TENNANT CO
Form 10-K
March 05, 2007
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

x ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended December 31, 2006

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from __________ to __________.

Commission File Number 001-16191

TENNANT COMPANY

Minnesota State of Incorporation	**41-0572550** I.R.S. Employer Identification No.
701 North Lilac Drive, P.O. Box 1452 **Minneapolis, Minnesota 55440** Address of Principal Executive Offices	**763-540-1200** Telephone Number

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

Title of Each Class	Name of Exchange on Which Registered
Common Stock, par value $0.375 per share	New York Stock Exchange
Preferred Share Purchase Rights	New York Stock Exchange

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

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

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

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

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

Large accelerated filer o Accelerated filer x Non-accelerated filer o

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

The aggregate market value of common stock held by non-affiliates as of June 30, 2006, was approximately $464,150,287.

As of February 22, 2007, 18,784,804 shares of Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE

2007 Proxy Part III (Partial)

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TENNANT COMPANY

2006

ANNUAL REPORT

Form 10 K

(Pursuant to Securities Exchange Act of 1934)

PART I

ITEM 1 Business

General Development of Business

Tennant Company, a Minnesota corporation incorporated in 1909, is a world leader in designing, manufacturing and marketing of solutions that help create a cleaner, safer world. The Company s floor maintenance and outdoor cleaning equipment, specialty surface coatings and related products are used to clean and coat floors in factories, office buildings, parking lots and streets, airports, hospitals, schools, warehouses, shopping centers and more. Customers include building service contract cleaners to whom organizations outsource facilities maintenance, as well as end-user businesses, healthcare facilities, schools and federal, state and local governments who handle facilities maintenance themselves. We reach these customers through the industry s largest direct sales and service organization and through a strong and well-supported network of authorized distributors worldwide.

Industry Segments, Foreign and Domestic Operations and Export Sales

The Company, as described under "General Development of Business," has one reportable business segment. The Company sells its products domestically and internationally. Financial information on the Company s geographic areas is provided on page 34 of this Form 10 K. Nearly all of the Company s foreign investments in assets reside within The Netherlands, Australia, the United Kingdom, France, Germany, Canada, Austria, Japan, Spain and China.

Principal Products, Markets and Distribution

Products consisting mainly of motorized cleaning equipment and related products, including specialty surface coatings and preservation products, are sold through direct and distribution channels in various regions around the world. In North America, products are sold through a direct sales organization and independent distributors; in Australia, Japan and 15 countries principally in Western Europe, products are sold primarily through direct sales organizations; and in more than 80 other countries Tennant relies on a broad network of independent distributors.

Raw Materials and Purchased Components

The Company has not experienced any significant or unusual problems in the availability of raw materials or other product components. The Company has sole-source vendors for certain components, primarily for automotive and plastic parts. A disruption in supply from such vendors may disrupt the Company s operations. However, the Company believes that it can find alternate sources in the event there is a disruption in supply from such vendors.

Patents and Trademarks

The Company applies for and is granted United States and foreign patents and trademarks in the ordinary course of business, no one of which is of material importance in relation to the business as a whole.

Seasonality

Although the Company s business is not seasonal in the traditional sense, historically revenues and earnings have been more concentrated in the fourth quarter of each year reflecting the tendency of customers to increase capital spending during such quarter and the Company s efforts to close orders and reduce order backlogs. In addition, we offer annual distributor rebates and sales commissions which tend to drive sales in the fourth quarter.

Working Capital

We fund our operations through a combination of cash and cash equivalents, short-term investments and cash flows from operations. Wherever possible, cash management is centralized and intercompany financing is used to provide working capital to subsidiaries as needed. In addition, our credit facilities are available for additional working capital needs or investment opportunities.

Major Customers

The Company sells its products to a wide variety of customers, no one of which is of material importance in relation to the business as a whole. Our customer base includes several governmental entities; however, these customers generally have terms similar to our other customers.

Backlog

The Company processes orders within two weeks on average. Therefore, no significant backlogs existed at December 31, 2006 or 2005.

Competition

While there is no industry association or industry data, the Company believes, through its own market research, that it is a world-leading manufacturer of floor maintenance equipment. Significant competitors exist in all key geographic regions. However, the key competitors vary by region. The Company believes its market share exceeds that of several competitors in certain areas. The Company competes primarily on the basis of offering a broad line of high-quality, innovative products supported by an extensive sales and service network in major markets.

Product Research and Development

The Company strives to be the industry leader in innovation and is committed to investing in research and development. The Company believes that it regularly commits an above-average amount of resources to product research and development. In 2006, 2005 and 2004, respectively, the Company spent $21,939,000, $19,351,000 and $17,198,000 on research and development activities relating to the development of new products and technologies and improvements of existing product design or manufacturing processes.

