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MATERIAL SCIENCES CORP

Form 10-K/A

May 23, 2006

United States

Washington, D.C. 20549

Form 10-K/A

(Amendment No. 1)

X Annual Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934

For the fiscal year ended: February 28, 2006

OR

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

For the transition period from _____ to _____

Commission file number: 1-8803

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

95-2673173

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

2200 East Pratt Boulevard, Elk Grove Village, Illinois
(Address of principal executive offices)
Registrant's telephone number, including area code: 847-439-2210

60007
(Zip Code)

Securities registered pursuant to Section 12(b) of the Act:

Title of each class

Name of each exchange
on which registered
New York Stock Exchange

Common Stock, \$0.02 par value
Securities registered pursuant to Section 12(g) of the Act: None

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

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

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

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of accelerated filer and large accelerated filer in Rule 12b-2 of the Exchange Act.

Large accelerated filer _____ Accelerated filer X Non-accelerated filer _____

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

The aggregate market value of the voting and non-voting stock of the registrant held by shareowners of the registrant (not including any voting and non-voting stock owned by directors, executive officers or other affiliates of the registrant) was approximately \$194,745,494 as of August 31, 2005, the last business day of the registrant's most recently completed second fiscal quarter (based on the closing sale price on the New York Stock Exchange on such date, as reported by The Wall Street Journal Midwest Edition).

As of May 1, 2006, the registrant had outstanding an aggregate of 14,746,574 shares of its common stock.

Document Incorporated by Reference

Portions of the following document are incorporated herein by reference into the indicated part of this Form 10-K:

Document

Part of Form 10-K
into which incorporated
Part III

Registrant's Proxy Statement for the Annual Meeting of Shareowners

held on June 22, 2006

EXPLANATORY NOTE:

This Amendment No. 1 on Form 10-K/A to our Annual Report on Form 10-K for the fiscal year ended February 28, 2006, which was filed with the Securities and Exchange Commission on May 19, 2006 (the Original Filing), is being filed to correct a typographical error in our Consolidated Balance Sheet for the fiscal year ended February 28, 2006 (Fiscal 2006) contained in Part II, Item 8 of the Original Filing. The typographical error related to the sub-total amount shown as Total Other Assets. The Consolidated Balance Sheet for Fiscal 2006 erroneously reflected this amount as \$5,158, when the correct amount should have been reflected as \$4,829 (see page 32 below). Total Assets is not affected and no other changes have been made to the Original Filing. The correct amount was properly disclosed in the Consolidated Balance Sheet for Fiscal 2006 that was printed and mailed to our shareowners in connection with the 2006 Annual Meeting of Shareholders. The correction, however, was omitted in the EDGAR version of the Consolidated Balance Sheet filed with the SEC on May 19, 2006.

In order to comply with certain technical requirements of the SEC s rules in connection with the filing of this amendment on Form 10-K/A, we are including in this amendment the complete text of Part II, Item 8 (Financial Statements and Supplementary Data). As a result of this amendment, (1) the certifications pursuant to Section 302 and Section 906 of the Sarbanes-Oxley Act of 2002, filed and furnished, respectively, as exhibits to the Original Filing, have been re-executed and re-filed as of the date of this Form 10-K/A; and (2) a revised Consent of Deloitte & Touche LLP dated May 23, 2006 to cover both the audit report relating to our Consolidated Financial Statements and the audit report relating to our internal control over financial reporting dated May 19, 2006 is being filed. Accordingly, the Exhibit Index attached to this Form 10-K/A is being updated to reflect the consent and new certifications described above.

No attempt has been made in this Form 10-K/A to modify or update the disclosures or financial statements in the Original Filing except as described above. This Form 10-K/A continues to describe conditions as of the date of Original Filing, and the disclosures and financial statements contained herein have not been updated to reflect events, results or developments that occurred after the Original Filing, or to modify or update those disclosures or financial statements affected by subsequent events. Among other things, forward-looking statements made in the Original Filing have not been revised to reflect events, results or developments that occurred or facts that became known to us after the date of the Original Filing, and such forward-looking statements should be read in conjunction with our filings with the SEC subsequent to the filing of the Original Filing.

Item 8. Financial Statements and Supplementary Data

The following pages contain the Financial Statements and Supplementary Data as required by Item 8 of Part II of Form 10-K.

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Note: All other financial statement schedules are omitted because they are not applicable or the required information is included in the Consolidated Financial Statements or notes thereto.

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders

of Material Sciences Corporation

Elk Grove Village, IL

We have audited the accompanying consolidated balance sheets of Material Sciences Corporation and subsidiaries (the Company) as of February 28, 2006 and 2005, and the related consolidated statements of income (loss), shareholders' equity, cash flows, and comprehensive income (loss) for each of the three years in the period ended February 28, 2006. Our audits also included the financial statement schedule listed in the Index in Item 15. These financial statements and financial statement schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Material Sciences Corporation as of February 28, 2006 and 2005, and the results of their operations and their cash flows for the three years in the period ended February 28, 2006 in conformity with accounting principles generally accepted in the United States of America. Also, in our opinion, such financial statement schedule, when considered in relation to the basic consolidated financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of February 28, 2006, based on the criteria established in Internal Control - Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated May 19, 2006 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an adverse opinion on the effectiveness of the Company's internal control over financial reporting because of a material weakness.

Deloitte & Touche LLP

Chicago, Illinois

May 19, 2006

Consolidated Statements of Income (Loss)

Material Sciences Corporation and Subsidiaries

For the years ended February 28 or 29,

| (In thousands, except per share data) | 2006 | 2005 | 2004 |
|---|------------|------------|-------------|
| Net Sales | \$ 286,614 | \$ 263,323 | \$ 242,748 |
| Cost of Sales | 235,882 | 208,252 | 202,136 |
| Gross Profit | 50,732 | 55,071 | 40,612 |
| Selling, General and Administrative Expenses | 36,655 | 40,832 | 32,981 |
| Asset Impairments, Restructuring and Other | 218 | 2,657 | 15,982 |
| Income (Loss) from Operations | 13,859 | 11,582 | (8,351) |
| Other (Income) and Expense: | | | |
| Interest (Income) Expense, Net | (58) | 889 | 2,896 |
| Loss on Early Retirement of Debt | | 4,205 | |
| Equity in Results of Joint Venture | (196) | (178) | 211 |
| Other, Net | (6) | | 90 |
| Total Other (Income) Expense, Net | (260) | 4,916 | 3,197 |
| Income (Loss) from Continuing Operations Before Provision (Benefit) for Income Taxes | 14,119 | 6,666 | (11,548) |
| Provision (Benefit) for Income Taxes | 6,918 | 3,457 | (1,928) |
| Income (Loss) from Continuing Operations | 7,201 | 3,209 | (9,620) |
| Loss on Discontinued Operations Including Loss on Sale of EMD (Net of Benefit for Income Taxes of \$1,228, \$2,330 and \$2,305, Respectively) | (1,997) | (3,529) | (3,561) |
| Net Income (Loss) | \$ 5,204 | \$ (320) | \$ (13,181) |

Basic Net Income (Loss) Per Share:

| | | | |
|--|---------|-----------|-----------|
| Income (Loss) from Continuing Operations | \$ 0.49 | \$ 0.22 | \$ (0.69) |
| Loss on Discontinued Operations | (0.14) | (0.24) | (0.25) |
| Basic Net Income (Loss) Per Share | \$ 0.35 | \$ (0.02) | \$ (0.94) |

Diluted Net Income (Loss) Per Share:

| | | | |
|--|---------|-----------|-----------|
| Income (Loss) from Continuing Operations | \$ 0.49 | \$ 0.22 | \$ (0.69) |
| Loss on Discontinued Operations | (0.14) | (0.24) | (0.25) |
| Diluted Net Income (Loss) Per Share | \$ 0.35 | \$ (0.02) | \$ (0.94) |

Weighted Average Number of Common Shares Outstanding

| | | | |
|---|--------|--------|--------|
| Used for Basic Net Income (Loss) Per Share | 14,661 | 14,351 | 13,990 |
| Dilutive Shares | 29 | 64 | |
| Weighted Average Number of Common Shares Outstanding Plus Dilutive Shares | 14,690 | 14,415 | 13,990 |
| Outstanding Common Stock Options Having No Dilutive Effect | 125 | 22 | 427 |

The accompanying notes are an integral part of these statements.

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Consolidated Balance Sheets

Material Sciences Corporation and Subsidiaries

| (In thousands, except share data) | February 28, 2006 | February 28, 2005 |
|--|----------------------|----------------------|
| Assets | | |
| Current Assets: | | |
| Cash and Cash Equivalents | \$ 13,600 | \$ 1,774 |
| Receivables, Less Reserves of \$5,264 and \$5,945, Respectively | 36,419 | 39,713 |
| Income Taxes Receivable | 2,687 | 134 |
| Prepaid Expenses | 1,234 | 1,211 |
| Inventories: | | |
| Raw Materials | 15,840 | 17,904 |
| Finished Goods | 24,218 | 23,637 |
| Deferred Income Taxes | 2,599 | 2,727 |
| Current Assets of Discontinued Operation EMD | 4 | |
| Total Current Assets | 96,601 | 87,100 |
| Property, Plant and Equipment: | | |
| Land and Building | 55,032 | 54,533 |
| Machinery and Equipment | 168,283 | 166,048 |
| Construction in Progress | 10,291 | 3,807 |
| | 233,606 | 224,388 |
| Accumulated Depreciation | (160,468) | (149,828) |
| Net Property, Plant and Equipment | 73,138 | 74,560 |
| Other Assets: | | |
| Investment in Joint Venture | 2,153 | 1,694 |
| Goodwill | 1,319 | 1,319 |
| Deferred Income Taxes | 813 | 3,496 |
| Other | 544 | 1,058 |
| Total Other Assets | 4,829 | 7,567 |
| Total Assets | \$ 174,568 | \$ 169,227 |
| Liabilities | | |
| Current Liabilities: | | |
| Accounts Payable | \$ 30,492 | \$ 25,938 |
| Accrued Payroll Related Expenses | 5,877 | 10,355 |
| Accrued Expenses | 5,896 | 5,753 |
| Current Liabilities of Discontinued Operation EMD | 467 | |
| Current Liabilities of Discontinued Operation Pinole Point Steel | 216 | 366 |
| Total Current Liabilities | 42,948 | 42,412 |
| Long-Term Liabilities: | | |
| Long-Term Debt | | 1,100 |
| Other | 9,748 | 9,473 |
| Total Long-Term Liabilities | 9,748 | 10,573 |
| Shareowners' Equity | | |
| Preferred Stock, \$1.00 Par Value; 10,000,000 Shares Authorized; 1,000,000 Designated Series B Junior Participating Preferred; None Issued | | |
| Common Stock, \$.02 Par Value; 40,000,000 Shares Authorized; 18,912,582 Shares Issued and 14,723,934 Shares Outstanding as of February 28, 2006 and 18,827,944 Shares Issued and 14,639,296 Shares Outstanding as of February 28, 2005 | | |
| | 378 | 377 |
| Additional Paid-In Capital | 78,573 | 77,402 |
| Treasury Stock at Cost, 4,188,648 Shares as of February 28, 2006 and 2005 | (46,528) | (46,528) |
| Retained Earnings | 88,131 | 82,927 |
| Accumulated Other Comprehensive Income | 1,318 | 2,064 |
| Total Shareowners' Equity | 121,872 | 116,242 |
| Total Liabilities and Shareowners' Equity | \$ 174,568 | \$ 169,227 |

The accompanying notes are an integral part of these statements.

