax expense, minimum federal and state taxes and accrued foreign withholding taxes. The Company's effective tax rate in the first quarter of fiscal year 2009 was impacted by its decision in the fourth quarter of fiscal year 2008 to reverse a substantial portion of the valuation allowance recorded against net deferred tax assets in the U.S. Additionally, in accordance with FASB Interpretation No. 18, Accounting for Income Taxes in Interim Periods an interpretation of APB Opinion No. 28, the effective tax rate excludes the benefit of losses in selected foreign jurisdictions in which the Company anticipates providing a full valuation allowance against the loss carryforward.

During the three months ended July 31, 2007, after concluding that its German operations have achieved sustainable profitability, the Company reversed its valuation allowance against deferred tax assets in this jurisdiction, which resulted in a \$1.3 million tax benefit, or \$.04 per basic and dilutive income per share, as a reduction in the deferred tax asset valuation allowance. This reversal impacted our effective tax rate for the quarter ended July 31, 2007.

With the exception of certain of its subsidiaries, it is the general practice and intention of the Company to reinvest the earnings of its non-U.S. subsidiaries in those operations. As of July 31, 2008 the Company has not made a provision for US or additional foreign withholding taxes of the excess of the amount for financial reporting 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. The Company repatriated \$1.0 million from one of its foreign subsidiaries in the first quarter of fiscal year 2008. There

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was no repatriation of earnings in the fiscal quarter of fiscal year 2009; however, the Company intends to continue to repatriate funds from certain of its foreign subsidiaries in the future.

Note 12 Discontinued Operations

In April 2008, the Company decided to sell its CIS Technical Solutions division (CIS division), which would have been reported as part of its Advanced segment. Accordingly, the Company has classified the financial results of its CIS division as discontinued operations in the Condensed Consolidated Statements of Income for all periods presented. The Condensed Consolidated Balance Sheets as of July 31, 2008 and April 30, 2008 and the Condensed Consolidated Statements of Cash Flows for the periods ended July 31, 2008 and 2007 do not reflect discontinued operations treatment for the CIS division as the related amounts are not material.

Summarized financial information for this discontinued operation for the three months ended July 31, 2008 and 2007 is set forth below:

| | Three Months Ended July 31, | |
|---|--|-------------|
| | 2008 | 2007 |
| Sales | \$ 765 | \$ 998 |
| Income before provision for income taxes | 107 | 132 |
| Provision for income taxes | (37) | (45) |
| Income from operations of discontinued operations | 70 | 87 |

Note 13 Segment Information

Effective May 1, 2008, the Company modified its internal reporting process and the manner in which the business is managed and in turn, reassessed its segment reporting. As a result of this process, the Company is now reporting its operating results to the chief operating decision maker based on market segments which has resulted in a change to the operating and reportable segments. Previously, we managed our business based on geography. Our change in operating and reportable segments from a geographic basis to market segments is consistent with management's long-term growth strategy. Our new reportable segments are Standard and Advanced. The Standard segment includes sales and expenses related to our cutting 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 expenses related to our complex aerospace and automation systems which require specific custom configuration and advanced features to match unique customer applications as well as parts and services to sustain these installed systems.

Accordingly, prior year segment data has been recast to reflect the new segment structure. The chief operating decision maker evaluates the performance of the Company's segments based on sales, gross margin and operating income (loss).

A summary of operations by reportable segment is as follows:

| | Standard | Advanced | All Other* | Inter- segment Eliminations | Total |
|---|-----------------|-----------------|-----------------------|--|--------------|
| Three Months Ended July 31, 2008 | | | | | |
| External sales | \$ 52,754 | \$ 4,311 | \$ | \$ | \$ 57,065 |
| Inter-segment sales | 479 | | | (479) | |
| Gross margin | 25,148 | 966 | | 17 | 26,131 |
| Operating income (loss) | 10,433 | (2,468) | (4,225) | 17 | 3,757 |

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| | | | | | |
|---|-----------|----------|---------|----------|-----------|
| Total assets | 153,939 | 24,116 | 8,576 | (37,829) | 148,802 |
| Three Months Ended July 31, 2007 | | | | | |
| External sales | \$ 50,762 | \$ 7,098 | \$ | \$ | \$ 57,860 |
| Inter-segment sales | 813 | | | (813) | |
| Gross margin | 22,508 | 1,043 | | (167) | 23,384 |
| Operating income (loss) | 8,007 | (1,519) | (7,957) | (167) | (1,636) |
| Total assets | 115,898 | 29,234 | 12,425 | (37,353) | 120,205 |

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* Includes corporate overhead expenses as well as general and administrative expenses of inactive subsidiaries that do not constitute segments.

A summary reconciliation of total segment operating income (loss) to total consolidated income from continuing operations before provision for income taxes is as follows:

| | Three Months Ended July 31, | |
|---|--|-------------|
| | 2008 | 2007 |
| Operating income (loss) for reportable segments | \$ 3,757 | \$ (1,636) |
| Interest income | 179 | 191 |
| Interest expense | (130) | (83) |
| Other income, net | 391 | 246 |
| Income (loss) before provision for income taxes | \$ 4,197 | \$ (1,282) |

Table of Contents**Note 14 Pending Omax Transaction**

On December 4, 2007, the Company entered into an Option Agreement (the *Option Agreement*) with Omax Corporation (*Omax*). Omax is a leading provider of precision-engineered, computer-controlled, two-axis abrasivejet systems for use in the general machine shop environment.