Environmental Protection

Compliance with federal, state and local provisions regulating the discharge of materials into the environment, or otherwise relating to the protection of

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the environment, has not had, and the Company does not expect it to have, a material effect upon the Company s capital expenditures, earnings or competitive position.

Employment

The Company employed 2,653 people in worldwide operations as of December 31, 2006.

Access to Information on the Company s Website

The Company makes available free of charge, through the Company s website at www.tennantco.com, its annual reports on Form 10-K, quarterly reports on Form 10-Q, and current reports on Form 8-K, and any amendments to those reports filed or furnished pursuant to Section 13(a) or Section 15(d) of the Exchange Act as soon as reasonably practicable after such reports are filed with, or furnished to, the Securities and Exchange Commission (SEC).

ITEM 1A Risk Factors

The following are significant factors known to us that could materially adversely affect our business, financial condition, or operating results. The risks described below are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results.

We may encounter difficulties obtaining raw materials or component parts needed to manufacture our products and the prices of these materials are subject to fluctuation.

Raw materials and commodity-based components. As a manufacturer, our sales and profitability are dependent upon availability and cost of raw materials, which are subject to price fluctuations, and the ability to control or pass on an increase in costs of raw materials to our customers. We purchase raw materials, such as steel, rubber, and petroleum-based resins, for use in our manufacturing operations. The availability of these raw materials is subject to market forces beyond our control. Under normal circumstances, these materials are generally available on the open market from a variety of sources. From time to time, however, the prices and availability of these raw materials fluctuate due to global market demands, which could impair our ability to procure necessary materials, or increase the cost of such materials. Inflationary and other increases in the costs of these raw materials have occurred in the past and may recur from time to time, and our performance depends in part on our ability to incorporate changes in costs in the selling prices for our products.

Given the worldwide steel market conditions, we have experienced cost increases in our steel-based raw materials and component parts. In addition, freight costs associated with shipping and receiving product and sales and service vehicle fuel costs are impacted by fluctuations in the cost of oil and gas. We do not use derivative commodity instruments to manage our exposure to changes in commodity prices such as steel, oil, and gas. Any fluctuations in the supply or prices for any of these raw materials could have a material adverse affect on our profit margins and financial condition.

Single-source supply. We depend on many suppliers for the necessary parts to manufacture our products. However, there are some components, primarily automotive and plastic parts, that are purchased from a single supplier due to price, quality, technology or other business constraints. These components cannot be quickly or inexpensively re-sourced to another supplier. If we are unable to purchase on acceptable terms or experience significant delays or quality issues in the delivery of these necessary parts or components from a particular vendor and we needed to locate a new supplier for these parts and components, shipments for products impacted could be delayed which could have a material adverse affect on our business, financial condition and results of operations.

We are subject to risks associated with changes in foreign currency exchange rates.

We are exposed to market risks from changes in foreign currency exchange rates. As a result of our increasing international presence, we have experienced an increase in transactions and balances denominated in currencies other than the U.S. dollar. There is a direct financial impact of foreign currency exchange when translating profits from local currencies to U.S. dollars. Our primary exposure is to transactions denominated in the Euro, Australian and Canadian dollar, Japanese yen and the British pound. In 2006, we also began to have a foreign currency exchange impact related to the Chinese yuan. Any significant change in the value of the currencies of the countries in which we do business against the U.S. dollar could affect our ability to sell products competitively and control our cost structure. Because a substantial portion of our products are manufactured in the United States, a stronger U.S. dollar generally has a negative impact on results from operations outside the United States while a weaker dollar generally has a positive effect. Unfavorable changes in exchange rates between the U.S. dollar and these currencies impact the cost of our products sold internationally and could significantly reduce our reported sales and earnings. We periodically enter into contracts, principally forward exchange contracts, to protect the value of certain of our foreign currency-denominated assets and liabilities. The gains and losses on these contracts generally approximate changes in the value of the related assets and liabilities. However, all foreign currency exposures cannot be fully hedged, and there can be no assurances that our future results of operations will not be adversely affected by currency fluctuation.

If the United States economy or global economies slow down, the demand for our products could decrease and our revenue may be adversely affected.

The demand for our products and services is dependent upon the overall success and general economic well-being of the U.S. and the foreign economies in which we conduct business. We are primarily susceptible to economic downturns in North America, Europe, the Middle East, Asia, Japan, Latin America, and Australia. The global economy affects overall capital spending by businesses and consumers. An economic slowdown in the U.S. or abroad could result in a decrease in actual and projected spending on capital equipment. If, as a result of general economic uncertainty or otherwise, companies reduce their spending levels, such a decrease in spending could substantially reduce demand for our products and services and negatively impact our operating results.

Our inability to achieve certain planned operational efficiencies may adversely affect our strategic objectives, profit margins, and our earnings growth.