Consolidated Statements of Cash Flows

Material Sciences Corporation and Subsidiaries

| (In thousands) | For the years ended February 28 or 29, | | |
|--|--|-----------|-------------|
| | 2006 | 2005 | 2004 |
| Cash Flows From: | | | |
| Operating Activities: | | | |
| Net Income (Loss) | \$ 5,204 | \$ (320) | \$ (13,181) |
| Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by | | | |
| Operating Activities: | | | |
| Depreciation and Amortization | 11,526 | 11,802 | 14,849 |
| Asset Impairments | | | 14,633 |
| Provision (Benefit) for Deferred Income Taxes | 6,144 | 3,008 | (1,928) |
| Compensatory Effect of Stock Plans | (67) | 110 | 800 |
| Tax Benefit of Stock Options | 125 | 380 | |
| (Gain) Loss on Sale of Assets | 106 | (176) | (92) |
| Other, Net | (196) | (178) | (817) |
| Changes in Assets and Liabilities: | | | |
| Receivables | 2,715 | 700 | (10,236) |
| Income Taxes Receivable | (2,678) | (83) | 1,183 |
| Prepaid Expenses | (37) | 85 | 510 |
| Inventories | 1,176 | (10,140) | (4,733) |
| Accounts Payable | 1,909 | 5,167 | (1,543) |
| Accrued Expenses | (6,657) | (2,453) | (3,539) |
| Other, Net | (141) | (297) | (1,226) |
| Net Cash Provided by (Used in) Continuing Operations | 19,129 | 7,605 | (5,320) |
| Net Cash Provided by (Used in) Discontinued Operations | 1,147 | (2,171) | 9,717 |
| Net Cash Provided by Operating Activities | 20,276 | 5,434 | 4,397 |
| Investing Activities: | | | |
| Capital Expenditures | (8,449) | (5,117) | (4,519) |
| Acquisitions, Net of Cash Acquired | | | (568) |
| Proceeds from Sale of Asset | | 2,822 | 679 |
| Investment in Joint Venture | | | (358) |
| Purchases of Marketable Securities | | | (83) |
| Proceeds from Sale of Marketable Securities | | | 1,167 |
| Change in Restricted Cash Related to Letters of Credit | | 3,357 | (1,077) |
| Other | | 124 | 75 |
| Net Cash Provided by (Used in) Investing Activities | (8,449) | 1,186 | (4,684) |
| Financing Activities: | | | |
| Proceeds Under Lines of Credit | 19,000 | 84,318 | |
| Payments of Long-Term Debt | (20,100) | (127,162) | (11,558) |
| Payments of Rights Redemption | | | (148) |
| Issuance of Common Stock | 1,114 | 4,533 | 1,596 |
| Net Cash Provided by (Used in) Financing Activities | 14 | (38,311) | (10,110) |
| Effect of Exchange Rate Changes on Cash | (15) | (18) | |
| Net Increase (Decrease) in Cash | 11,826 | (31,709) | (10,397) |
| Cash and Cash Equivalents at Beginning of Year | 1,774 | 33,483 | 43,880 |
| Cash and Cash Equivalents at End of Year | \$ 13,600 | \$ 1,774 | \$ 33,483 |
| Non-Cash Transactions: | | | |
| Asset Retirement Obligation Established | \$ 81 | \$ | \$ |
| Capital Expenditures in Accounts Payable at Year End | \$ 2,698 | \$ | \$ |
| Supplemental Cash Flow Disclosures: | | | |
| Interest Paid | \$ 117 | \$ 1,695 | \$ 3,462 |
| Income Taxes Paid | \$ 3,335 | \$ 207 | \$ 684 |

The accompanying notes are an integral part of these statements.

Consolidated Statements of Changes in Shareowners' Equity

Material Sciences Corporation and Subsidiaries

| | Common Stock | | Additional | | Treasury Stock | |
|--|--------------|--------|-----------------|-------------------|----------------|-------------|
| | Shares | Amount | Paid-In Capital | Retained Earnings | Shares | Amount |
| (In thousands, except share data) | | | | | | |
| Balance as of February 28, 2003 | 18,221,830 | \$ 365 | \$ 70,143 | \$ 96,428 | (4,188,648) | \$ (46,528) |
| Net Loss | | | | (13,181) | | |
| Issuance of Common Stock | 165,284 | 4 | 1,572 | | | |
| Rights Redemption | | | (148) | | | |
| Compensatory Effect of Stock Plans | 44,884 | | 800 | | | |
| Tax Benefit from Exercise of Stock Options | | | 20 | | | |
| Balance as of February 29, 2004 | 18,431,998 | 369 | 72,387 | 83,247 | (4,188,648) | (46,528) |
| Net Loss | | | | (320) | | |
| Issuance of Common Stock | 411,371 | 8 | 4,525 | | | |
| Compensatory Effect of Stock Plans | (15,425) | | 110 | | | |
| Tax Benefit from Exercise of Stock Options | | | 380 | | | |
| Balance as of February 28, 2005 | 18,827,944 | 377 | 77,402 | 82,927 | (4,188,648) | (46,528) |
| Net Income | | | | 5,204 | | |
| Issuance of Common Stock | 106,138 | 2 | 1,112 | | | |
| Compensatory Effect of Stock Plans | (21,500) | (1) | (66) | | | |
| Tax Benefit from Exercise of Stock Options | | | 125 | | | |
| Balance as of February 28, 2006 | 18,912,582 | \$ 378 | \$ 78,573 | \$ 88,131 | (4,188,648) | \$ (46,528) |

The accompanying notes are an integral part of these statements.

Consolidated Statements of Comprehensive Income (Loss)

Material Sciences Corporation and Subsidiaries

| (In thousands) | For the years ended February 28 or 29, | | |
|---|--|----------|-------------|
| | 2006 | 2005 | 2004 |
| Net Income (Loss) | \$ 5,204 | \$ (320) | \$ (13,181) |
| Other Comprehensive Income (Loss): | | | |
| Foreign Currency Translation Adjustments | (251) | 348 | 1,418 |
| Minimum Pension Liability, Net of Benefit for Income Taxes of \$340, \$179 and \$24, Respectively | (495) | (275) | (38) |
| Total Other Comprehensive Income (Loss) | (746) | 73 | 1,380 |
| Comprehensive Income (Loss) | \$ 4,458 | \$ (247) | \$ (11,801) |

The accompanying notes are an integral part of these statements.

Material Sciences Corporation and Subsidiaries

Notes to Consolidated Financial Statements

(In thousands, except per share data)

Note 1: Summary of Significant Accounting Policies

Nature of Operations

The operations of Material Sciences Corporation and its wholly owned subsidiaries (MSC or the Company) consist of providing material-based solutions for acoustical, coated metal and electronic applications. Principal markets include the automotive, building and construction, electronics, lighting and appliance markets.

Summary of Significant Accounting Policies

The significant accounting policies of MSC, as summarized below, conform with accounting principles generally accepted in the United States of America (GAAP). As discussed in Note 2 entitled Sale of Business , the results of operations of the Company s Electronic Materials and Devices Group (EMD) have been reclassified to reflect EMD as a discontinued operation for all periods presented. The Company, however, has not reclassified prior period amounts in the Consolidated Balance Sheets. Certain other prior year amounts have been reclassified to conform to the fiscal 2006 presentation.

The preparation of the Company s financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported and the disclosures in the financial statements. Actual results could differ from those estimates. Significant estimates include cash flow projections related to the assessment of long-lived assets and goodwill impairments, deferred tax asset valuation allowances, reserves for inventory and receivable exposures, customer claims, income taxes, pension and postretirement benefits and contingencies.

Principles of Consolidation

The accompanying consolidated financial statements include the accounts for MSC after all significant intercompany transactions have been eliminated. In South America, the Company owns a 51% interest in a joint-venture partnership with Tekno S.A. (Tekno) which provides for the manufacture and sale of acoustical products. The Company maintains a voting interest no greater than 50% in Tekno. Under the terms of the Tekno agreement, significant actions require unanimous consent of all parties and, as a result, MSC does not have a controlling interest in Tekno. Accordingly, the Company accounts for Tekno under the equity method.

Fair Value of Financial Instruments

The Company s financial instruments include cash and cash equivalents, accounts receivable, accounts payable and long-term debt. The carrying amount of any long-term debt approximates fair value due to the variable interest rates. The carrying amounts of the other financial assets and liabilities approximate fair value due to the short maturities of these instruments.

Cash and Cash Equivalents

Cash and cash equivalents consist of highly liquid investments with original maturities of three months or less.

Accounts Receivable

Accounts receivable are recorded at their fair market value net of allowances for doubtful accounts, claims, discounts and other credits expected to be granted to customers. The Company provides reserves for uncollectible receivables due to customer bankruptcy, insolvency or disputes over pricing. The methodology for calculating the allowance for doubtful accounts includes an assessment of specific receivables that are aged and an assessment of the aging of the total receivable pool. The Company also records reductions of revenue for credits issued to customers resulting from manufacturing claims for product defects based upon historical experience and upon specific claims issues as they arise. Any material differences between these estimates and actual costs are recorded on a monthly basis and are reflected in the historical experience prospectively. The total accounts receivable reserves were \$5,264 and \$5,945 at February 28, 2006 and 2005, respectively.

Inventories

Inventories are stated at the lower of cost or market, using either the specific identification, average cost, or first-in, first-out method of cost valuation. Due to the continuous nature of the Company's operations,

work-in-process inventories are not material. The Company holds some of its inventory at outside processors. The Company had approximately \$4,300 and \$3,400 of inventory at outside processors at February 28, 2006 and 2005, respectively.

Long-Lived Assets

Property, Plant and Equipment are recorded at cost. Improvements and replacements are capitalized, while expenditures for maintenance and repairs are charged to expense as incurred. Depreciation is computed using the straight-line method over the assets' estimated useful lives as follows: buildings and building improvements, 5 to 20 years; operating equipment, 5 to 20 years; furniture and fixtures, 5 to 10 years; software, 3 to 5 years. Leasehold improvements are amortized over the lesser of their expected useful life or the remaining life of the lease.

