

TENNANT CO
Form 10-Q
November 06, 2006

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

- Quarterly Report Under Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 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 No. 1-16191

TENNANT COMPANY

(Exact Name of Registrant as Specified in Its Charter)

Minnesota
(State or Other Jurisdiction of
Incorporation or Organization)

410572550
(I.R.S. Employer
Identification No.)

701 North Lilac Drive
P.O. Box 1452

Minneapolis, Minnesota 55440

(Address of Principal Executive Offices, Including Zip Code)

763-540-1200

(Registrant's Telephone Number, Including Area Code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, 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 Accelerated filer Non-accelerated filer

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

The number of shares outstanding of Registrant's common stock, par value \$.375 on October 26, 2006, was 18,724,438.

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ITEM 1 Financial Statements

CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited)

(In thousands, except per share data)

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|--|--|-----------------|---|------------------|
| | 2006 | 2005 | 2006 | 2005 |
| Net sales | \$ 145,690 | \$ 137,820 | \$ 432,117 | \$ 400,897 |
| Cost of sales | 85,073 | 78,706 | 248,902 | 229,349 |
| Gross profit | 60,617 | 59,114 | 183,215 | 171,548 |
| Operating expenses: | | | | |
| Research and development | 5,536 | 4,937 | 16,166 | 13,906 |
| Selling and administrative | 45,212 | 45,576 | 137,864 | 132,172 |
| Total operating expenses | 50,748 | 50,513 | 154,030 | 146,078 |
| Profit from operations | 9,869 | 8,601 | 29,185 | 25,470 |
| Interest income, net | 251 | 364 | 1,421 | 779 |
| Net foreign currency transaction gains | 396 | 161 | 560 | 216 |
| ESOP income | 636 | 107 | 895 | 291 |
| Other expense, net | (55) | (330) | (343) | (1,255) |
| Profit before income taxes | 11,097 | 8,903 | 31,718 | 25,501 |
| Income tax expense | 3,175 | 2,643 | 10,206 | 9,000 |
| Net earnings | \$ 7,922 | \$ 6,260 | \$ 21,512 | \$ 16,501 |
| Per share: | | | | |
| Basic earnings | \$ 0.43 | \$ 0.35 | \$ 1.16 | \$ 0.92 |
| Diluted earnings | \$ 0.42 | \$ 0.35 | \$ 1.14 | \$ 0.91 |
| Dividends | \$ 0.12 | \$ 0.11 | \$ 0.34 | \$ 0.33 |

Weighted average number of shares:

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---------|------------------------------------|--------|-----------------------------------|--------|
| Basic | 18,579 | 17,942 | 18,526 | 17,983 |
| Diluted | 18,977 | 18,146 | 18,942 | 18,180 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED BALANCE SHEETS (Unaudited)
(In thousands)

| | September 30, 2006 | December 31, 2005 |
|---|--------------------------|-------------------------|
| ASSETS | | |
| Cash and cash equivalents | \$ 35,068 | \$ 41,287 |
| Short-term investments | 10,000 | |
| Receivables, less allowances of \$4,777 and \$4,756, respectively | 101,239 | 105,917 |
| Inventories | 61,420 | 52,666 |
| Prepaid expenses | 3,632 | 3,503 |
| Deferred income taxes, current portion | 8,327 | 8,228 |
| Total current assets | 219,686 | 211,601 |
| Property, plant and equipment | 233,875 | 221,620 |
| Accumulated depreciation | (157,966) | (149,032) |
| Property, plant and equipment, net | 75,909 | 72,588 |
| Deferred income taxes, long-term portion | 2,153 | 1,522 |
| Goodwill | 25,738 | 22,253 |
| Other intangibles, net | 4,704 | 1,502 |
| Other assets | 1,319 | 2,006 |
| Total assets | \$ 329,509 | \$ 311,472 |

LIABILITIES & SHAREHOLDERS EQUITY

LIABILITIES

| | | |
|------------------|----------|----------|
| Current debt | \$ 2,313 | \$ 2,232 |
| Accounts payable | 27,575 | 28,613 |

| | September 30, 2006 | December 31, 2005 |
|---|-----------------------------------|----------------------------------|
| Employee compensation and benefits | 24,368 | 31,501 |
| Income taxes payable | 2,656 | 3,172 |
| Other current liabilities | 23,060 | 23,447 |
| | <u> </u> | <u> </u> |
| Total current liabilities | 79,972 | 88,965 |
| Long-term debt | 1,852 | 1,608 |
| Employee-related benefits | 27,571 | 27,797 |
| Deferred income taxes, long-term portion | 942 | |
| | <u> </u> | <u> </u> |
| Total long-term liabilities | 30,365 | 29,405 |
| | <u> </u> | <u> </u> |
| Total liabilities | 110,337 | 118,370 |
| | <u> </u> | <u> </u> |
| SHAREHOLDERS' EQUITY | | |
| Common stock | 7,027 | 3,459 |
| Additional paid-in capital | 13,117 | 6,963 |
| Retained earnings | 204,455 | 189,221 |
| Accumulated other comprehensive income (loss) | (1,429) | (2,931) |
| Receivable from ESOP | (3,998) | (3,610) |
| | <u> </u> | <u> </u> |
| Total shareholders' equity | 219,172 | 193,102 |
| | <u> </u> | <u> </u> |
| Total liabilities and shareholders' equity | \$ 329,509 | \$ 311,472 |
| | <u> </u> | <u> </u> |

See accompanying Notes to Condensed Consolidated Financial Statements.