As a manufacturing and service company operating with facilities, inventories, and workforce, our operations have been, and may continue to be, adversely affected by our ability to control costs and achieve planned operational efficiencies. We continuously endeavor to lower our cost structure through various savings measures, including lower-cost sourcing alternatives and consolidation of higher-cost manufacturing facilities. In support of this effort, we launched several corporate priorities in 2006 that focus on leveraging our global cost structure through rationalizing our global manufacturing footprint, expansion in China, global sourcing, creating a lean enterprise and continuous process improvement. In connection with the manufacturing footprint rationalization, we anticipate selling our Maple Grove, Minnesota facility in 2007. Through these initiatives and by establishing Asia as a key source for parts and components, we expect to broaden our global sourcing capabilities, reduce product costs and improve operating efficiencies over the next three to five years. Our operating results may be adversely affected if we are unable to find lower-cost sources for our materials, shift production from higher-cost facilities, or cost-effectively manage our existing manufacturing facilities.

We also plan to continue our efforts to improve our performance through the adoption of lean manufacturing principles and continuous focus on

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process improvement. It is our goal to become more efficient, better employ automation and lower our operating costs. These initiatives will take some time to fully implement. Additionally, we may be unable to effectively complete the implementation of these initiatives or the impact of the initiatives may be less than expected, which could result in lower-than-expected financial results.

Our strategic plans include international expansion. Our failure to meet the challenges associated with international expansion could adversely impact our ability to grow our business and our financial condition.

We plan to continue international expansion of our product sales and manufacturing operations, which will require significant management attention and financial resources. There are certain risks inherent in doing business in international markets. We must ensure compliance with the laws and regulations of foreign governmental and regulatory authorities of each country in which we conduct business. Our international operations could be adversely affected by changes in political and economic conditions, trade protection measures, restrictions on repatriation of earnings, or changes in regulatory requirements that restrict the sales of our products or increase our costs. We may encounter difficulties in collecting receivables, enforcing intellectual property rights, staffing and managing new foreign operations, achieving cost-reduction strategies because of, among other things, competitive conditions overseas, product acceptance in already established domestic markets, or certain cultural barriers. We may experience increased infrastructure costs including costs for legal, tax, accounting and information technology services. Failure of our products to succeed in the global marketplace could reduce our revenues and margins, thereby adversely impacting our financial condition, results of operations, and timing of our planned business expansion.

We are subject to risks associated with developing innovative products and technologies, which could delay the timing and success of new product releases.

Our products are sold in competitive markets throughout the world. Competition is based on product features and design, brand recognition, reliability, durability, technology, breadth of product offerings, price, customer relationships, and after-sale service. Although we believe that the performance and price characteristics of our products will provide competitive solutions for our customers needs, there can be no assurance that our customers will continue to choose our products over products offered by our competitors.

The market for our products is characterized by changing technological and industry standards. Our product lines may be threatened by these new technologies or market demands for competitors products may reduce the value of our current product lines. Our success is based in part on our ability to develop innovative new products and bring them to market more quickly than our competitors. Our ability to compete successfully will depend on our ability to enhance and improve our existing products, to continue to bring innovative products to market in a timely fashion, to adapt our products to the needs and standards of our customers and potential customers, and to continue to improve operating efficiencies and lower manufacturing costs. Product development requires substantial investment by us. If our products, markets and services are not competitive, we may experience a decline in sales, pricing, and market share, which adversely impacts revenues, margin, and the success of our operations.

We are subject to product liability claims and product quality issues that could adversely affect our operating results or financial condition.

Our business exposes us to potential product liability risks that are inherent in the design, manufacturing and distribution of our products. If product liability claims are brought against us for damages that are in excess of our insurance coverage or for uninsured liabilities and it is determined we are liable, our business could be adversely impacted. If products are used incorrectly by our customers, injury may result leading to product liability claims against us. Any losses we suffer from any liability claims, and the effect that any product liability litigation may have upon the reputation and marketability of our products, may have a negative impact on our business and operating results. Some of our products or product improvements may have defects or risks that we have not yet identified that may give rise to product quality issues, liability and warranty claims. We could experience a material design or manufacturing failure in our products, a quality system failure, other safety issues, or heightened regulatory scrutiny that could warrant a recall of some of our products. Any unforeseen product quality problems could result in loss of market share, reduced sales, and higher warranty expense.

We may consider acquisition of suitable candidates to accomplish our growth objectives. We may not be able to successfully integrate the businesses we acquire.