Intangible assets consist principally of the excess of cost over the fair market value of net assets acquired (goodwill) and intangibles related to the accounting for pension benefits. As discussed below, goodwill is no longer subject to amortization and is subject to at least an annual assessment of impairment by applying a fair value based test.

Long-lived assets are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount may not be recoverable based on projections of cash flows on a non-discounted basis. If the fair value is less than the carrying amount of the asset, a loss is recognized for the difference. Fair value is determined based on market quotes, if available, or is based on valuation techniques, such as discounted cash flows.

Revenue Recognition

The Company recognizes revenue upon shipment of goods to customers, at which time title (MSC's value-added content in the case of toll processing) and risk of loss pass to the customer. The Company records shipping and handling billed to a customer in a sales transaction as revenue. Costs incurred for shipping and handling are recorded in cost of sales. Volume discounts due customers are recognized as earned and reported as reductions of revenue in the Consolidated Statements of Income (Loss). The Company's revenue recognition policies comply with the criteria set forth in Staff Accounting Bulletin (SAB) No. 104, Revenue Recognition.

Research and Development

The Company expenses all research and development costs in the period incurred. Research and development expenses from continuing operations of \$2,299, \$2,629 and \$2,900 in fiscal 2006, 2005 and 2004, respectively, are included in the Selling, General and Administrative Expenses on the Consolidated Statements of Income (Loss). The Company also expensed \$416, \$1,796 and \$1,447 of research and development costs for EMD in fiscal 2006, 2005 and 2004, respectively, included in discontinued operations.

Concentrations of Credit Risks

Certain financial instruments potentially subject the Company to concentrations of credit risk. These financial instruments consist primarily of trade receivables. The Company reviews the collectability of accounts receivable on a regular basis, taking into account customer liquidity, payment history and industry condition. The following table contains significant accounts receivable percentages as of the end of the last two fiscal years.

| | February 28, 2006 | February 28, 2005 |
|---------------------------|-------------------|-------------------|
| Automotive Customers | 67% | 43% |
| U.S. Steel Mill Customers | 4% | 12% |
| Hard Disk Drive Customer | 4% | 5% |
| Foreign Currency | | |

The Company's international operations are translated into U.S. dollars using current exchange rates at the balance sheet date for assets and liabilities. A weighted average exchange rate is used to translate sales, expenses, gains and losses. The currency translation adjustments are reflected in Accumulated Other Comprehensive Income (Loss) in Shareowners' Equity.

Goodwill

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In June 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, Business Combinations and SFAS No. 142, Goodwill and Other

Intangible Assets. SFAS No. 141 requires that all business combinations initiated after June 30, 2001, be accounted for using the purchase method of accounting. With the adoption of SFAS No. 142 on March 1, 2002, goodwill is no longer subject to amortization over its estimated useful life. Goodwill is subject to at least an annual assessment of impairment by applying a fair value based test, beginning on the date of adoption of the new accounting standard. The Company performs its annual impairment test as of the last day of the fiscal year. In the fourth quarter of fiscal 2004, based on its annual assessment of the goodwill associated with the acquisition of Goldbach Automobil Consulting (GAC), the Company recorded a pretax impairment charge of \$6,739 during the fourth quarter of fiscal 2004. The impairment resulted from slower growth in the penetration of the European brake market than previously projected. In addition, the Company experienced delays in the negotiation of definitive agreements with a potential strategic partner related to the marketing and sales of Quiet Steel® in Europe (see Note 13 of the Notes to the Consolidated Financial Statements entitled Asset Impairments and Restructuring).

Apart from goodwill, the Company has no other identified intangible assets. There were no changes in the carrying amount of goodwill for the years ended February 28, 2006 and 2005. The Company performed its annual impairment test of goodwill in the fourth quarter of fiscal 2006 and there was no impairment as a result of this test. The net goodwill balance was \$1,319 as of February 28, 2006 and 2005.

Equity Plans

The Company has four equity award plans: the Material Sciences Corporation 1985 Stock Option Plan for Key Employees (1985 Plan); the Material Sciences Corporation 1992 Omnibus Awards Plan for Key Employees (1992 Plan); the Material Sciences Corporation Stock Option Plan for Non-Employee Directors (1996 Directors Plan); and the Material Sciences Corporation 2001 Compensation Plan for Non-Employee Directors (2001 Directors Plan). MSC accounts for all plans in accordance with APB Opinion No. 25, under which no compensation cost has been recognized. Had compensation cost for employee stock purchases under the Employee Stock Purchase Plan and for stock options awarded under the stock option plans been determined using the fair market value-based accounting method, the Company's net income (loss) and basic and diluted net income (loss) per share would have been as shown in the following pro forma amounts:

| | 2006 | 2005 | 2004 |
|--|----------|------------|-------------|
| Net Income (Loss): | | | |
| As Reported | \$ 5,204 | \$ (320) | \$ (13,181) |
| Add: Stock-Based Employee Compensation Expense (Income) Included in Reported Net Income, Net of Related Tax Effects | (41) | 3,199 | 485 |
| Deduct: Total Stock Based Employee Compensation (Expense) Income Determined Under Fair Value Based Method for All Awards, Net of Related Tax Effects | 24 | (4,046) | (1,388) |
| Pro Forma | \$ 5,187 | \$ (1,167) | \$ (14,084) |
| Basic Net Income (Loss) Per Share: | | | |
| As Reported | \$ 0.35 | \$ (0.02) | \$ (0.94) |
| Pro Forma | \$ 0.35 | \$ (0.08) | \$ (1.01) |
| Diluted Net Income (Loss) Per Share: | | | |
| As Reported | \$ 0.35 | \$ (0.02) | \$ (0.94) |
| Pro Forma | \$ 0.35 | \$ (0.08) | \$ (1.01) |
| Accumulated Other Comprehensive Income (Loss) | | | |

The components of Accumulated Other Comprehensive Income (Loss) at February 28 are as follows:

| | 2006 | 2005 |
|--|----------|----------|
| Foreign Currency Translation | \$ 2,838 | \$ 3,089 |
| Minimum Pension Liability, net of tax of \$983 and \$643 | (1,520) | (1,025) |
| Total | \$ 1,318 | \$ 2,064 |

Recent Accounting Pronouncements

In November 2004, the FASB issued SFAS No. 151, *Inventory Costs* an amendment of ARB No. 43, which requires abnormal amounts of idle facility expense, freight, handling costs, and wasted material (spoilage), to be recognized as current period charges. In addition, it requires that allocation of fixed production overhead costs to inventory be based on the normal capacity of the production facility. The provisions of this Standard apply prospectively and are effective for the Company beginning March 1, 2006. The Company expects the adoption of this standard will have no material impact on the Company's financial position, results of operations and cash flows.

In December 2004, the FASB issued SFAS No. 123(R), *Share-Based Payment*, which requires compensation costs related to share-based payment transactions to be measured at grant-date fair value and the expense to be recognized in the financial statements. Additionally, SFAS No. 123(R) amends the presentation of the statement of cash flows and requires additional annual disclosures. SFAS No. 123(R) will be effective for the Company's first quarter of fiscal 2007. The Company expects the adoption of this standard will have no material impact on the Company's financial position, results of operations and cash flows.

In February 2006, the Company adopted FASB Interpretation No. 47, *Accounting for Conditional Asset Retirement Obligations* (FIN 47). FIN 47 clarifies that the term *conditional asset retirement obligation* as used in FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, refers to a legal obligation to perform an asset retirement activity in which the timing and/or method of settlement are conditional on a future event that may or may not be within the control of the entity. Thus the timing and/or method of settlement may be conditional on a future event. The adoption of FIN 47 had no material impact on the Company's financial position, results of operations and cash flows.

Note 2: Sale of Business

On June 20, 2005, the Company completed a transaction for the sale of substantially all of the assets (including fixed assets, intellectual property and other assets) of its EMD business to TouchSensor Technologies, LLC (TST) in consideration of the release from current and future contractual commitments to TST and the assumption of certain contractual obligations of EMD. As a result of the transaction, the Company was relieved of the fee obligations under the license agreement with TST in fiscal 2006 of \$2,750 as well as approximately \$825 of obligations related to certain cost sharing agreements between the Company and TST projected for the 18 months ending in November 2006. The Company no longer reports EMD as a separate segment, rather it reports EMD as a discontinued operation with all prior period results of operations set forth herein reclassified to reflect that presentation. The Company, however, has not reclassified prior period amounts in the Consolidated Balance Sheets.

The Company recorded a loss on the sale of EMD assets of \$139 (or \$.01 per diluted common share), net of income tax benefit of \$86, in the second quarter of fiscal 2006. The loss included \$225 in deal costs and asset write-offs, net of the cost sharing liabilities that were forgiven as part of the deal.

Note 3: Joint Venture and Partnership

On May 7, 2003, International Steel Group, Inc. (ISG) purchased substantially all of Bethlehem Steel Corporation's (BSC) assets, including BSC's 33.5% interest in Walbridge Coatings (the Partnership), and MSC purchased this Partnership interest from ISG for \$3,600. Accordingly, as of such date, the Company has a 100% ownership interest in the Walbridge operation. Prior to May 7, 2003, the Company did not have voting control of the Partnership and accounted for the Partnership under the equity method. Beginning May 7, 2003, the results of Walbridge Coatings have been consolidated with the results of MSC and are included in the Consolidated Financial Statements. In conjunction with these transactions, the Company entered into a tolling agreement with ISG to provide electrogalvanizing and other coating and ancillary services to ISG until December 31, 2004, and ISG assumed all amounts payable by BSC to the Partnership. Through the expiration date of the tolling agreement, ISG had priority production rights for up to 25% of the available line time at the Walbridge, Ohio facility, and MSC marketed the remaining 75% of the line time. In fiscal 2006, ISG utilized less than 1% of available line time at the Walbridge facility compared to 20% of available time in fiscal 2005. Subsequent to the expiration of the tolling agreement with ISG, the Company provides services to ISG in the ordinary course of business.

Prior to May 7, 2003, MSC's net sales for electrogalvanizing primarily consisted of various fees charged to the Partnership for operating the facility. The fees charged to the Partnership consisted of a variable portion, based on the production volumes and product mix, and a fixed portion, including taxes, rent, insurance and the fixed portion of electricity. The overall profitability to MSC depended on the Company's processing skill and efficiency. MSC had the right to utilize available line time to the extent BSC did not order Partnership services.

Summarized financial information for the Partnership is presented below.

| Income Statement Information: | 2006 | 2005 | 2004 |
|-------------------------------|------|------|----------|
| Net Sales | \$ | \$ | \$ 4,849 |
| Loss from Operations | | | (446) |
| Net Loss | | | (440) |

In November 2000, a subsidiary of MSC formed a joint venture partnership with Tekno S.A. (Tekno) for the manufacture and sale of Quiet Steel® and disc brake noise damper material for the South American market. Tekno's sales were \$3,345, \$2,325 and \$1,260 in fiscal 2006, 2005 and 2004, respectively. Tekno's income was \$405, \$350 and \$160 in fiscal 2006, 2005 and 2004, respectively.