Under the Option Agreement, Omax agreed to an Exclusivity Period (defined below) during which the Company and Omax intend to complete negotiations and to agree on the acquisition of 100% of the outstanding capital stock of Omax by the Company, under the terms and conditions set forth in the Option Agreement, including the negotiation of mutually acceptable definitive agreements and the approval of the shareholders of Omax (the *Proposed Merger*). The Company paid into escrow \$6 million on signing the Option Agreement (*Option Escrow*).

The Option Agreement provides that the Company shall pay an additional \$3 million into the Option Escrow on execution of the definitive agreements relating to the Proposed Merger.

The Option Agreement establishes that the Definitive Agreements will provide for the following payments by the Company, subject to indemnification escrows as described below:

At Closing, \$66 million plus the funds in the Option Escrow to be paid in cash, minus amounts to be paid by the Company at Closing in satisfaction of certain litigation fees of Omax, if any, and less amounts to be placed into an employee retention pool, described below;

At Closing, 3.75 million shares of Company common stock, or if the Closing Share Price (defined as the average daily closing price of the Company common stock during the ten trading day period prior to Closing) is less than \$9.00, such greater number as is necessary so that the total value of the shares delivered is \$33.75 million (the Company may pay cash for any additional shares otherwise payable pursuant this paragraph, based on the number of additional shares in excess of 3,750,000 which would otherwise be payable times the Closing Share Price); and

Two years after Closing, up to 1,733,334 additional shares of common stock based on the Average Share Price (defined as the average closing price for the six months ending twenty four months after Closing). Shares will be paid on a straight line interpolation, with no shares being delivered if the Average Share Price is \$13 or less, and 1,733,334 shares being delivered if the Average Share Price is \$15 or more; provided that if the Closing Share Price is less than \$9.00, the \$13 and \$15 prices will be reduced by the difference between \$9.00 and the Closing Share Price. The Company may elect to pay the consideration required in this paragraph in cash based upon the Average Share Price times the number of shares which would otherwise be issued. If the Company elects to pay in cash, the total amount paid shall not exceed \$26 million and shall be paid in full satisfaction of the right to receive additional shares.

The cash consideration at Closing is subject to adjustment based on Omax Net Working Capital at Closing.

The consideration will be adjusted upward or downward on a dollar-for-dollar basis if the Net Working Capital is below \$7 million or above \$9 million.

The Option Agreement provides that in the event that the Proposed Merger does not close or is otherwise terminated, the funds in the Option Escrow will be released and Omax may retain such amounts. However, that in the event Omax thereafter obtains a judgment against the Company in the litigation matter, referred to in Note 9, *Omax Corporation v Flow International Corporation* (the *Litigation*) or the Company agrees to pay Omax an amount to settle the Litigation, the Company will receive a credit against any such judgment and/or settlement in an amount equal to 50% of the \$6 million payment and 100% of the \$3 million payment.

The Option Agreement further sets forth that the Definitive Agreements will:

provide for two separate indemnification escrows in an aggregate amount of \$13.2 million to be funded at Closing from the cash consideration. \$7 million will be subject to a General Escrow that will end July 31, 2009, to indemnify the Company for losses from breaches of representations and warranties to the extent that such breach or breaches, individually or in the aggregate, result in claims in excess of \$1,000,000. \$6.2 million will be subject to a Special Escrow that will end two years after Closing, to indemnify the Company for losses

with respect to certain potential liabilities identified during the course of due diligence. The amount to be placed in the Special Escrow is subject to reduction under conditions to be specified in the Definitive Agreements. The General and Special Escrows will be funded proportionally from the cash payments (including the funds in the Option Escrow) and the shares of common stock delivered at Closing;

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provide that at Closing the Company will place into escrow a portion of the cash consideration as a retention pool for key Omax employees that will provide such employees the equivalent of three months salary, to be allocated upon the six month anniversary of Closing;

include mutually acceptable executive officer agreements for Drs. John B. Cheung, John H. Olsen and Mr. James M. O Connor to become executives of the Company and provide that as soon as is commercially reasonable following Closing, the Company will expand its Board of Directors and elect Dr. Cheung to the vacancy thereby created; and

provide that Omax stock options that are currently outstanding and unvested shall vest immediately prior to Closing and shall be exercised or terminated at Closing, or otherwise treated in a manner mutually acceptable to the parties.

The negotiation and execution of the Definitive Agreements are subject to the completion of certain due diligence activities and the closing of the transaction will be subject to satisfactory completion of certain due diligence after execution of the Definitive Agreements and standard closing conditions..