We may consider, as part of our growth strategy, supplementing our internal growth through acquisitions of complementary businesses or products. We have engaged in acquisitions in the past and believe future acquisitions may provide meaningful opportunities to grow our business and improve profitability. Acquisitions allow us to enhance the breadth of our product offerings and expand the market and geographic participation of our products and services. However, our success in growing by acquisition is dependent upon identifying businesses to acquire and integrating the newly acquired businesses with our existing businesses. We may incur difficulties in the realignment and integration of business activities when assimilating the operations and products of an acquired business or in realizing projected efficiencies, cost savings, revenue synergies, and profit margins. Acquired businesses may not achieve the levels of revenue, profit, productivity or otherwise perform as expected. We are also subject to incurring unanticipated liabilities and contingencies associated with the acquired entity that are not identified or fully understood in the due diligence process. Current and/or future acquisitions may not be successful or accretive to earnings if the acquired businesses do not achieve expected financial results. In addition, we may record significant goodwill or other intangible assets in connection with an acquisition. We are required to perform impairment tests at least annually and whenever events indicate that the carrying value may not be recoverable from future cash flows. If we determine that any intangible asset values need to be written down to their fair values, this could result in a charge that may be material to our operating results and financial condition.

We may not be able to adequately acquire, retain and protect our proprietary intellectual property rights which could put us at a competitive disadvantage.

We rely on trade secret, copyright, trademark and patent laws and contractual protections to protect our proprietary technology and other proprietary rights. Our competitors may attempt to copy our products or gain access to our trade secrets. Notwithstanding the precautions we take to protect our intellectual property rights, it is possible that third parties may illegally copy or otherwise obtain and use our proprietary technology without our consent. Any litigation concerning infringement could result in substantial cost to us and diversions of our resources, either of which could adversely affect our business. In some cases, there may be no effective legal recourse against duplication of products or services by competitors. Intellectual property rights in foreign jurisdictions may be limited or unavailable. Patents of third parties also have an important bearing on our ability to offer some of our products and services. Our competitors may obtain patents related to the types of products and services we offer or plan to offer. Any infringement by us on intellectual property rights of others could result in litigation and adversely affect our ability to continue to provide, or could increase the cost of providing, our products and services.

Environmental compliance costs and liabilities could increase our expenses and adversely affect our financial condition.

Our manufacturing operations and our past and present ownership and operations of real property are subject to extensive and changing federal, state, and local environmental laws and regulations, as well as those of other

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countries pertaining to the handling or discharge of hazardous materials into the environment. We must conform our operations and properties to these laws and adapt to regulatory requirements in the countries in which we operate as these requirements change. We expect to continue to incur costs to comply with environmental laws and regulations. We may also be identified as a responsible party and be subject to liability relating to any investigation and clean-up of current or former properties that have been used for industrial purposes or the generation of hazardous substances in our operations. These laws and regulations can also result in the imposition of substantial fines and sanctions for violations, and could require the installation of costly pollution control equipment or operational changes to limit pollution emissions or decrease the likelihood of accidental hazardous substance releases. Imposition of new environmental laws and regulations, stricter enforcement of existing laws and regulations, or discovery of previously unknown contamination could require us to incur costs, or become the basis for new or increased liabilities, that could have a material adverse effect on our business, financial condition, or results of operations.

ITEM 1B Unresolved SEC Staff Comments

None.

ITEM 2 Properties

The Company s corporate offices are owned by the Company and are located in the Minneapolis, Minnesota, metropolitan area. Manufacturing facilities are located in Minnesota, Michigan, Uden and Schaijk, The Netherlands, Northampton, United Kingdom and Shanghai, China. Sales offices, warehouse and storage facilities are leased in various locations in North America, Europe, Japan, Asia, and Australia. The Company s facilities are in good operating condition, suitable for their respective uses and adequate for current needs. Further information regarding the Company s property and lease commitments is included on pages 12, 13 and 30 of this Form 10-K.

ITEM 3 Legal Proceedings

There are no material pending legal proceedings other than ordinary routine litigation incidental to the Company s business.

ITEM 4 Submission of Matters to a Vote of Security Holders

No matters were submitted to a vote of security holders during the fourth quarter of 2006.

PART II

ITEM 5 Market for Registrant s Common Equity, Related Shareholder Matters and Issuer Purchases of Equity Securities

STOCK MARKET INFORMATION Tennant common stock is traded on the New York Stock Exchange, under the ticker symbol TNC. As of January 31, 2007, there were approximately 600 shareholders of record and 5,700 beneficial shareholders. The common stock price was $30.92 per share on January 31, 2007.

STOCK SPLIT On April 26, 2006, the Board of Directors declared a two-for-one common stock split effective July 26, 2006. As a result of the stock split, shareholders of record received one additional common share for every share held at the close of business on July 12, 2006. All share and per share data has been retroactively adjusted to reflect the stock split, except for the Consolidated Balance Sheets and the Consolidated Statements of Shareholders Equity and Comprehensive Income in Item 8 of this Form 10-K.