Under the equity method, MSC includes its portion of the Partnership's and Tekno's results of operations in the Consolidated Statements of Income (Loss) under Equity in Results of Joint Venture. The Equity in Results of Joint Venture was net income of \$196 in fiscal 2006, net income of \$178 in fiscal 2005 and a net loss of \$211 in fiscal 2004.

Note 4: Contingencies

MSC is a party to various legal proceedings in connection with the remediation of certain environmental matters. The most significant proceeding relates to the Company's involvement in a Superfund site in Gary, Indiana. MSC has been named as a potentially responsible party (PRP) for the surface, soil and ground water contamination at this site.

The United States District Court for the Northern District of Indiana has entered a Consent Decree between the government and certain PRPs on the scope of the remediation work at the Gary site. The Company receives periodic updates on the projected costs of the remediation work from the environmental consultant employed by certain PRPs (including the Company) to manage the remediation project. In late December 2005, the Company received an update indicating that the projected remediation costs would increase significantly primarily due to additional efforts required to complete the remediation project, higher energy costs associated with certain remediation techniques employed and increased oversight costs of the United States Environmental Protection Agency. Accordingly, the Company treated the cost update as a change in estimate and increased its reserves related to this matter by \$467 as of the end of the second quarter of fiscal 2006 to reflect the Company's share of the increased remediation costs. This charge was recorded in Selling, General and Administrative expenses in the accompanying Consolidated Statement of Income (Loss). The estimated range of the Company's remaining liability for this site is \$950 to \$1,000. Remediation work is ongoing and MSC maintains a letter of credit for approximately \$1,200 to secure its obligation to pay its currently estimated share of the remediation expenses at this site.

In November 2003, MSC, along with many other companies, was named as a PRP by the U.S. Environmental Protection Agency under CERCLA at the Lake Calumet Cluster Site in Chicago, Illinois for allegedly sending certain waste from its Elk Grove Village facility to the site. Initial estimates show the Company's potential range of liability to be \$25 to \$35, but the information provided to-date has been limited.

In May 2002, the Company sold substantially all of the assets of its Pinole Point Steel business. In December 2004, the purchaser of the facility received a letter from the California Regional Water Quality Control Board requesting an investigation of contamination of the soil and groundwater at the facility. Depending on the results of the investigation, remediation efforts may be required. The Company believes that any such contamination occurred prior to its acquisition of the facility in 1997, and, therefore, the sellers of the facility in the 1997 transaction are responsible for the funding of any necessary remediation. In the event that the sellers fail to fund the remediation, the Company may be required to do so. The Company is unable to estimate the potential liability, if any, in this matter due to the limited information provided to-date.

The Company's environmental reserves, based on management's best estimate, were approximately \$1,100 and \$1,000 as of February 28, 2006 and 2005, respectively. The Company does not believe that the outcome of its environmental legal proceedings will have a material adverse effect on the Company's financial statements, given the reserves recorded as of February 28, 2006 and, where applicable, taking into account contributions from other PRPs. There are, however, a number of uncertainties, including without limitation, the cost of site cleanup, the discretionary authority of federal and state regulatory authorities in bringing enforcement actions and other factors, which affect the Company's range of exposures. MSC believes its range of exposure for all known sites, based on allocations of liability among PRPs and the most recent estimate of remedial work, is \$1,100 to \$1,600.

On May 8, 2006, the Company received a notice from the Securities and Exchange Commission (SEC) requesting that the Company voluntarily produce information regarding the material weaknesses in the internal control over financial reporting disclosed in the Company's Annual Report on Form 10-K/A for the fiscal year ended February 28, 2005. The Company is fully cooperating with the SEC's request. The Company cannot predict whether the SEC will seek additional information or what the outcome of this matter will be.

The Company is also a party to various legal actions and customer disputes arising in the ordinary course of its business. These legal actions and customer disputes cover a broad variety of claims spanning the Company's entire business. The Company believes that the resolution of these legal actions and customer disputes will not, individually or in the aggregate, have a material adverse effect on the Company's financial statements.

Note 5: Indebtedness

Long-term debt consists of the obligations presented in the chart below.

| Long-Term Debt Obligations | | 2006 | 2005 |
|----------------------------------|--|------|----------|
| Borrowings Under Lines of Credit | | \$ | \$ 1,100 |
| Less Current Portion | | | |
| Long-Term Debt | | \$ | \$ 1,100 |

The Company entered into an amended and restated \$30,000 committed line of credit (New Line) on April 30, 2004. The New Line agreement expires on October 11, 2007. There were no borrowings outstanding under the New Line as of February 28, 2006. Borrowing capacity reserved for the Company's outstanding letters of credit was \$1,864, and the amount remaining available to be borrowed was \$28,136 as of February 28, 2006. The Company classified \$1,100 outstanding under the New Line as long-term debt as of February 28, 2005. At the Company's option, interest is at the bank's prime rate (7.5% and 5.5% as of February 28, 2006 and 2005, respectively) or at LIBOR plus a margin based on the ratio of funded debt to EBITDA (as defined in the agreement). The financial covenants include a fixed charge coverage ratio of not less than 1.25 to 1.0 commencing May 31, 2004; a maximum leverage ratio (3.0 to 1.0); and minimum net worth of \$80,000 plus 50% of positive consolidated net income ending on or after May 31, 2004, or \$84,449 on February 28, 2006. As of February 28, 2006, the Company was in compliance with all debt covenants. As of May 15, 2006, the Company was in violation of certain reporting covenants required under the New Line due solely to the failure to timely file and deliver this Annual Report on Form 10-K for the fiscal year ended February 28, 2006. On May 15, 2006, the lenders under the New Line waived the Company's breach of such reporting covenants. Under the New Line, there are restrictions on the Company's use of its cash and cash equivalents related to repurchases of stock, dividends and acquisitions. The New Line is secured by specific personal property (including receivables, inventory and property, plant and equipment) of the Company.

In March 2004, one of the Company's letters of credit for \$275 was canceled and the related cash collateral was released to the Company. On May 11, 2004, the remaining cash collateral of \$3,082 was released to the Company upon the effective date of the amended and restated line of credit described above. In July 2004, a letter of credit for \$1,077, related to a customer dispute, expired and was not renewed. In January 2005, a letter of credit related to Workers Compensation was reduced by \$141. As of February 28, 2006 and 2005, the Company had \$1,864 in outstanding letters of credit.

On February 27, 1998, MSC authorized the issuance and sale of \$61,500 Senior Notes (1998 Senior Notes) in two series. The interest rate on the \$5,000 Series A Note was 6.49%, and the Note matured on May 31, 2003. The interest rate on the \$56,500 Series B Notes was 6.80%, and the Notes were to mature on May 31, 2010. The 1998 Senior Notes were issued and funded on February 27, 1998. On June 2, 2003, the Company made a principal payment of \$11,278 against the 1998 Senior Notes. The estimated fair value of the 1998 Senior Notes, based on discounted cash flows, was less than the carrying value by \$5,493 as of February 29, 2004.

In May 2004, the Company repaid all of its 1998 Senior Notes. The debt prepayment consisted of principal of \$43,944, interest of \$1,346 and a contractual prepayment penalty of \$4,051. The Company recorded a loss on the early retirement of debt of \$4,205 which included the contractual prepayment penalty and the write-off of previously capitalized financing costs.

Note 6: Leases

MSC leases one manufacturing facility (Walbridge, Ohio) under a five year lease ending June 30, 2008 with the option to extend in five-year increments through June 30, 2028. The Walbridge, Ohio facility lease contains certain covenants with which the Company was in compliance. Other equipment is leased under non-cancelable operating leases.

The table below presents future minimum lease payments, gross of \$869 in future income under contractual sublease agreements.

| Minimum Lease Payments | |
|-------------------------------------|------------------|
| 2007 | \$ 2,092 |
| 2008 | 2,151 |
| 2009 | 1,052 |
| 2010 | 489 |
| 2011 | 500 |
| 2012 and Thereafter | 3,964 |
| Total Minimum Lease Payments | \$ 10,248 |

There was no amortization of leased property in fiscal 2006 and 2005. Amortization of leased property in fiscal 2004 was \$279.

Total rental expense under operating leases was \$2,297 in fiscal 2006, \$2,448 in fiscal 2005 and \$2,781 in fiscal 2004.

Note 7: Retirement Plans

MSC has non-contributory defined benefit and defined contribution pension plans that cover a majority of its employees. The Company funds amounts required to meet ERISA funding requirements for the defined benefit plans. The Company makes an annual contribution to the defined contribution plan for the amount earned by participating employees after the end of each calendar year. The cost of the defined contribution plan was \$639 in fiscal 2006, \$727 (including \$30 for EMD) in fiscal 2005 and \$1,131 (including \$33 for EMD) in fiscal 2004. In addition to the benefits previously described, some former MSC officers participate in a non-contributory supplemental pension plan.

The Company provides its retired employees with certain postretirement health care benefits, which MSC may periodically amend or modify. Certain employees may be eligible for these benefits if they reach normal retirement age while employed by the Company.