Under the Option Agreement, Omax agreed to a period of exclusivity that ends on the earlier of (i) the mutual consent of the parties that all discussions related to the Proposed Transaction have terminated, (ii) 180 days following the receipt of a definitive final response from federal regulatory authorities concerning the HSR filing, (iii) 60 days following the receipt of a definitive final response from federal regulatory authorities concerning the HSR filing (should the parties not have entered into the Definitive Agreements by such date), or (iv) December 5, 2008 (the Exclusivity Period). During the Exclusivity Period, Omax will not, without the advance written consent of the Company, (1) solicit, initiate discussions, engage in or encourage discussions or negotiations with, or enter into any agreement, including any non-disclosure agreement, with, any party relating to or in connection with (a) the possible merger with Omax, (b) the possible acquisition of any material portion of the Company s capital stock or assets, including the claims in the Litigation, or (c) any other transaction outside of the ordinary course of business that could materially impair the value of Omax s assets post-Closing (collectively, a Restricted Transaction), or (2) disclose any non-public information relating to Omax or its subsidiaries or afford access to the properties, books or records of Omax or its subsidiaries to, any person concerning a Restricted Transaction.

On July 10, 2008, in connection with the pending merger with Omax , the Federal Trade Commission (FTC) accepted an Agreement Containing Consent Order (the proposed consent order) to remedy competitive concerns about the proposed transaction alleged in the FTC s simultaneously issued Complaint. The proposed consent order was subject to a 30 day public notice and comment period, following which it became final. The consent decree provides that Flow will make available to other abrasive waterjet companies royalty-free licenses to OMAX s U.S. Patents 5,508,596 and 5,892,345, which relate just to the controllers used in waterjet cutting systems. The licenses do not include any transfer of technology, will not cover any other patented equipment or processes owned by Flow or OMAX, and do not apply to any intellectual property outside of the U.S. There can be no assurances that a mutually acceptable definitive agreement will be negotiated and that all other closing conditions will be satisfied and that the Omax merger will be consummated.

As of July 31, 2008, the Company had accumulated approximately \$8.1 million in deferred costs incurred in contemplation of the Proposed Transaction which includes \$6 million paid into escrow upon the signing of the Option Agreement above. The deferred acquisition costs will be included in the purchase price allocation in the event that the merger is consummated. In the event that the merger is not consummated, the deferred acquisition costs will be expensed.

If the merger is consummated, the litigation with Omax referred to in Note 7: *Commitments and Contingencies* will be terminated without any additional payments in settlement by either party.

Note 15 Fair Value of Financial Instruments

Effective May 1, 2008, the Company adopted the provision of Statement of Financial Accounting Standard No. 157 Defining Fair Value Measurement (SFAS 157) for financial assets and liabilities measured on a recurring basis. SFAS 157 applies to all financial assets and liabilities that are being measured and reported on a fair value

basis. The adoption of SFAS 157 did not affect the consolidated financial statements. SFAS 157 establishes a framework for measuring fair value and expands disclosure about fair value measurements. The statement requires fair value measurements to be classified and disclosed in one of the following three categories:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2: Quoted prices in markets that are not active or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability;

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Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e., supported by little or no market activity).

The following table sets forth information regarding the Company's financial liabilities by the above SFAS 157 categories as of July 31, 2008:

| | Total Carrying Value at July 31, 2008 | Fair Value Measure at July 31, 2008 | | |
|--------------|--|--|--|--|
| | | Quoted Prices in Active Market (Level 1) | Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Liabilities: | | | | |
| Derivatives | \$ 62 | \$ | \$ 62 | |

The Company uses derivatives from time to time to mitigate the effect of foreign currency fluctuations. The Company records qualifying derivatives in accordance with Statement of Financial Accounting Standards No. 133, Accounting for Derivative Instruments and Hedging Activities (FAS 133), and related amendments. Fair value measurements for the Company's derivatives, which at July 31, 2008, consisted primarily of foreign currency forward contracts for which hedge accounting has not been applied, are classified under Level 2 because such measurements are determined using published market prices or estimated based on observable inputs such as future exchange rates.

Note 16 Restatement of Prior Period Financial Statements

As previously disclosed in the Company's Annual report on Form 10-K for the fiscal year ended April 30, 2008, and subsequent to the issuance of its Condensed Consolidated Financial Statements for the period ended July 31, 2007, management identified errors in fiscal year 2008 which related primarily to fiscal year 2006. Management determined that these errors, when aggregated with other uncorrected errors which management had previously determined to be immaterial in fiscal years 2006 and 2007, were material to the fiscal years 2006 and 2007 Consolidated Financial Statements. As a result, management determined that the 2006 and 2007 Consolidated Financial Statements should be restated.

Certain of the restatement adjustments affected interim quarterly financial information presented in the Company's previously issued Quarterly Report on Form 10-Q for the fiscal quarter ended July 31, 2007. As a result, the Condensed Consolidated Financial Statements for the quarter ended July 31, 2007, presented herein, have been restated from amounts previously reported as described below. The effect of the correction of these errors, which were primarily related to sales and operating expenses, resulted in an increase of \$58,000 or \$.00 per basic and dilutive income per share of net income for the quarter ended July 31, 2007.