QUARTERLY PRICE RANGE The accompanying chart shows the split-adjusted quarterly price range of the Company s shares over the past two years:

	First	**Second**	**Third**	**Fourth**
2005	$ 18.65-20.41	$ 17.39-19.75	$ 17.43-21.08	$ 19.69-26.23
2006	$ 21.71-27.75	$ 23.38-27.59	$ 22.21-27.63	$ 24.00 29.88

DIVIDEND INFORMATION Cash dividends on Tennant s common stock have been paid for 63 consecutive years. Cash dividends increased for the 35th consecutive year to $0.46 per share in 2006, an increase of $0.02 per share over 2005. Dividends generally are declared each quarter. Following are the anticipated record dates for 2007: May 31, 2007, August 31, 2007 and November 30, 2007.

DIVIDEND REINVESTMENT OR DIRECT DEPOSIT OPTIONS Shareholders have the option of reinvesting quarterly dividends in additional shares of Company stock or having dividends deposited directly to a bank account. The Transfer Agent should be contacted for additional information.

TRANSFER AGENT AND REGISTRAR Shareholders with a change of address or questions about their account may contact:

Wells Fargo Bank, N.A.
Shareowner Services
161 North Concord Exchange
South St. Paul, MN 55075 0738
651-450-4064, 1-800-468-9716

SHARE REPURCHASES In November 2004, Tennant Company s Board of Directors authorized the repurchase of 400,000 shares of our common stock under the share repurchase program approved by the Board of Directors in May 2001. In August 2006, the Board of Directors approved the adjustment of the number of shares then available for repurchase to reflect the impact of the two-for-one stock split. Share repurchases are made from time to time in the open market or through privately negotiated transactions, primarily to offset the dilutive effects of shares issued through our stock-based compensation programs.

For the Quarter Ended 12/31/2006	Total Number of Shares Purchased[1]	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Number of Shares that May Yet Be Purchased
October 1 31, 2006	23,778	$ 25.81	23,700	538,474
November 1 30, 2006	41,700	28.54	41,700	496,774
December 1 31, 2006	21,900	29.19	21,900	474,874
Total	87,378	$ 27.96	87,300	474,874

[1] Includes 78 shares delivered or attested to in satisfaction of the exercise price and/or tax withholding obligations by employees who exercised stock options or restricted stock under employee stock compensation plans.

COMPARATIVE STOCK PERFORMANCE The following graph compares the cumulative total shareholder return on the Common Stock of the Company for the last five fiscal years with the cumulative total return over the same period on the Overall Stock Market Performance Index (Hemscott Composite Index) and the Industry Index (Hemscott Group Index 62 Industrial Goods, Manufacturing).

This assumes an investment of $100 in the Company s Common Stock, the Hemscott Composite Index and the Hemscott Group Index on December 31, 2001, with reinvestment of all dividends.

COMPARE 5-YEAR CUMULATIVE TOTAL RETURN
AMONG TENNANT COMPANY
HEMSCOTT COMPOSITE INDEX AND HEMSCOTT GROUP INDEX

	2001	2002	2003	2004	2005	2006
Tennant Company	100.00	89.87	122.10	113.65	152.36	173.02
Hemscott Group Index	100.00	88.69	127.86	157.35	173.28	208.58
Hemscott Composite Index	100.00	79.43	105.75	118.62	127.02	147.03

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ITEM 6 Selected Financial Data

(In thousands, except shares and per share data)

Years Ended December 31		2006	2005	2004	2003	2002
Year-end Financial Results						
Net sales	$	598,981	552,908	507,785	453,962(2)	424,183
Cost of sales	$	347,402	318,044	305,277	272,285(2)	254,360
Gross margin %		42.0	42.5	39.9	40.0	40.0
Research and development expenses	$	21,939	19,351	17,198	16,696	16,331
% of net sales		3.7	3.5	3.4	3.7	3.9
Selling and administrative expenses	$	189,676	180,676	164,003(1)	142,306	133,914
% of net sales		31.7	32.7	32.3	31.3	31.6
Profit from operations	$	39,964	34,837	21,307(1)	22,675(2)	15,576(3)
% of net sales		6.7	6.3	4.2	5.0	3.7
Other income (expense)	$	3,338	157	72	(192)	(678)
Income tax expense	$	13,493	12,058	7,999	8,328	6,633
% of earnings before income taxes		31.2	34.5	37.4	37.0	44.5
Net earnings	$	29,809	22,936	13,380(1)	14,155(2)	8,265(3)
% of net sales		5.0	4.2	2.6	3.1	1.9