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The following tables present a reconciliation of the change in benefit obligation, a reconciliation of the change in plan assets, a statement of the funded status of the plans, the components of net periodic benefit cost and the assumptions used in determining the plans' funded status. The assumptions do not consider salary increases as the majority of plans are either frozen or do not provide for salary increases in future benefits.

| | Pension Benefits | | Postretirement Benefits | |
|--|------------------|------------|-------------------------|------------|
| | 2006 | 2005 | 2006 | 2005 |
| Change in Benefit Obligation: | | | | |
| Obligation, March 1 | \$ 13,545 | \$ 14,356 | \$ 2,188 | \$ 1,909 |
| Service Cost Benefits Earned During the Period | 158 | 149 | 73 | 67 |
| Interest Cost on Benefit Obligation | 803 | 754 | 120 | 115 |
| Plan Amendments | | | | |
| Actuarial Loss | 1,145 | 560 | 312 | 297 |
| Benefit Payments | (1,126) | (2,286) | (173) | (200) |
| Curtailments | | | | |
| Other Plan Changes | | 12 | | |
| Obligation, February 28 | \$ 14,525 | \$ 13,545 | \$ 2,520 | \$ 2,188 |
| Change in Plan Assets: | | | | |
| Plan Assets at Fair Value, March 1 | \$ 6,812 | \$ 6,035 | \$ 61 | \$ 65 |
| Actual Return on Plan Assets | 827 | 824 | (3) | (4) |
| Company Contributions | 834 | 2,239 | 173 | 200 |
| Benefit Payments | (1,126) | (2,286) | (173) | (200) |
| Plan Assets at Fair Value, February 28 | \$ 7,347 | \$ 6,812 | \$ 58 | \$ 61 |
| Funded Status: | | | | |
| Funded Status | \$ (7,178) | \$ (6,733) | \$ (2,462) | \$ (2,127) |
| Unrecognized Transition Obligation | 1 | 4 | | |
| Unrecognized Prior Service Cost | 302 | 397 | | |
| Unrecognized Loss | 2,503 | 1,705 | 660 | 349 |
| Net Amount Recognized | \$ (4,372) | \$ (4,627) | \$ (1,802) | \$ (1,778) |

| | Pension Benefits | |
|---|------------------|-----------|
| | 2006 | 2005 |
| Plans with Accumulated Benefit Obligation in excess of Plan Assets | | |
| Projected Benefit Obligation | \$ 14,525 | \$ 13,545 |
| Accumulated Benefit Obligation | \$ 14,525 | \$ 13,508 |
| Fair Value of Plan Assets | \$ 7,347 | \$ 6,812 |

| | Pension Benefits | | | Postretirement Benefits | | |
|---|------------------|--------|----------|-------------------------|--------|------------|
| | 2006 | 2005 | 2004 | 2006 | 2005 | 2004 |
| Components of Net Periodic Benefit Cost: | | | | | | |
| Service Cost Benefits Earned During the Period | \$ 158 | \$ 149 | \$ 172 | \$ 73 | \$ 67 | \$ 111 |
| Interest Cost on Benefit Obligation | 803 | 754 | 738 | 120 | 115 | 126 |
| Expected Return on Assets | (561) | (513) | (397) | (5) | (6) | (6) |
| Amortization of Transition Obligation | 4 | 3 | 2 | | | |
| Amortization of Prior Service Cost | 94 | 96 | 98 | | | (34) |
| Amortization of Net (Gain) Loss | 81 | 25 | 44 | 10 | | |
| Expense Due to Plan Amendments | | | 270 | | | |
| Settlements and Curtailment | | 11 | 1,467 | | | (1,951) |
| Net Periodic Benefit Cost | \$ 579 | \$ 525 | \$ 2,394 | \$ 198 | \$ 176 | \$ (1,754) |

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| | Pension Benefits | | Postretirement Benefits | |
|--|------------------|------------|-------------------------|------------|
| | 2006 | 2005 | 2006 | 2005 |
| Amounts Recognized in the Consolidated Balance Sheets | | | | |
| Prepaid Benefit Cost | \$ 625 | \$ 626 | \$ | \$ |
| Accrued Benefit Liability | (7,803) | (7,322) | (1,802) | (1,778) |
| Intangible Asset | 303 | 401 | | |
| Accumulated Other Comprehensive Income | 2,503 | 1,668 | | |
| Net Amount Recognized | \$ (4,372) | \$ (4,627) | \$ (1,802) | \$ (1,778) |
| Additional Information | | | | |
| Increase in Minimum Liability Included in Other Comprehensive Income | \$ 835 | \$ 454 | | |

| | 2006 | 2005 | 2004 |
|--|-------|-------|-------|
| Assumptions Used in Determining the Plans' Funded Status: | | | |
| Discount Rate | 5.50% | 5.75% | 6.00% |
| Expected Long-Term Rate of Return on Assets | 8.40% | 8.40% | 8.40% |
| Rate of Increase in Compensation Levels | N/A | 3.00% | 3.00% |

MSC continues to review its postretirement benefits, incorporating actual and anticipated benefit changes. In determining the present value of the accumulated postretirement benefit obligation, of which only a minor amount has been funded, and net cost, MSC used a 10% health care cost trend rate decreasing until leveling off at 5% in calendar 2010, however for some benefits no trend rate is applicable. The Company's weighted average trend rate was 5.5% as of February 28, 2006.

A 1% increase in assumed health care cost trend rates will raise the total of the service and interest cost components of net periodic postretirement benefit cost by \$47 and the health care component of the accumulated postretirement benefit obligation by \$326 as of February 28, 2006. A 1% decrease in assumed health care cost trend rates will lower the total of the service and interest cost components of net periodic postretirement benefit cost by \$36 and the health care component of the accumulated postretirement benefit obligation by \$266 as of February 28, 2006.

On May 19, 2004, the Financial Accounting Standards Board (FASB) issued FASB Staff Position (FSP) 106-2, Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003. FSP 106-2 provides guidance on accounting for the effects of prescription drug provisions of the Medicare Act (Act) for employers that sponsor postretirement health care plans that provide prescription drug benefits and requires those employers to provide certain disclosures regarding the effect of the federal subsidy provided by this Act. This FSP supersedes FSP 106-1 of the same subject that allowed employers to either defer or recognize the legislation's effect. FSP 106-2 required accounting for the effects of the Act no later than the Company's quarter ended November 30, 2004. The adoption of FSP 106-2 did not have a material impact on the Company's Consolidated Financial Statements.

During the second quarter of fiscal 2004, as part of a continuing major cost reduction program, the Company curtailed the future retiree health care benefits for certain active employees of the Company resulting in a one-time reduction in operating expenses and improvement of income from continuing operations of \$1,951 which is included in Asset Impairments, Restructuring and Other in the Consolidated Statements of Income (Loss).

During the fourth quarter of fiscal 2004, the Company entered into agreements with certain employees for the buyout of certain Supplemental Pension Plan (SERP) obligations. Approximately \$917 was expensed in the fourth quarter of fiscal 2004 for SERP buyout. The payments were made on May 31, 2004.

Plan Assets. The Company's pension plan weighted-average asset allocations at February 28, 2006 and 2005, by asset category, were as follows:

| | 2006 | 2005 |
|-------------------|------|------|
| Equity Securities | 65% | 67% |
| Debt Securities | 35% | 33% |
| Total | 100% | 100% |

The investment objective of the Company's pension plans is to meet the current and future defined benefit payments of participants and beneficiaries of the Company's retirement plans. The Company will invest its assets in funds with appropriate long-term goals and objectives. Individual funds included will seek to provide a long-term competitive rate of return, net of expenses, at appropriate risk levels, that over the long run is equal to or exceeds outlined benchmarks. In order to maximize diversification, the Plans will invest in portfolios within four broad asset classes: bonds, large company stocks, small company domestic stocks and foreign stocks. To provide additional diversification and further reduce the volatility of the portfolio, the Plans will divide the large and small stock domestic portions between value and growth managers.

The approach used to determine the expected long-term rate of return on plan assets assumption is based on weighting historical market index returns for various asset classes in proportion to the assets held in the Material Sciences Corporation Master Trust (Trust). The Trust targets an asset allocation of approximately 63% in equity securities and 37% in fixed income securities. Weighting 10-year compounded trailing returns on equity and fixed income indices in proportion to the above asset mix yields an expected long-term return of 8.4%.

The Company expects to contribute approximately \$952 to its qualified and non-qualified defined benefit pension plans in fiscal 2007. Benefits expected to be paid in each of the next five fiscal years, and in the aggregate for the five fiscal years thereafter are shown in the table below.

| Expected Benefit Payments: | |
|----------------------------|-----------|
| 2007 | \$ 1,194 |
| 2008 | 1,281 |
| 2009 | 1,233 |
| 2010 | 1,239 |
| 2011 | 1,163 |
| 2012 and Thereafter | 5,348 |
| | \$ 11,458 |

The Company expects to contribute approximately \$96 to its postretirement benefit plans other than pensions in fiscal 2007. Benefits expected to be paid in each of the next five fiscal years, and in the aggregate for the five fiscal years thereafter are shown in the table below.

| Expected Benefit Payments: | |
|----------------------------|----------|
| 2007 | \$ 96 |
| 2008 | 98 |
| 2009 | 107 |
| 2010 | 110 |
| 2011 | 120 |
| 2012 and Thereafter | 720 |
| | \$ 1,251 |

Note 8: Interest (Income) Expense, Net

The table presented below analyzes the components of interest (income) expense, net.

| Interest (Income) Expense, Net | 2006 | 2005 | 2004 |
|--------------------------------|---------|--------|----------|
| Interest Expense | \$ 141 | \$ 959 | \$ 3,273 |
| Interest Income | (199) | (70) | (377) |
| Interest (Income) Expense, Net | \$ (58) | \$ 889 | \$ 2,896 |

Note 9: Income Taxes

Deferred income taxes result from recognizing revenues and expenses in different periods for tax and financial reporting purposes.

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The components of the provision (benefit) for income taxes from continuing operations and reconciliation between the statutory rate for federal income taxes and the effective tax rate are summarized and presented below.

| | 2006 | 2005 | 2004 |
|--|----------|----------|------------|
| Tax Provision (Benefit) | | | |
| Current: | | | |
| Federal | \$ 32 | \$ | \$ |
| State | 742 | 69 | |
| | 774 | 69 | |
| Deferred: | | | |
| Federal | 5,354 | 2,445 | (1,888) |
| State | 790 | 943 | (40) |
| | 6,144 | 3,388 | (1,928) |
| Tax Provision (Benefit) | \$ 6,918 | \$ 3,457 | \$ (1,928) |
| Tax Rate Reconciliation | | | |
| Tax Provision (Benefit) at Federal Statutory Rate | \$ 4,942 | \$ 2,333 | \$ (4,042) |
| State and Local Taxes, Net of Federal Tax Benefit | 567 | 30 | (1,059) |
| Reserve Adjustment | 207 | (770) | 266 |
| Valuation Allowance | 655 | 1,275 | 3,041 |
| Non Deductible Compensation Expense | | 565 | |
| Other, Net | 547 | 24 | (134) |
| Tax Provision (Benefit) at Effective Income Tax Rate | \$ 6,918 | \$ 3,457 | \$ (1,928) |

The management of the Company periodically estimates the probable tax obligations of the Company using historical experience in tax jurisdictions and informed judgments. There are inherent uncertainties related to the interpretation of tax regulations in the jurisdictions in which the Company transacts business. The judgments and estimates made at a point in time may change based on the outcome of tax audits, as well as changes to or further interpretations of regulations. If such changes take place, there is a risk that the tax rate may increase or decrease in any period. Amounts accrued for tax liabilities due to the potential change in judgments and estimates are \$1,635 and \$1,428 at February 28, 2006 and 2005, respectively. Accruals relate to tax issues for both U.S. federal and domestic states.

During fiscal 2006, 2005 and 2004, the Company generated losses from its German subsidiary as well as in certain states in which the Company operates. As such, deferred tax assets increased to reflect the additional net operating loss carryforward. The valuation allowance also increased due to Management's belief that it is more likely than not that the operating loss will not be fully utilized due to recent significant operating losses.

During fiscal 2005, the Company reduced tax reserves by \$770 due to changes in tax law in certain states in which the Company operates and the lapsing of the statute of limitations for specific tax contingencies.