The following items in the Condensed Consolidated Statement of Income and the Condensed Consolidated Statement of Cash Flows for the three months ended July 31, 2007 have been restated as follows:

| | Three Months Ended July 31, 2007 | | |
|--|----------------------------------|-----------|--|
| | As Previously Reported | Restated | As Restated and Reclassified for Discontinued Operations* |
| Condensed Consolidated Statement of Income: | | | |
| Sales | \$ 58,666 | \$ 58,858 | \$ 57,860 |
| Cost of Sales | 35,066 | 35,221 | 34,476 |

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| | | | |
|--------------------------------------|---------|---------|---------|
| Gross Margin | 23,600 | 23,637 | 23,384 |
| Sales and Marketing Expenses | 10,457 | 10,458 | 10,394 |
| General & Administrative Expenses | 12,416 | 12,404 | 12,346 |
| Total Operating Expenses | 25,153 | 25,142 | 25,020 |
| Operating Loss | (1,553) | (1,505) | (1,636) |
| Other Income | 312 | 246 | 246 |
| Loss Before Benefit for Income Taxes | (1,133) | (1,151) | (1,282) |
| Income Tax Benefit | 1,510 | 1,586 | 1,630 |

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| | Three Months Ended July 31, 2007 | | |
|---|---|-----------------|--|
| | As | | As Restated and Reclassified for Discontinued Operations* |
| | Previously Reported | Restated | |
| Income from Continuing Operations | 377 | 435 | 348 |
| Income from Operations of Discontinued Operations | | | 87 |
| Net Income | 377 | 435 | 435 |

| | Three Months Ended July 31, 2007 | |
|---|---|-----------------|
| | As Previously Reported | Restated |
| Condensed Consolidated Statement of Cash Flows: | | |
| Net Income | \$ 377 | \$ 435 |
| Adjustments to Reconcile Net Income to Cash Provided by Operating Activities: | | |
| Provision for Slow Moving Inventory | ** | 399 |
| Bad Debt Expense | ** | 203 |
| Warranty Expense | ** | 942 |
| Incentive Stock Compensation Expense | 698 | 605 |
| Other | 266 | 263 |
| Changes in Operating Assets and Liabilities: | | |
| Receivables | 901 | 534 |
| Inventories | (1,826) | (2,225) |
| Other Operating Assets ** | 709 | 864 |
| Deferred Revenue | (185) | (244) |
| Customer Deposits | 288 | 354 |
| Other Operating Liabilities ** | 624 | (450) |
| Cash Provided by Operating Activities | 919 | 747 |
| Cash Flows from Investing Activities: | | |
| Expenditures for Property and Equipment and Intangible Assets | (1,425) | (1,395) |
| Cash Provided by (Used In) Investing Activities | (706) | (676) |
| Increase (Decrease) in Cash and Cash Equivalents | (4,777) | (4,919) |
| Cash and Cash Equivalents at Beginning of Period | 38,146 | 38,288 |

* The Company's
Condensed
Consolidated
Statement of
Income for the
quarter ended
July 31, 2007

has been reclassified to reflect the results of operations of its CIS Technical Solutions division as discontinued operations.

** Prior year amounts have been conformed to current year presentation in the Condensed Consolidated Financial Statements.

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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

We have restated our previously issued Condensed Consolidated Financial Statements for the quarter ended July 31, 2007 as described in Note 16 to the accompanying Condensed Consolidated Financial Statements included in Item 1. All affected amounts related to the quarter ended July 31, 2007 described herein have been restated accordingly.

Forward-looking Statements

This management's discussion and analysis should be read in conjunction with our financial statements and its related notes. The terms may, expect, believe, anticipate, estimate, plan and similar expressions are intended to identify forward-looking statements made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Although we believe that the assumptions underlying our forward-looking statements are reasonable, any of the assumptions could prove to be inaccurate. Actual results could differ materially from those projected in these forward-looking statements for a variety of reasons. Examples of forward-looking statements include, but are not limited to, the following:

our belief that the strategies and actions we intend to take in fiscal year 2009 and beyond, including increasing market awareness of waterjet technology to drive increased market penetration and improvement of our operational efficiency, will help us achieve our long-term goals of compound annual revenue growth rate of 10% and operating income annual growth rate of at least 20%;

our belief that we will be able to fund the commitments for inventory purchases, including all open purchase orders, with existing cash and our cash flows from operations in future periods

our investment in the development of innovative products and services to maintain our technological leadership position as well as enhancement of our current product lines;

our intent to continue to make improvements to our system of internal controls and to continue to make improvements in the documentation and implementation training of our accounting policies;

our plan to continue capital spending on information technology and facilities and our expectation that the funds necessary for this will be generated internally;

our expectation that for matters other than Omax, Crucible, and Collins and Aikman, these pending legal proceedings will not have a material adverse effect on our consolidated financial position;

our expectation that our credit line will provide us with liquidity that could be used to make acquisitions, or fund the repurchase of shares;

our belief that our existing cash, our cash from operations, and credit facilities at July 31, 2008 are adequate to fund our operations for the next twelve months;

our expectation that our unrecognized tax benefits will not change significantly within the next twelve months. Additional information on these and other factors that could affect our financial results is set forth below. Finally, there may be other factors not mentioned above or included in our SEC filings that may cause our actual results to differ materially from those in any forward-looking statement. You should not place undue reliance on these forward-looking statements. We assume no obligation to update any forward-looking statements as a result of new information, future events or developments, except as required by federal securities laws.