Years Ended December 31		2006	2005	2004	2003	2002
Return on beginning shareholders equity %		15.4	13.2	8.1	9.2	5.4
Per Share Data						
Basic net earnings	$	1.61	1.27	0.74(1)	0.79(2)	0.46(3)
Diluted net earnings	$	1.57	1.26	0.73(1)	0.78(2)	0.46(3)
Cash dividends	$	0.46	0.44	0.43	0.42	0.41
Shareholders equity (ending)	$	12.25	10.50	9.67	9.21	8.58
Year-End Financial Position						
Cash and cash equivalents	$	31,021	41,287	16,837	24,587	16,356
Total current assets	$	235,404	211,601	188,631	176,370	162,901
Property, plant and equipment, net	$	82,835	72,588	69,063	61,121	69,153
Total assets	$	354,250	311,472	285,792	258,873	256,237
Current liabilities excluding current debt	$	92,992	86,733	74,179	58,477	55,401
Current ratio excluding current debt		2.5	2.4	2.5	3.0	2.9
Long-term liabilities excluding long-term debt	$	27,875	27,797	28,876	27,455	26,743
Debt:						
Current	$	1,812	2,232	7,674	1,030	14,948
Long-term	$	1,907	1,608	1,029	6,295	5,000
Total debt as % of total capital		1.6	2.0	4.8	4.2	11.5
Shareholders equity	$	229,664	193,102	174,034	165,616	154,145
Cash Flow Increase (Decrease)						
Related to operating activities	$	40,319	44,237	36,697	30,470	19,219
Related to investing activities	$	(45,959)	(11,781)	(32,062)	(6,391)	(10,423)
Related to financing activities	$	(4,876)	(8,111)	(12,130)	(15,780)	(16,214)
Other Data						
Interest income	$	2,698	1,691	1,479	1,441	1,891
Interest expense	$	737	564	1,147	833	1,381
Depreciation and amortization expense	$	14,321	13,039	12,972	13,879	16,947
Net expenditures for property, plant and equipment	$	23,872	20,880	21,089	6,391	10,423
Number of employees at year-end		2,653	2,496	2,474	2,351	2,380
Diluted average shares outstanding		18,989	18,210	18,300	18,128	18,096
Closing share price at year-end	$	29.00	26.00	19.83	21.65	16.30
Common stock price range during year	$	21.71 29.88	17.39-26.23	18.25-22.17	14.50-22.90	13.18-22.00
Closing price/earnings ratio		18.5	20.6	27.2	27.8	35.4

(1) 2004 includes workforce reduction expenses of $2,301 pretax ($1,458 after tax or $0.08 per diluted share). (2) 2003 includes sales of $6,430, gross profit of $2,917 and after-tax earnings of $1,796 ($0.10 per diluted share) related to the recognition of previously deferred revenue resulting from the amendment of a contract and pretax charges of $1,960 ($1,215 net of taxes or $0.07 per diluted share) related to the dissolution of a joint venture. (3) 2002 includes unusual charges of $5,002 pretax ($3,619 net of taxes or $0.20 per diluted share) primarily related to restructuring charges.

ITEM 7 Management s Discussion and Analysis of Financial Condition and Results of Operations

Overview

Tennant Company is a world leader in designing, manufacturing and marketing of solutions that help create a cleaner, safer world. We provide equipment, parts and consumables and specialty surface coatings to contract cleaners, end-user businesses, healthcare facilities, schools and local, state and federal governments. We sell our products through our direct sales and service organization and a network of authorized distributors worldwide. Geographically, our customers are primarily located in North America, Europe and other international markets including the Middle East, Asia, Japan, Latin America and Australia. We strive to be an innovator in our industry through our commitment to understanding our customers needs and using our expertise to create innovative solutions.

On April 26, 2006, the Board of Directors declared a two-for-one common stock split effective July 26, 2006. As a result of the stock split, shareholders of record received one additional common share for every share held at the close of business on July 12, 2006. Share and per share data in Management s Discussion and Analysis of Financial Condition and Results of Operations have been retroactively adjusted to reflect the stock split.

In 2006, Tennant built on its strong 2005 performance with record net sales of $599.0 million and a 24.6% increase in diluted net earnings per share to $1.57. Current year growth in net sales of 8.3% was complemented by a year-over-year improvement of 14.7% in operating profit to $40.0 million. Our 2006 results included $3.4 million in costs to support our strategic initiatives and $1.0 million in stock option expense resulting from the required adoption of Statement of Financial Accounting Standards No. 123(R) Share-Based Payment-Revised 2004 (SFAS No. 123(R)). Price increases taken earlier in the year and manufacturing cost-reduction actions were not enough to offset rising material costs, resulting in a decline in gross profit margins of 0.5 percentage points to 42%. Despite these increased costs, we were able to leverage our growth in net sales into improved profitability through operating efficiencies and cost controls within selling and administrative expenses. A decrease in the effective tax rate of 3.3 percentage points, primarily due to a one-time tax benefit, as well as an increase in interest and ESOP income also contributed to the improved profitability.

Tennant s financial position remains strong, enabling continued investment in innovative product development and global expansion. We ended 2006 with a debt-to-capital ratio of 1.6% and $45.3 million in cash, cash equivalents and short-term investments. We generated operating cash flows of $40.3 million during 2006.

Shareholders equity increased by 18.9% to $229.7 million, as compared to 2005. In the fourth quarter of 2006, as required, we adopted Statement of Financial Accounting Standards No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans. The new standard requires the net funded position of the our retirement benefit plans to be recognized as an asset or liability on our balance sheet. The net effect of adopting this new standard was an increase to shareholders equity of $0.6 million.