Temporary differences that give rise to deferred tax (assets) and liabilities were as follows:

| | 2006 | 2005 |
|---|-------------|-------------|
| Reserves Not Deductible Until Paid | \$ (2,324) | \$ (2,284) |
| Employee Benefit Liabilities | (4,024) | (4,742) |
| Deferred State Income Taxes, Net | (2,454) | (1,957) |
| Net Operating Loss and Tax Credit Carryforwards | (4,649) | (9,072) |
| Other | | (104) |
| Total Gross Deferred Tax Asset | \$ (13,451) | \$ (18,159) |
| Valuation Allowance | 5,621 | 4,966 |
| Total Deferred Tax Assets | \$ (7,830) | \$ (13,193) |
| Property and Equipment | 4,418 | 6,970 |
| Other | | |
| Total Deferred Tax Liabilities | \$ 4,418 | \$ 6,970 |
| Net Deferred Tax Assets | \$ (3,412) | \$ (6,223) |

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Deferred state income taxes primarily relate to net operations loss carryforwards. As of February 28, 2006, deferred tax assets for federal, state and foreign net operating losses and tax credit carryforwards of \$4,589 were available with an unlimited expiration date, and the remaining \$2,423 expires in varying amounts through fiscal 2026.

Deferred Tax (Assets) Liabilities, Net have been recorded on the Company's Consolidated Balance Sheets as follows:

| | 2006 | 2005 |
|--|------------|------------|
| Current Assets - Deferred Income Taxes | \$ (2,599) | \$ (2,727) |
| Long-Term Assets - Deferred Income Taxes | (813) | (3,496) |
| | \$ (3,412) | \$ (6,223) |

The Company's effective tax rate for the tax benefit of the loss on discontinued operations was 38.1% in fiscal 2006 compared to 39.3% in fiscal 2005 and 2004.

Note 10: Significant Customers and Export Sales

Due to the concentration in the automotive industry, the Company believes that sales to individual automotive customers, including indirect sales, are significant. The following table shows sales to the Company's significant customers as a percentage of consolidated net sales for fiscal 2006, 2005 and 2004.

| Customer | % of Consolidated Net Sales | | |
|-----------------|-----------------------------|-------------|-------------|
| | Fiscal 2006 | Fiscal 2005 | Fiscal 2004 |
| DaimlerChrysler | 14% | 12% | 6% |
| General Motors | 12% | 4% | ** |
| Ford | 10% | ** | ** |

** denotes less than 1%

The following table shows gross accounts receivable from the Company's significant customers as a percentage of total consolidated gross accounts receivable as of February 28, 2006 and 2005.

| Customer | % of Consolidated Gross Accounts Receivable | |
|-----------------|---|----------------------|
| | February 28, 2006 | February 28, 2005 |
| DaimlerChrysler | 11% | 14% |
| General Motors | 14% | 6% |
| Ford | 21% | ** |

** denotes less than 1%

Export sales decreased in fiscal 2006 to 3% of the Company's net sales primarily as a result of the change in the supply model for hard disk drives from package to toll processing eliminating the cost and price of steel in the sale. Export sales for the Company were 8% in fiscal 2005 and 10% in fiscal 2004.

MSC's domestic and foreign net sales are presented in the chart below. Of the foreign sales, no one country comprised greater than 10% of consolidated MSC net sales.

| Net Sales | 2006 | 2005 | 2004 |
|-----------|------------|------------|------------|
| | Domestic | \$ 274,675 | \$ 253,131 |
| Foreign | 11,939 | 10,192 | 12,072 |
| Total | \$ 286,614 | \$ 263,323 | \$ 242,748 |

Note 11: Equity and Compensation Plans

The Company has four equity award plans: the 1985 Plan, the 1992 Plan, the 1996 Directors Plan and the 2001 Directors Plan.

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There are 2,512,500 shares authorized under the 1985 Plan to provide for the shares issued to or purchased by employees and directors under several prior plans and the Material Sciences Corporation Employee Stock Purchase Program.

There are 3,262,500 shares authorized under the 1992 Plan to provide stock options and restricted stock under various programs. Non-qualified stock options generally vest over three years from the date of grant and expire 10 years from the date of grant. Incentive stock options (ISOs) were issued in fiscal 1994 at fair market value at the date of grant and expired 10 years from the date of grant. These ISOs were issued in tandem with a restricted stock grant and vest two years after the vesting of the restricted stock, if the corresponding restricted stock still is owned by the participant.

Under the 1992 Plan, restricted stock and cash awards generally vest over three to five years from the date of grant. Certain of these awards require a cash contribution from the employee. Shares of restricted stock are awarded in the name of the employee, who has all the rights of a shareowner, subject to certain restrictions or forfeitures. Restricted stock and cash awards have been issued with restrictions based upon time, stock price performance or a combination thereof. The market value of the restricted stock at the date of grant is amortized to compensation expense over the period in which the shares vest (time-based awards). In the event of accelerated vesting due to the achievement of market value appreciation as defined by the plan, the recognition of the unamortized expense would be accelerated. For awards based on both time and performance (performance-based awards), the Company determines the compensation cost to be recorded on the date the performance levels are achieved. On that date, compensation expense representing a pro rata portion of the total cost is recognized. The remaining compensation expense is recorded ratably over the remaining vesting period. If the specified stock performance levels are not achieved by the end of the five-year period from the date of grant, the employee contribution, elected restricted stock and the cash award are forfeited.

There are 250,000 shares authorized under the 1996 Directors Plan. This plan consisted of grants that provided for 50% of each non-employee director's annual retainer (Retainer Options) and annual incentive stock options (Incentive Options). The Retainer Options vested on the date of grant and expire five years after that date. The Incentive Options vest one year from the date of grant and expire five years after the date of grant. No further shares will be issued under this plan, and no shares were outstanding as of February 28, 2006. The 1996 Directors Plan was replaced with the 2001 Directors Plan that was approved by the shareowners in June 2000 and was effective March 1, 2001.

There are 150,000 shares authorized under the 2001 Directors Plan. This plan consists of grants that provide for all or a portion of each non-employee director's annual retainer, according to the non-employee director's election to receive the annual retainer either in cash, shares of common stock, deferred stock units (entitles the non-employee director to receive shares at a later date), or a combination thereof. The shares and deferred stock units vest in four equal installments, on the date of grant and the three, six and nine-month anniversaries of the date of grant. Any portion which has not vested prior to the date the non-employee director ceases to be a non-employee director shall expire and be forfeited. The 2001 Directors Plan also consists of grants to provide for annual incentive stock options (Incentive Options). The Incentive Options vest one year from the date of grant and expire ten years after the date of grant. The 2001 Directors Plan expired on February 29, 2004 and no additional grants will be made under the plan. As of February 28, 2006, 82,993 shares were outstanding under the 2001 Directors Plan.

The exercise price of all options equals the market price of the Company's stock either on the date of grant or, in the case of the 1996 Directors Plan, on the day prior to the grant. All outstanding stock options are fully vested as of February 28, 2006. There were no stock options granted in fiscal 2006 and 2005 under any of the equity plans.

Stock Option Activity

A summary of transactions under the stock option plans is presented below.

| Stock Option Activity | Options Outstanding and Exercisable | | |
|-------------------------------------|-------------------------------------|---------------|---------------------------------|
| | Directors | Key Employees | Weighted Average Exercise Price |
| Outstanding as of February 28, 2003 | 177,062 | 1,397,062 | \$ 12.12 |
| Granted | 37,453 | | 9.61 |
| Exercised | | (107,749) | 10.00 |
| Canceled | (47,589) | (546,449) | 11.99 |
| Outstanding as of February 29, 2004 | 166,926 | 742,864 | \$ 12.36 |
| Granted | | | |
| Exercised | (50,932) | (312,328) | 11.28 |
| Canceled | (54,377) | (98,065) | 12.09 |
| Outstanding as of February 28, 2005 | 61,617 | 332,471 | \$ 13.14 |
| Granted | | | |
| Exercised | (4,777) | (78,948) | 10.22 |
| Canceled | | (81,564) | 16.43 |
| Outstanding as of February 28, 2006 | 56,840 | 171,959 | \$ 13.04 |

| Range of Exercise Prices | Options Outstanding | | | Exercisable Options | |
|--------------------------|---------------------|---|---------------------------------|-------------------------|---------------------------------|
| | Shares | as of February 28, 2006 | | as of February 28, 2006 | |
| | | Weighted Average Remaining Life (Years) | Weighted Average Exercise Price | Shares | Weighted Average Exercise Price |
| \$ 6.80 - \$9.90 | 19,181 | 4.03 | \$ 8.34 | 19,181 | \$ 8.34 |
| \$10.00 - \$11.71 | 75,561 | 2.61 | 10.20 | 75,561 | 10.20 |
| \$12.34 - \$14.50 | 64,232 | 1.11 | 14.03 | 64,232 | 14.03 |
| \$16.38 - \$18.00 | 69,825 | 0.97 | 16.50 | 69,825 | 16.50 |
| \$ 6.80 - \$18.00 | 228,799 | 1.81 | \$ 13.04 | 228,799 | \$ 13.04 |

The weighted average fair value of individual options granted in fiscal 2004 was \$9.61. No options were granted in fiscal 2006 or 2005.

The fair value of each option grant is estimated on the date of grant using the Black-Scholes option pricing model. The following weighted average assumptions were used for the option grants in fiscal 2004: risk-free interest rates of 2.92%; expected life of 5.00 years; and expected volatility of 48.92%.

A summary of restricted stock transactions was as follows:

| Restricted Stock Activity | |
|----------------------------------|-----------|
| Unvested as of February 29, 2004 | 170,017 |
| Granted | |
| Vested | (129,475) |
| Canceled | (15,425) |
| Unvested as of February 28, 2005 | 25,117 |
| Granted | |
| Vested | (3,617) |
| Canceled | (21,500) |
| Unvested as of February 28, 2006 | |

Net income reported for fiscal 2006 includes a reduction of expense of \$67, before income taxes, for expenses related to the Company's restricted stock plans. Net income reported for fiscal 2005 and fiscal 2004 includes restricted stock expense, before income taxes, of \$110 and \$800, respectively. These amounts have been charged against income and recorded as Additional Paid-In Capital in the Consolidated Balance Sheets.

The Employee Stock Purchase Plan permits eligible employees to purchase shares of common stock on the last day of two six-month purchase periods (February 28 or 29 and August 31 of each year) at 95% of the fair market value of the stock on these measurement dates. Prior to fiscal 2006, employees were permitted to purchase shares of common stock at 85% of the fair market value of the stock on the first or last day of these same six-month purchase periods, whichever was lower. Shares of common stock sold to employees under this plan were 22,413 in fiscal 2006, 48,111 in fiscal 2005, and 57,535 in fiscal 2004. MSC does not record expense related to the stock purchase price discount permitted under the Employee Stock Purchase Plan for eligible employees to purchase shares of common stock. The 5% or 15% stock purchase price discount would have resulted in expense of \$7 in fiscal 2006, \$155 in fiscal 2005, and \$122 in fiscal 2004.