The following discussion and analysis should be read in conjunction with our Condensed Consolidated Financial Statements and accompanying notes included elsewhere in this Form 10-Q.

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Our MD&A includes the following major sections:

Executive Summary

Results of Operations

Liquidity and Capital Resources

Off Balance Sheet Arrangements

Contractual Obligations

Critical Accounting Policies and Estimates

Recently Issued Accounting Pronouncements

Executive Summary

Our objective is to deliver profitable dynamic growth by providing technologically advanced waterjet cutting and cleaning systems to our customers. To achieve this objective, we offer versatile waterjet cutting and industrial cleaning systems and we strive to:

expand market share in our current markets;

continue to identify and penetrate new markets;

capitalize on the our customer relationships and business competencies;

develop and market innovative products and applications; and

continue to improve operating margins by focusing on operational improvements.

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. These risks and uncertainties pertaining to our business are set forth in Part I, Item 1A of our Annual Report on Form 10-K for the year ended April 30, 2008.

Effective May 1, 2008, we modified our internal reporting process and the manner in which the business is managed and in turn, reassessed our segment reporting. As a result of this process, we are now reporting our operating results to the chief operating decision maker based on market segments which has resulted in a change to the operating and reportable segments. Previously, we managed our business based on geography. Our change in operating and reportable segments from a geographic basis to market segments is consistent with management's long-term growth strategy. Our new reportable segments are Standard and Advanced. The Standard segment includes sales and expenses related to our cutting 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 expenses related to our complex aerospace and automation systems which require specific custom configuration and advanced features to match unique customer applications as well as parts and services to sustain these installed systems.

Accordingly, prior year segment data has been recast to reflect the new segment structure. The chief operating decision maker evaluates the performance of the Company's segments based on sales, gross margin and operating income (loss).

Certain factors may cause our results to vary year over year. For the three months ended July 31, 2008 and 2007, we have identified such factors as follows:

Introduction of New Products

In fiscal year 2007, we introduced the 87,000 psi intensifier pump at the bi-annual International Manufacturing Technology Show (IMTS) in September 2006.

Exit or Disposal Activities

In April 2008, we decided to sell our CIS Technical Solutions division (CIS division), which would have been reported as part of our Advanced segment. Accordingly, we have recast all periods presented to reflect the results of operating of this division in discontinued operations. Income from the operations of this division totaled \$70,000 and \$87,000 for the three months ended July 31, 2008 and 2007, respectively.

On June 2, 2008, we committed to a plan to establish a single facility for designing and building its advanced waterjet systems at its Jeffersonville, Indiana facility and to close its manufacturing facility in Burlington, Ontario, Canada. We recorded charges of \$1.5 million associated with this facility closure. These charges

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included employee severance and termination benefits of \$1.4 million and an inventory write-down of \$108,000 for inventory parts.

Results of Operations**Summary Consolidated Results for the Three Months ended July 31, 2008 and 2007**

| (In thousands, except per share amounts) | Three Months ended July 31, | | |
|--|-----------------------------|-----------|----------|
| | 2008 | 2007 | % Change |
| Sales | \$ 57,065 | \$ 57,860 | (1)% |
| Operating Income (Loss) | 3,757 | (1,636) | 330% |

| (In thousands, except per share amounts) | Three Months ended July 31, | | |
|--|-----------------------------|-----------|----------|
| | 2008 | 2007 | % Change |
| Sales | | | |
| Systems | \$ 39,088 | \$ 41,462 | (6)% |
| Consumable parts | 17,977 | 16,398 | 10% |
| Total Sales | 57,065 | 57,860 | (1)% |

Despite the prevailing weak economic conditions in North America, which comprised approximately 45% of our sales in the prior fiscal year, sales for the three months ended July 31, 2008 remained consistent with prior year same period primarily as a result of strong growth in our other foreign locations.

Total system sales were down \$2.4 million or 6%. Consumable parts sales increased \$1.6 million or 10% due to the increased installed base of systems and improved parts availability as well as the use of Flowparts.com and Floweuroparts.com, our easy-to-use internet order entry systems. Flowparts.com has been deployed in the United States for three years and Floweuroparts.com has been deployed in Europe for approximately two years.

Operating income growth of \$5.4 million was primarily driven by improved gross profit margins based on a shift in product mix, lower corporate general and administrative expenses including patent and legal fees related to the Omax litigation discussed further in Note 7, *Commitments and Contingencies*, of the Condensed Consolidated Financial Statements, as litigation related expenditure has been stayed while we pursue the merger with Omax. This pending merger with Omax is discussed further in Note 14, *Pending Omax Transaction*, of the Condensed Consolidated Financial Statements. Additionally, the prior year comparative period included \$2.9 million related to compensation expenses to amend our former CEO's contract. These positive impacts to operating income were partially offset by restructuring charges of \$1.4 million related to the closure of our manufacturing facility in Burlington.