During 2006, we incurred approximately $3.4 million in support of our previously disclosed China expansion and global manufacturing footprint consolidation initiatives. We manufactured our first product in our China facility during the third quarter of 2006 and have been successful at building our distributor base in China during the year. Our manufacturing footprint consolidation initiative was in its early phases during 2006 and is expected to be completed during 2007. We expect to incur approximately $3.5 million to $4.0 million in costs associated with completing these initiatives during 2007. Through these initiatives and by establishing Asia as a key source for parts and components, we expect to broaden our global sourcing capabilities, reduce product costs and improve operating efficiencies over the next three to five years.

In connection with our manufacturing footprint consolidation, we anticipate selling our Maple Grove, Minnesota facility near the end of 2007. While we cannot estimate the impact of selling this facility because of the uncertainty of the transaction price and timing, we anticipate a substantial gain on the sale.

During 2006, we decided to stop production of our Centurion chassis-mounted street sweeper once our remaining chassis commitment with a third-party manufacturer had been utilized. By the end of the year, we had produced and sold all of our remaining Centurions. During 2006, the Centurion contributed approximately $11 million to net sales. We discontinued this product in order to devote Tennant s resources to stronger growth opportunities in other areas of the business.

During 2006, we launched six new products which targeted all markets as part of our efforts to grow through innovation. A similar level of new product launches are planned for 2007. Sales of new products introduced in the past three years generated almost 30% of our total growth in net sales during 2006.

We also grew our revenue base during 2006 through expanded market coverage in Europe with the acquisition of Hofmans Machinefabriek (Hofmans) in July 2006. Hofmans, a manufacturer of outdoor cleaning equipment based in Schaijk, The Netherlands, complements our current suite of products in the European market and adds approximately $7 million in annual revenue to our European operations. The acquisition is further discussed in Note 18 to the Consolidated Financial Statements. The operations of Hofmans have been included in our results of operations since July 3, 2006, the date of acquisition. We believe we can continue to grow our revenue through both innovation and expanded market coverage in 2007 and beyond.

These initiatives also support our efforts to meet the business challenges we face. Current challenges facing Tennant include successful mitigation of continued cost increases for raw materials and other purchased components, due to rising commodity costs, through price increases and cost-reduction actions. We expect to see a continued upward trend in commodity prices driving increases in our cost of commodity-based products in 2007.

The relative strength or weakness of the global economies in 2007 may also impact demand for our products and services in the markets we serve. Despite general improvements in macro-economic indicators for our industry in 2006, the global economy remains unpredictable and somewhat volatile.

Lastly, our results continue to be impacted by changes in value of the U.S. dollar primarily against the Euro, the Australian and Canadian dollars, the British pound, the Japanese yen and the Chinese yuan. To the extent the applicable exchange rates weaken relative to the U.S. dollar, the related direct foreign currency exchange effect would have an unfavorable impact on our 2007 results. If the applicable exchange rates strengthen relative to the U.S. dollar, our results would be favorably impacted.

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Historical Results

The following compares the historical results of operations for the years ended December 31, 2006, 2005 and 2004 in dollars and as a percentage of net sales (dollars in thousands, except per share amounts):

	2006	**%**	**2005**	**%**	**2004**	**%**
Net sales	**$ 598,981**	**100.0**	$ 552,908	100.0	$ 507,785	100.0
Cost of sales	**347,402**	**58.0**	318,044	57.5	305,277	60.1
Gross profit	**251,579**	**42.0**	234,864	42.5	202,508	39.9
	21,939	**3.7**	19,351	3.5	17,198	3.4

	2006	%	2005	%	2004	%
Research and development expenses						
Selling and administrative expenses	189,676	31.7	180,676	32.7	164,003	32.3
Profit from operations	39,964	6.7	34,837	6.3	21,307	4.2
Interest income	2,698	0.5	1,691	0.3	1,479	0.3
Interest expense	(737)	0.1	(564)	0.1	(1,147)	0.2
Interest income, net	1,961	0.3	1,127	0.2	332	0.1
Net foreign currency transaction gains (losses)	516	0.1	8		(126)	
ESOP income	1,205	0.2	387	0.1	262	0.1
Other expense, net	(344)	0.1	(1,365)	0.2	(396)	0.1
Total other income (expense)	1,377	0.2	(970)	0.2	(260)	0.1
Profit before income taxes	43,302	7.2	34,994	6.3	21,379	4.2
Income tax expense	13,493	2.3	12,058	2.2	7,999	1.6
Net earnings	$ 29,809	5.0	$ 22,936	4.2	$ 13,380	2.6
Earnings per diluted share	$ 1.57		$ 1.26		$ 0.73	

Consolidated Financial Results

In 2006, net earnings increased 30.0% to $29.8 million or $1.57 per diluted share. Net earnings were impacted by:

Growth in net sales of 8.3% to $599.0 million, driven by increases in all geographic regions (North America, Europe and Other International) and all product categories (equipment; service, parts and consumables; and specialty surface coatings).