On December 16 and 17, 2004, the Company's Non-Executive Chairman of the Board, certain executive officers and key managers vested in long-term incentives in the form of phantom stock units granted during fiscal 2005. According to the terms of the long-term incentive agreements, the units vested and cash payouts for all of the phantom stock units were due as a result of the Company's stock price closing above \$14.00 and \$15.00 for thirty consecutive trading days. The Company recorded expense and paid cash of \$4,116 during the fourth quarter of fiscal 2005.

In conjunction with the Company's review of several strategic business alternatives and the related fiscal year 2004 fourth quarter business decisions, the Company entered into retention agreements with certain employees that relate to various periods ending on May 31, 2005. The Company also bought out the SERP benefits of these employees. Approximately \$322 and \$917 were expensed in the fourth quarter of fiscal 2004 for retention and SERP, respectively, and \$1,605 was expensed in fiscal 2005 for retention.

On February 8, 2006, the Company announced that its Board of Directors had authorized the repurchase of up to one million shares of common stock, or approximately 7% of the shares outstanding at that time. As of February 28, 2006, the Company has not repurchased any shares under this program.

Note 12: Discontinued Operations

As explained in Note 2 entitled "Sale of Business", the Company sold substantially all of the assets of its EMD business in June 2005 and reclassified all results of EMD operations to discontinued operations for all periods presented. The following table shows the results of discontinued operations of the Company for fiscal 2006, 2005 and 2004.

| | 2006 | 2005 | 2004 |
|---|------------|------------|------------|
| EMD Operations: | | | |
| Net Sales | \$ 1,132 | \$ 1,530 | \$ 470 |
| Gross Profit | 890 | 880 | 403 |
| SG&A and Other Expenses | 4,005 | 6,445 | 5,464 |
| Loss Before Income Taxes | (3,115) | (5,565) | (5,061) |
| Benefit for Income Taxes | (1,185) | (2,187) | (1,989) |
| Loss on Discontinued Operations - EMD | (1,930) | (3,378) | (3,072) |
| Loss on Sale of EMD (Net of Tax Benefit of \$86, \$0 and \$0, Respectively) | (139) | | |
| Income (Loss) on Discontinued Operations - Pinole (Net of Tax (Provision) Benefit of (\$43), \$143 and \$316, Respectively) | 72 | (151) | (489) |
| Loss on Discontinued Operations - Total | \$ (1,997) | \$ (3,529) | \$ (3,561) |

The Company recorded losses of \$1,930, \$3,378 and \$3,072, net of income taxes, on discontinued operations for EMD in fiscal 2006, 2005 and 2004, respectively. The loss in fiscal 2006 included \$2,207 in severance and related costs incurred in preparation for the disposal of the EMD business. The Company has paid \$1,743 of the severance and severance-related costs as of February 28, 2006. The remaining \$464 is recorded as Current Liabilities of Discontinued Operations - EMD in the Consolidated Balance Sheet and are expected to be paid in fiscal 2007. The Company also recorded a loss on the sale of the EMD assets of \$139, net of income tax benefit of \$86, in fiscal 2006. See Note 2 for more information on the sale of EMD.

On May 31, 2002, the Company completed the sale of substantially all of the assets of its Pinole Point Steel business. The Company recorded income from discontinued operations, net of tax, of \$72 for Pinole in fiscal 2006. The Company recorded losses on discontinued operation, net of tax, of \$151 and \$489 in fiscal 2005 and 2004, respectively. The income in fiscal 2006 is the result of the recovery of a previously written-off receivable balance partially offset by workers compensation expenses. The Pinole activity in fiscal 2005 and 2004 was primarily related to workers compensation expenses and adjustments. As of February 28, 2006 and 2005, there were \$216 and \$366 in net liabilities remaining, respectively. The remaining net liabilities include liabilities (primarily workers compensation exposure) not assumed by Grupo IMSA S.A. de C.V. Pinole Point Steel is reported as a discontinued operation, and the Consolidated Financial Statements have been reclassified to segregate the net liabilities and operating results of the business.

Note 13: Asset Impairments and Restructuring

Asset Impairments

As a result of the strategic review and fourth quarter 2004 events (industry-wide metal shortages, higher metal pricing and the loss of a significant customer serviced by the Middletown, Ohio facility), the Company announced the closing of the Middletown facility. The Board concluded that operating the remaining coil coating facilities would provide the best opportunity for a greater return to shareowners. This resulted in a pretax asset impairment charge of \$7,991 recorded in the fourth quarter of fiscal 2004. The facility was closed in July 2004.

In the fourth quarter of fiscal 2004, MSC completed its annual assessment of goodwill under SFAS No. 142, "Goodwill and Other Intangible Assets." Based on the assessment of the goodwill associated with the acquisition of GAC, the Company recorded a pretax impairment charge of \$6,739. The impairment resulted from slower growth in the penetration of the European brake market than previously projected.

Restructuring

During the first quarter of fiscal 2005, the Company announced the closing of its Middletown, Ohio coil coating facility. In conjunction with this announcement and other restructuring actions, MSC recorded restructuring expenses of \$2,657 for the fiscal year ended February 28, 2005. A total of 97 employees were affected by this restructuring. Of the total amount recorded, \$1,771 related to the Middletown closing (\$749 in severance, \$573 in severance related expense [mainly healthcare costs, outplacement and employer taxes] and \$449 in shutdown costs related to closing the Middletown facility) and \$886 related to other restructuring actions (\$622 in severance and \$264 in severance related expense). The Company also recorded \$239 in expenses for these restructuring plans during fiscal 2006 primarily to cover medical-related expenses that were higher than originally planned. A total of \$541 was paid in fiscal 2006 related to these restructuring plans.

In fiscal 2003, the Company entered into a separation arrangement related to the resignation of the former Chairman, President and Chief Executive Officer. As a result of this arrangement, the Company had a pretax charge to earnings of \$1,821 in the first quarter of fiscal 2004. Of this amount, \$1,543 was scheduled to be paid out over two years and the remainder related to the executive's non-contributory supplemental pension plan to be paid out in accordance with the plan. The Company recorded additional restructuring expenses of \$143 in the first quarter of fiscal 2004. Total restructuring expenses for fiscal 2004 were \$1,964. The Company reduced these restructuring reserves by \$21 in fiscal 2006 based on a revision to the total amounts expected to be paid out for these plans. Cash of \$82 was paid during fiscal 2006. A total of \$5 is recorded in Accrued Expenses and \$22 is recorded as Other Long-Term Liabilities in the Consolidated Balance Sheet as of February 28, 2006.

The restructuring reserve as of February 28, 2006, is presented in the chart below which includes both the fiscal 2004 and 2005 restructuring plans.

| | Severance | Other | Total |
|---|-----------|---------|---------|
| Restructuring Reserve as of February 28, 2003 | \$ 391 | \$ 81 | \$ 472 |
| Restructuring Reserve Recorded During Fiscal 2004 | 1,013 | 951 | 1,964 |
| Reclassification of Supplemental Pension Reserve | | (338) | (338) |
| Cash Payments | (794) | (623) | (1,417) |
| Restructuring Reserve as of February 29, 2004 | \$ 610 | \$ 71 | \$ 681 |
| Restructuring Reserve Recorded During Fiscal 2005 | 1,371 | 1,286 | 2,657 |
| Cash Payments | (1,677) | (1,229) | (2,906) |
| Restructuring Reserve as of February 28, 2005 | \$ 304 | \$ 128 | \$ 432 |
| Restructuring Reserve Recorded During Fiscal 2006 | (51) | 269 | 218 |
| Cash Payments | (248) | (375) | (623) |
| Restructuring Reserve as of February 28, 2006 | \$ 5 | \$ 22 | \$ 27 |

Note 14: Business Segments

MSC operates in one segment based on how management views its business for evaluating performance and making operating decisions. MSC focuses on providing material-based solutions for acoustical, coated metal, and electronic applications. The acoustical material-based solutions include multilayer composites consisting of metals, polymeric coatings and other materials used to manage noise and vibration. The coated metal material-based solutions include coil coated and EG protective and decorative coatings applied to coils of metal in a continuous, high-speed, roll-to-roll process. The electronic material-based solutions primarily include coated and laminated noise reducing materials used in electronic applications to solve customer specific problems and enhance performance. The Company's material-based solutions are designed to meet specific customer requirements for the automotive, building and construction, electronics, HVAC, lighting and appliance markets.

Note 15: Earnings Per Share

Below is the computation of basic and diluted earnings per share for the fiscal years ended February 28 or 29, 2006, 2005 and 2004.

| | 2006 | 2005 | 2004 |
|---|----------|-----------|-------------|
| Income (Loss) from Continuing Operations | \$ 7,201 | \$ 3,209 | \$ (9,620) |
| Loss on Discontinued Operations | (1,997) | (3,529) | (3,561) |
| Net Income (Loss) | \$ 5,204 | \$ (320) | \$ (13,181) |
| Weighted Average Number of Common Shares Outstanding Used for Basic Net Income (Loss) Per Share | 14,661 | 14,351 | 13,990 |
| Dilutive Stock Options | 29 | 44 | |
| Dilutive Restricted Stock | | 20 | |
| Weighted Average Number of Common Shares Outstanding Plus Dilutive Shares | 14,690 | 14,415 | 13,990 |
| Basic Net Income (Loss) Per Share: | | | |
| Income (Loss) from Continuing Operations | \$ 0.49 | \$ 0.22 | \$ (0.69) |
| Loss on Discontinued Operations | (0.14) | (0.24) | (0.25) |
| Basic Net Income (Loss) Per Share | \$ 0.35 | \$ (0.02) | \$ (0.94) |
| Diluted Net Income (Loss) Per Share: | | | |
| Income (Loss) from Continuing Operations | \$ 0.49 | \$ 0.22 | \$ (0.69) |
| Loss on Discontinued Operations | (0.14) | (0.24) | (0.25) |
| Diluted Net Income (Loss) Per Share | \$ 0.35 | \$ (0.02) | \$ (0.94) |

Options to purchase 125,456 shares of common stock at a price range of \$13.05-\$18.00 per share were outstanding at the end of fiscal 2006 but were not included in the computation of diluted earnings per share because the options exercise price was greater than the average market price of the common shares.