Segment Results of Operations

As discussed above, effective May 1, 2008, we operate in two reportable segments, which are Standard and Advanced. This section provides a comparison of net sales and operating expenses for each of our reportable segments for the three months ended July 31, 2008 compared to the prior year same period. A discussion of corporate overhead and general expenses related to inactive subsidiaries which do not constitute segments has also been provided under

All Other. For further discussion on our reportable segments, refer to Note 13: *Segment Information* of the Consolidated Financial Statements.

Table of Contents**Standard Segment**

| (In thousands) | Three Months ended July 31, | | |
|----------------------------|-----------------------------|-----------|-------------|
| | 2008 | 2007 | % Change |
| Sales | \$ 52,754 | \$ 50,762 | 4% |
| % of total company sales | 92% | 88% | NM |
| Gross Margin | 25,148 | 22,508 | 12% |
| Gross Margin as % of sales | 48% | 44% | 4% |
| Operating Expenses | | | |
| Sales and Marketing | 9,584 | 9,589 | (0)% |
| Research and Engineering | 1,837 | 1,761 | 4% |
| General and Administrative | 3,294 | 3,151 | 5% |
| Total Operating Expenses | \$ 14,715 | \$ 14,501 | 1% |
| Operating Income (Loss) | \$ 10,433 | \$ 8,007 | 30% |

NM = Not
Meaningful

For the three months ended July 31, 2008:

Sales in our standard segment increased \$2 million or 4% over the prior year comparative period and constituted 92% of total sales primarily due to the following:

In total, system sales declined from \$35.9 million in the prior year to \$35.7 million for the quarter ended July 31, 2008, due to weak economic conditions in North America where system sales declined 28%. This decline was offset by a 29% increase in system sales in our foreign locations driven by increased market awareness and adoption of waterjet technology, as well as the benefit of a weaker U.S. dollar.

Consumable parts sales increased 14% to \$17 million due to increased number of systems in service.

Excluding the impact of foreign currency changes, sales decreased \$1.7 million or 3% compared to the prior year comparative period.

Gross margin for the three months ended July 31, 2008 amounted to \$25.1 million or 48% of sales compared to \$22.5 million or 44% of sales in the prior year comparative period. Generally, comparison of gross margin rates will vary period over period based on changes in our product sales mix and prices, and levels of production volume. Margins in our standard segment increased due mainly to a higher mix of consumable parts sales versus systems sales. Consumable parts sales constituted 32% of total sales in our Standard segment in the current period versus 29% in the prior year same period. Excluding the impact of foreign currency changes, gross margin increased \$1.2 million or 5% compared to the prior year comparative period.

Operating expense changes consisted of the following:

A reduction in sales and marketing expenses of \$5,000 or 0%;

An increase in research and engineering costs of \$76,000 or 4% driven by severance costs related to the streamlining of the product development function; and

An increase in general and administrative expenses of \$143,000 or 5% primarily attributable to slightly higher expenses to support growth in this segment in our foreign location.

Excluding the impact of foreign currency changes, operating expenses decreased \$820,000 compared to the prior year comparative period.

Table of Contents**Advanced Segment**

| (In thousands) | Three Months ended July 31, | | |
|----------------------------|------------------------------------|-------------|---------------------|
| | 2008 | 2007 | % Change |
| Sales | \$ 4,311 | \$ 7,098 | (39)% |
| % of total company sales | 8% | 12% | NM |
| Gross Margin | 966 | 1,043 | (7)% |
| Gross Margin as % of sales | 22% | 15% | 7% |
| Operating Expenses | | | |
| Sales and Marketing | 514 | 805 | (36)% |
| Research and Engineering | 413 | 519 | (20)% |
| General and Administrative | 1,071 | 1,238 | (13)% |
| Restructuring Charges | 1,436 | | NM |
| Total Operating Expenses | \$ 3,434 | \$ 2,562 | 34% |
| Operating Loss | \$ (2,468) | \$ (1,519) | 62% |

NM = Not
Meaningful

Sales in the advanced segment will fluctuate quarter over quarter for various reasons such as the timing of contract awards, timing of project design and manufacturing schedule and finally, shipment to the customers.

For the three months ended July 31, 2008:

Sales in our advanced segment decreased \$2.8 million or 39% over the prior year comparative period and constituted 8% of total sales primarily due to the following:

Our exit from non-waterjet automation which contributed \$1.8 million of sales in the prior year comparative period.

A slowdown in our advanced cutting cell business due to the weakness in the automotive industry.

Gross margin for the three months ended July 31, 2008 amounted to \$966,000 or 22% of sales compared to \$1 million or 15% of sales in the prior year comparative period. The improvement in gross margin as a percentage of sales when compared to the prior year same period is attributable to improved contract pricing and labor efficiencies.

Operating expense changes consisted of the following:

A reduction in sales and marketing expenses of \$291,000 or 36% primarily as a result of a lower customer support costs driven by lower aerospace sales when compared to the prior year same period;

A reduction in research and engineering costs of \$106,000 or 20% related to lower personnel expenses related to the shutdown of the Burlington facility; and

A reduction in general and administrative expenses of \$167,000 or 13% primarily attributable to a reduction of staff in conjunction with the closure of our manufacturing facility in Burlington, Ontario, Canada based on our plan to establish a single facility for designing and building advanced Waterjet systems at our Jeffersonville, Indiana facility.