A gross profit margin decrease of 0.5 percentage points to 42.0% as price increases taken earlier in the year and cost reductions were not enough to offset higher material costs and expenses associated with the startup of our China facility and our manufacturing footprint consolidation.

A decrease in S&A expenses as a percentage of net sales of 1.0 percentage point as growth in net sales outpaced increases in S&A expenses, despite higher costs for strategic initiatives, stock option expense associated with the adoption of SFAS No. 123(R) and other cost increases.

An increase in interest and other income, net of $3.2 million primarily due to increased interest and ESOP income. In addition, Tennant s contribution of $0.8 million to the Tennant Foundation in 2005 was not repeated in 2006.

A decrease in the effective tax rate of 3.3 percentage points to 31.2%, substantially related to a refund from a state protective tax claim and the release of tax reserves accrued in prior years.

In 2005, net earnings increased 71.4% to $22.9 million or $1.26 per diluted share. Net earnings were impacted by:

Growth in net sales of 8.9% to $552.9 million, driven by increases in all three geographic regions and all product categories. Growth in equipment sales was attributable to volume growth, primarily from new products, as well as price increases in certain geographic regions.

Gross profit margin improvement of 2.6 percentage points to 42.5%.

An increase in S&A as a percentage of sales of 0.4 percentage points due to increased expenses of $16.7 million. The increase was due in part to higher performance-based incentive compensation expense. Expanded sales and service market coverage, primarily in Europe, an increase in bad debt expense, senior management transition costs, higher fuel costs and Sarbanes-Oxley compliance costs also contributed to the increase.

A decrease in the effective tax rate of 2.9 percentage points to 34.5%, driven by the resolution of certain state, federal and foreign tax matters.

We use Economic Profit as a key indicator of financial performance and the primary metric for performance-based incentives. Economic Profit is based on our net operating profit after taxes less a charge for the net assets used in the business. The key drivers of net operating profit we focus on include net sales, gross margin and operating expenses. The key drivers we focus on to measure how effectively we utilize net assets in the business include Accounts Receivable Days Sales Outstanding (DSO), Days Inventory on Hand (DIOH) and capital expenditures. These key drivers are discussed in greater depth throughout Management s Discussion and Analysis.

Net Sales

In 2006, consolidated net sales of $599.0 million increased 8.3% from 2005. Consolidated net sales of $552.9 million in 2005 increased 8.9% from 2004. In 2006, growth was driven by increases in all geographic regions and all product categories. Growth in equipment sales was attributable to volume growth and price increases. Equipment volume increases were driven by new product sales, organic growth in Europe and the acquisition of Hofmans. Organic volume growth in service, parts and consumables also contributed to the overall increase in net sales. Positive direct foreign currency exchange fluctuations increased net sales by approximately 1% in both 2006 and 2005.

The following table sets forth for the years indicated net sales by geography and the related percent change from the prior year (dollars in thousands):

	2006	%	2005	%	2004	%
North America	$ 391,309	5.7	$ 370,142	8.3	$ 341,856	6.9
Europe	147,657	16.3	126,913	10.4	114,954	29.5
Other International	60,015	7.5	55,853	9.6	50,975	12.0
Total	$ 598,981	8.3	$ 552,908	8.9	$ 507,785	11.9

North America In 2006, North American net sales increased 5.7% to $391.3 million compared with $370.1 million in 2005. Growth in net sales was driven by volume increases in all product categories and price increases. Organic growth accounted for the volume increases in service, parts and consumables sales, while the volume growth in equipment sales was primarily driven by the continued success of new products. Growth in specialty surface coatings also contributed to the increase in North America net sales as compared to 2005.

In 2005, North American net sales increased 8.3% to $370.1 million compared with $341.9 million in 2004. Growth in net sales was driven by increases in all product categories. The growth in equipment sales was primarily driven by volume increases from the continued success of new products launched in the latter part of 2004 and expanded market coverage as well as price increases. Growth in service, parts and consumables also contributed to the increase in North American net sales when compared to 2004.

Europe European net sales in 2006 increased 16.3% to $147.7 million compared to 2005 net sales of $126.9 million. Growth in net sales was driven by increased demand in certain regions and new product sales as well as price increases. The acquisition of Hofmans in July 2006 contributed $3.6 million to Europe s 2006 sales growth. Organic volume growth in service, parts and consumables also contributed to the overall increase in net sales. Positive direct foreign currency exchange effects increased European net sales by approximately 2% in 2006.

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European net sales in 2005 increased 10.4% to $126.9 million compared to 2004. This increase was driven by growth