Note 16: Selected Quarterly Results of Operations (Unaudited)

The table presented below is a summary of quarterly data for the years ended February 28, 2006 and 2005.

| | 2006 | | | |
|--|------------------|-------------------|------------------|-------------------|
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| Net Sales | \$ 73,428 | \$ 73,975 | \$ 74,836 | \$ 64,375 |
| Gross Profit | 15,074 | 13,014 | 13,095 | 9,549 |
| Income (Loss) from Continuing Operations (1) | 3,549 | 2,035 | 2,280 | (663) |
| Loss on Discontinued Operations | (810) | (1,150) | (35) | (2) |
| Net Income (Loss) (1) | \$ 2,739 | \$ 885 | \$ 2,245 | \$ (665) |
| Basic Net Income (Loss) Per Share: | | | | |
| Income (Loss) from Continuing Operations (1) | \$ 0.24 | \$ 0.14 | \$ 0.16 | \$ (0.05) |
| Loss on Discontinued Operations | (0.05) | (0.08) | (0.01) | |
| Basic Net Income (Loss) Per Share (1) | \$ 0.19 | \$ 0.06 | \$ 0.15 | \$ (0.05) |
| Diluted Net Income (Loss) Per Share: | | | | |
| Income (Loss) from Continuing Operations (1) | \$ 0.24 | \$ 0.14 | \$ 0.16 | \$ (0.05) |
| Loss on Discontinued Operations | (0.05) | (0.08) | (0.01) | |
| Diluted Net Income (Loss) Per Share (1) | \$ 0.19 | \$ 0.06 | \$ 0.15 | \$ (0.05) |
| | | | | |
| | 2005 | | | |
| | First Quarter | Second Quarter | Third Quarter | Fourth Quarter |
| Net Sales | \$ 70,187 | \$ 62,208 | \$ 66,991 | \$ 63,937 |
| Gross Profit | 15,080 | 12,938 | 14,860 | 12,193 |
| Income (Loss) from Continuing Operations | (575) | 1,591 | 3,356 | (1,163) |
| Loss on Discontinued Operations | (882) | (1,001) | (918) | (728) |
| Net Income (Loss) | \$ (1,457) | \$ 590 | \$ 2,438 | \$ (1,891) |
| Basic Net Income (Loss) Per Share: | | | | |
| Income (Loss) from Continuing Operations | \$ (0.04) | \$ 0.11 | \$ 0.23 | \$ (0.08) |
| Loss on Discontinued Operations | (0.06) | (0.07) | (0.06) | (0.05) |
| Basic Net Income (Loss) Per Share | \$ (0.10) | \$ 0.04 | \$ 0.17 | \$ (0.13) |
| Diluted Net Income (Loss) Per Share: | | | | |
| Income (Loss) from Continuing Operations | \$ (0.04) | \$ 0.11 | \$ 0.23 | \$ (0.08) |
| Loss on Discontinued Operations | (0.06) | (0.07) | (0.06) | (0.05) |
| Diluted Net Income (Loss) Per Share | \$ (0.10) | \$ 0.04 | \$ 0.17 | \$ (0.13) |

- (1) Fourth quarter, fiscal 2006, loss from continuing operations, net loss and loss per common share includes approximately \$300 of income tax expense related to contingencies identified in the current period and a \$150 increase in income tax expense resulting from adjustments to prior years' income tax items.

Signatures

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused Amendment No. 1 to this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Material Sciences Corporation

By: /s/ CLIFFORD D. NASTAS

Clifford D. Nastas

Chief Executive Officer and Director

Date: May 23, 2006

Exhibit Index

| Exhibit Number | Description of Exhibit |
|----------------|--|
| 2(a) | Asset Purchase Agreement by and among Colorstrip, Inc., the Registrant, and MSC Pinole Point Steel Inc., dated as of November 14, 1997. ⁽⁶⁾ |
| 3(a) | Registrant's Restated Certificate of Incorporation ⁽⁵⁾ |
| 3(b) | Form of Certificate of Designation, Preferences and Rights of Series B Junior Participating Preferred Stock. ⁽²⁾ |
| 3(c) | Registrant's By-laws, as amended ⁽⁶⁾ |
| 3(d) | Amendment to Registrant's By-Laws ⁽⁶⁾ |
| 4(a) | Amended and Restated Loan and Security Agreement dated as of April 30, 2004 among Material Sciences Corporation and LaSalle Bank National Association, The Northern Trust Company and LaSalle Bank National Association, as Agent. ⁽¹³⁾ |
| 4(b) | Consolidated Amended and Restated Guaranty and Security Agreement dated as of April 30, 2004, among the Grantors party thereto and LaSalle Bank National Association, as Agent. ⁽¹³⁾ |
| 10(a) | Material Sciences Corporation Stock Purchase Plan. ⁽¹⁾ |
| 10(b) | Material Sciences Corporation Supplemental Pension Plan. ⁽¹⁾ |
| 10(c) | Material Sciences Corporation Employee Stock Purchase Plan. ⁽¹⁰⁾ |
| 10(d) | Material Sciences Corporation 1985 Stock Option Plan for Key Employees. ⁽¹⁰⁾ |
| 10(e) | Material Sciences Corporation 1985 Stock Option Plan for Directors. ⁽¹⁰⁾ |
| 10(f) | Material Sciences Corporation 1992 Omnibus Stock Awards Plan for Key Employees. ⁽³⁾ |
| 10(g) | Material Sciences Corporation 1991 Stock Option Plan for Directors. ⁽¹⁰⁾ |
| 10(h) | Material Sciences Corporation Directors Deferred Compensation Plan. ⁽¹⁰⁾ |
| 10(i) | Material Sciences Corporation 1996 Stock Option Plan for Non-Employee Directors. ⁽⁴⁾ |
| 10(j) | Deferred Compensation Plan of Material Sciences Corporation and Certain Participating Subsidiaries. ⁽¹⁰⁾ |
| 10(k) | Lease and Agreement dated as of December 1, 1980, between Line 6 Corp. and Pre Finish Metals Incorporated, relating to Walbridge, Ohio facility. ⁽¹⁾ |
| 10(l) | First Amendment to Lease and Agreement dated as of May 30, 1986, between Corporate Property Associates and Corporate Property Associates 2 and Pre Finish Metals Incorporated. ⁽¹⁰⁾ |
| 10(m) | Lease Guaranty dated as of May 30, 1986, from Material Sciences Corporation to Corporate Property Associates and Corporate Property Associates 2. ⁽¹⁰⁾ |
| 10(n) | Agreement dated as of May 30, 1986, between Material Sciences Corporation and Corporate Property Associates and Corporate Property Associates 2. ⁽¹⁰⁾ |
| 10(o) | Form of Indemnification Agreement between Material Sciences Corporation and each of its officers and directors. ⁽¹⁰⁾ |
| 10(p) | Amendment to the Supplemental Employee Retirement Plan. ⁽⁹⁾ |
| 10(q) | Purchase Agreement, dated April 23, 2002, by and among Material Sciences Corporation, LTV Steel Company, Inc., LTV Walbridge, Inc. and MSC Walbridge Coatings Inc. ⁽¹¹⁾ |

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| Exhibit Number | Description of Exhibit |
|----------------|--|
| 10(r) | Purchase Agreement, dated as of May 2, 2003, by and among ISG Acquisition Inc., ISG Venture Inc., MSC Walbridge Coatings Inc. and Material Sciences Corporation. ⁽¹²⁾ |
| 10(s) | Tolling Agreement, dated as of May 6, 2003, by and among International Steel Group, Inc., MSC Walbridge Coatings Inc. and Material Sciences Corporation. ⁽¹²⁾ |
| 10(t) | Material Sciences Corporation Supplemental Retirement Plan. ⁽¹²⁾ |
| 10(u) | Material Sciences Corporation 2005 Long Term Incentive Plan dated March 1, 2005. ⁽¹⁵⁾ |
| 10(v) | Form of 2005 Long-Term Incentive Plan Award Agreement for Fiscal 2006. ⁽¹⁵⁾ |
| 10(w) | Severance and Change in Control Agreement dated June 30, 2005 between Material Sciences Corporation and Clifford D. Nastas. ⁽¹⁴⁾ |
| 10(x) | Severance and Change in Control Agreement dated June 30, 2005 between Material Sciences Corporation and Jeffrey J. Siemers. ⁽¹⁴⁾ |
| 10(y) | Severance and Change in Control Agreement dated June 30, 2005 between Material Sciences Corporation and John M. Klepper. ⁽¹⁴⁾ |
| 21 | Subsidiaries of the Registrant.** |
| 23 | Consent of Deloitte & Touche LLP. * |
| 31.1 | Rule 13a-14(a) / 15(d)-14(a) Certification of Chief Executive Officer.* |
| 31.2 | Rule 13a-14(a) / 15(d)-14(a) Certification of Chief Financial Officer.* |
| 32 | Section 1350 Certifications of Chief Executive Officer and Chief Financial Officer.* |

* Filed herewith.

** Filed with Original Filing.

Management contract or compensatory plan.

- (1) Incorporated by reference to the Registrant's Registration Statement on Form S-1 (Registration No. 2-93414), which was declared effective on November 27, 1984.
- (2) Incorporated by reference to the Registrant's Form 8-A filed on June 20, 1996 (File No. 1-8803).
- (3) Incorporated by reference to the Registrant's Registration Statement on Form S-8 (Registration No. 333-15679) which was filed on November 6, 1996.
- (4) Incorporated by reference to the Registrant's Registration Statement on Form S-8 (Registration No. 333-15677) which was filed on November 6, 1996.
- (5) Incorporated by reference to the Registrant's Form 10-Q Quarterly Report for the Quarter Ended August 31, 1997 (File No. 1-8803).
- (6) Incorporated by reference to the Registrant's Form 8-K filed on December 30, 1997 (File No. 1-8803).
- (7) Incorporated by reference to the Registrant's Form 10-K Annual Report for the Fiscal Year Ended February 28, 1998 (File No. 1-8803).
- (8) Incorporated by reference to the Registrant's Form 8-K filed on June 22, 1998 (File No. 1-8803).
- (9) Incorporated by reference to the Registrant's Form 10-Q Quarterly Report for the Period Ended May 31, 1998 (File No. 1-8803).
- (10) Incorporated by reference to the Registrant's Form 10-K Annual Report for the Fiscal Year Ended February 28, 1999 (File No. 1-8803).
- (11) Incorporated by reference to the Registrant's Form 10-K Annual Report for the Fiscal Year Ended February 28, 2002 (File No. 1-8803).
- (12) Incorporated by reference to the Registrant's Form 10-K Annual Report for the Fiscal Year Ended February 28, 2003 (File No. 1-8803).
- (13) Incorporated by reference to the Registrant's Form 10-K Annual Report for the Fiscal Year Ended February 29, 2004 (File No. 1-8803).
- (14) Incorporated by reference to the Registrant's Form 8-K filed on June 21, 2005 (File No. 1-8803).
- (15) Incorporated by reference to the Registrant's Form 8-K filed on August 23, 2005 (File No. 1-8803).
- (16) Incorporated by reference to the Registrant's Form 8-K filed on January 5, 2006 (File No. 1-8803).