Restructuring charges of \$1.4 million which were related to severance and termination benefits associated with our plan to shut down our Burlington, Ontario manufacturing facility.

Table of Contents**All Other**

Our All Other category includes corporate overhead expenses as well as general and administrative expenses related to inactive entities that do not constitute operating segments.

(In thousands)

| | Three Months ended July 31, | | |
|----------------------------|------------------------------------|-------------|---------------------|
| | 2008 | 2007 | % Change |
| General and Administrative | 4,225 | 7,957 | (47)% |

General and administrative expenses in our All Other category decreased by \$3.7 million or 47%. The prior year comparative period included \$2.9 million related to compensation expenses to amend our former CEO's contract. The decrease is also attributable to lower professional fees for legal, audit and Sarbanes Oxley compliance costs which were \$1.5 million for the three months ended July 31, 2008 compared to \$2.5 million in the prior year comparative period.

Table of Contents**Other (Income) Expense***Interest Income and Interest Expense*

Our interest income was \$179,000 and \$191,000 for the three months ended July 31, 2008 and 2007, respectively. Our interest expense also remained relatively unchanged at \$130,000 for the three months ended July 31, 2008 compared to \$83,000 for the three months ended July 31, 2007.

Other Income (Expense), Net

Our other Income (Expense), net in the Consolidated Statement of Operations is comprised of the following:

| | Three Months Ended July 31, | |
|---|--|---------------|
| | 2008 | 2007 |
| Realized Foreign Exchange Gains (Losses), Net | \$ 335 | \$ (58) |
| Unrealized Foreign Exchange Gains (Losses), Net | 21 | 377 |
| Other | 35 | (73) |
| | \$ 391 | \$ 246 |

During the three months ended July 31, 2008, we recorded Other Income, Net of \$391,000 compared to Other Income, Net of \$246,000 for the three months ended July 31, 2007. These changes primarily resulted from the fluctuation in realized and unrealized foreign exchange gains and losses as shown in the table above.

Income Taxes

For the three months ended July 31 2008, we recorded an income tax expense of \$2.7 million which consists of current tax expense of \$1.1 million and deferred tax expense of \$1.6 million. Our deferred tax expense is mainly attributable to the United States and German tax provisions. Our effective tax rate in the first quarter of fiscal year 2009 was impacted by our decision in the fourth quarter of fiscal year 2008 to reverse a substantial portion of the valuation allowance recorded against net deferred tax assets in the U.S.

We continue to provide a full valuation allowance against our net operating losses and other net deferred tax assets, arising in certain tax jurisdictions, mainly in Canada, because the realization of such assets is not more likely than not. For the three months ended July 31, 2008, our valuation allowance increased by \$0.9 million. The change is mainly attributable to an increase in net operating losses in Canada where we continue to provide a full valuation allowance against the loss carryforward. The majority of our foreign net operating losses can be carried forward indefinitely, with certain amounts expiring between fiscal years 2014 and 2017.

For the three months ended July 31, 2007, we recorded an income tax benefit of \$1.6 million which was primarily due to the reversal of approximately \$1.3 million of its valuation allowance against net deferred tax assets in its German jurisdiction, the first quarter of fiscal year 2008, after concluding that certain of its deferred tax assets in this jurisdiction were more likely than not to be realized. For the three months ended July 31, 2007, our valuation allowance decreased by \$0.5 million.

In the first quarter of fiscal year 2008, we repatriated \$1.0 million from one foreign subsidiary. We did not repatriate any earnings in the fiscal quarter of fiscal year 2009; however, it is our intention to continue to repatriate funds from certain of our foreign subsidiaries in the future.

Table of Contents**Liquidity and Capital Resources*****Cash Flow Summary***

The following table summarizes our cash flows from operating, investing and financing activities for the periods noted below:

| | Three Months Ended July 31, | |
|--|--|-------------|
| | 2008 | 2007 |
| Net Income | \$ 1,603 | \$ 435 |
| Noncash charges to income | 3,900 | 451 |
| Changes in working capital | (8,541) | (139) |
| Net cash (used in) provided by operating activities | (3,038) | 747 |
| Net cash used in investing activities | (1,371) | (676) |
| Net cash provided by (used in) financing activities | 254 | (5,366) |
| Effect of foreign exchange rate changes on cash and cash equivalents | (238) | 376 |
| Net decrease in cash and cash equivalents | (4,393) | (4,919) |
| Cash and cash equivalents at beginning of period | 29,099 | 38,288 |
| Ending cash balance | \$ 24,706 | \$ 33,369 |

Operating Activities

Cash generated by operating activities before the effects of changes in working capital was \$5.5 million for the three months ended July 31, 2008 compared to \$886,000 for the three months ended July 31, 2007. This increase was mainly attributable to the increase in net earnings and an increase in noncash benefits for deferred income taxes as a result of the valuation allowance release on U.S. net operating loss carryforwards in the fourth quarter of fiscal 2008. Changes in our working capital resulted in a net \$8.5 million use of cash for the three months ended July 2008 compared to \$139,000 use of cash in the prior year comparative period. This increase in net use of cash for working capital was mainly attributable to a significant decrease in accounts payable as a result of the timing of payments to vendors and an increase in our other operating assets based on advances to suppliers to meet anticipated demand in future periods.

Investing Activities

Net cash used in investing activities was \$1.4 million for the three months ended July 31, 2008 compared to \$676,000 for the three months ended July 31, 2007. The increase in the use of cash from investing activities primarily resulted in the use of cash for payments related to the pending merger with Omax during the current period. The lower net cash used in investing activities in the prior period was also offset by the receipt of \$550,000 for the sale of short-term investments.

Financing Activities

Net cash generated by financing activities was \$254,000 for the three months ended July 31, 2008 compared to \$5.4 million use of cash for the three months ended July 31, 2007. The net use of cash in the prior year comparative period was mainly due to the repayment of notes payable of \$5.3 million in the first quarter of fiscal year 2008 that was borrowed at the end of fiscal year 2007 for the repatriation of earnings.

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Debt

We have an outstanding seven-year collateralized long-term variable rate loan, expiring in 2011, bearing interest at an annual rate of 3.67% as of July 31, 2008. The loan is collateralized by our manufacturing facility in Taiwan. The outstanding balance on this loan was \$2.5 million as of July 31, 2008.

We also have three unsecured credit facilities in Taiwan with a commitment totaling \$4.3 million at July 31, 2008, bearing interest at 2.80%. At July 31, 2008, all the credit facilities will mature within one year and the balance outstanding under these credit facilities amounts to \$1.1 million, which is shown under Notes Payable in the Condensed Consolidated Financial Statements.

Sources of Liquidity

Funds generated by operating activities, available cash and cash equivalents, and our credit facilities continue to be our most significant sources of liquidity. At July 31, 2008, we had total cash and cash equivalents of \$24.7 million, of which approximately \$16.4 million was held by divisions outside the United States.

On June 9, 2008, we secured a new five-year senior secured credit facility with an aggregate principal amount of \$100 million, which includes a \$65 million revolving credit facility and a \$35 million term loan that we may draw upon for the pending merger with Omax. This line of credit has a maturity date of June 9, 2013 and is collateralized by a general lien on all of our material assets, as defined within the credit agreement. Borrowings on the credit facility, if any, will be based on the bank's prime rate or LIBOR rate plus a percentage spread between 1.25% and 2.00% depending on the Company's current leverage ratios, at the Company's option. The corresponding credit agreement associated with the new credit facility places certain debt covenant restrictions on us which will require us to maintain certain financial ratios as defined by the credit agreement. The Company also pays an annual letter of credit fee equal to 1.25% of the amount available to be drawn under each outstanding 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 July 31, 2008, we had \$97.6 million of domestic unused line of credit available, net of \$2.4 million in outstanding letters of credit. We are in compliance with all financial covenants as of July 31, 2008.

Our capital spending plans currently provide for outlays of approximately \$8.2 million over the next twelve months, primarily related to information technology spending and facility improvement. It is expected that funds necessary for these expenditures will be generated internally. Our capital spending for the three months ended July 31, 2008 and 2007 amounted to \$1.3 million and \$1.4 million, respectively.

We believe that our existing cash, cash from operations, and credit facilities at July 31, 2008 are adequate to fund our operations for at least the next twelve months.

Off-Balance Sheet Arrangements

We do not have any special purpose entities or off-balance sheet financing arrangements.

Contractual Obligations

During the three months ended July 31, 2008, 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 year ended April 30, 2008.

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 year ended April 30, 2008. We adopted Statement of Financial Accounting Standards. No. 157 as of May 1, 2008 with respect to our financial assets and liabilities with no material impact to our Consolidated Financial Statements as discussed in Note 15 of the Notes to the Condensed Consolidated Financial Statements in this Form 10-Q.

Recently Issued Accounting Pronouncements

Please refer to Note 2 to the Condensed Consolidated Financial Statements for a discussion of recently issued accounting pronouncements.

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Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no material changes in our market risk during the three months ended July 31, 2008. 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 year ended April 30, 2008.

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, or persons performing similar functions, 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 Flow International Corporation, including our consolidated subsidiaries, and was accumulated and communicated to the Company's management, including the principal executive officer and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

(b) Changes in Internal Controls

In connection with the evaluation required by paragraph (d) of Rule 13a-15 under the Exchange Act, there was no change identified in our internal control over financial reporting that occurred during the fiscal quarter ended July 31, 2008 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

At any time, the Company may be named as a defendant in legal proceedings. Please refer to Note 7 to the Condensed Consolidated Financial Statements for a discussion of the Company's legal proceedings.

Item 1A. Risk Factors

There are no material changes from the risk factors previously disclosed in Part I of Item 1A in our Annual Report on Form 10-K for the fiscal year ended April 30, 2008.

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

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

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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: September 4, 2008

/s/ CHARLES M. BROWN

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

Date: September 4, 2008

/s/ DOUGLAS P. FLETCHER

Douglas P. Fletcher
Chief Financial Officer
(Principal Financial Officer)