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CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

(In thousands)

| | Nine Months Ended September 30 | |
|--|---|-------------------|
| | 2006 | 2005 |
| | <u> </u> | <u> </u> |
| CASH FLOWS RELATED TO OPERATING ACTIVITIES: | | |
| Net earnings | \$ 21,512 | \$ 16,501 |

**Nine Months Ended
September 30**

| | | |
|---|-------------------|-------------------|
| Adjustments to net earnings to arrive at operating cash flows: | | |
| Depreciation and amortization | 10,449 | 9,820 |
| Deferred tax (income) expense | (721) | 276 |
| Stock-based compensation expense | 2,532 | 1,389 |
| Provision for bad debt and returns | 548 | 692 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 4,887 | 4,186 |
| Inventories | (4,737) | (7,830) |
| Accounts payable | (2,217) | 1,916 |
| Employee compensation and benefits and other accrued expenses | (6,441) | 1,772 |
| Income taxes payable | (612) | 3,896 |
| Other current/noncurrent assets and liabilities | 655 | (3,348) |
| Other, net | 1,842 | 740 |
| | <u> </u> | <u> </u> |
| Net cash flows related to operating activities | 27,697 | 30,010 |
| CASH FLOWS RELATED TO INVESTING ACTIVITIES: | | |
| Purchases of property, plant and equipment | (13,194) | (12,875) |
| Hofmans acquisition, net of cash acquired | (8,470) | |
| Purchases of short-term investments | (10,000) | |
| Sales of short-term investments | | 6,050 |
| Proceeds from disposals of property, plant and equipment | 692 | 1,454 |
| | <u> </u> | <u> </u> |
| Net cash flows related to investing activities | (30,972) | (5,371) |
| CASH FLOWS RELATED TO FINANCING ACTIVITIES: | | |
| Payment of long-term debt | | (5,000) |
| Capital lease payments | (1,476) | |
| Proceeds from issuance of common stock | 6,667 | 1,203 |
| Tax benefit on stock plans | 923 | |
| Purchases of common stock | (2,833) | (3,472) |
| Dividends paid | (6,323) | (5,923) |
| | <u> </u> | <u> </u> |
| Net cash flows related to financing activities | (3,042) | (13,192) |
| Effect of exchange rate changes on cash and cash equivalents | 98 | 237 |
| | <u> </u> | <u> </u> |
| Net (decrease) increase in cash and cash equivalents | (6,219) | 11,684 |
| Cash and cash equivalents at beginning of year | 41,287 | 16,837 |
| | <u> </u> | <u> </u> |
| Cash and cash equivalents at end of period | \$ 35,068 | \$ 28,521 |
| | <u> </u> | <u> </u> |
| SUPPLEMENTAL SCHEDULE OF NON-CASH INVESTING AND FINANCING ACTIVITIES | | |
| Capital expenditures funded through capital leases | \$ 2,206 | \$ 1,985 |
| Collateralized borrowings incurred for operating lease equipment | \$ 133 | \$ 47 |

See accompanying Notes to Condensed Consolidated Financial Statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands, except per share data)

(1) Basis of Presentation

Tennant Company is referred to as Tennant, us, we, or our in these notes to the condensed consolidated financial statements.

In our opinion, the accompanying unaudited, condensed consolidated financial statements contain all adjustments (consisting of only normal recurring adjustments, except as noted elsewhere in the notes to the condensed consolidated financial statements) necessary to present fairly our financial position as of September 30, 2006, the results of our operations for the three and nine months ended September 30, 2006 and 2005 and cash flows for the nine months ended September 30, 2006 and 2005. These statements are condensed and, therefore, do not include all of the information and note disclosures required by accounting principles generally accepted in the United States of America for complete financial statements. The statements should be read in conjunction with the consolidated financial statements and notes included in our Annual Report on Form 10-K for the year ended December 31, 2005. The results of operations for the three and nine months ended September 30, 2006 are not necessarily indicative of the results to be expected for the full year.

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. Share and per share data in these consolidated financial statements and related notes have been retroactively adjusted to reflect the stock split. In connection with the stock split, we amended our articles of incorporation to increase the number of authorized shares of common stock to 60,000.

New Accounting Pronouncements

In June 2006, the Financial Accounting Standards Board (FASB) issued Interpretation No. 48, Accounting for Uncertainty in Income Taxes (FIN 48). FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The requirements are effective for fiscal years beginning after December 15, 2006. Although we are still evaluating the impact that the adoption of FIN 48 will have on our consolidated financial statements, we do not believe it will have a material impact.

In September 2006, the Securities and Exchange Commission (SEC) issued Staff Accounting Bulletin No. 108, Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements (SAB No. 108). Due to diversity in practice among registrants, SAB No. 108 expresses SEC staff views regarding the process by which misstatements in financial statements are evaluated for purposes of determining whether financial statement restatement is necessary. SAB No. 108 is effective for fiscal years ending after November 15, 2006. We are currently evaluating the impact, if any, that SAB No. 108 will have on our consolidated financial

statements.

In September 2006, the FASB issued Statement (SFAS) No. 157, Fair Value Measurements (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value under generally accepted accounting principles, and expands disclosures about fair value measurements. The requirements are effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact that the adoption of SFAS No. 157 will have on our consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands, except per share data)

In September 2006, the FASB issued SFAS No. 158, Employers Accounting for Defined Benefit Pension and Other Postretirement Plans (SFAS No. 158). SFAS No. 158 requires an employer to recognize in its balance sheet the funded status of a benefit plan. Gains or losses and prior service costs or credits that arise during the period as a component of other comprehensive income are also required to be recognized. In addition, the measurement date of defined benefit plan assets and obligations must coincide with the year end date and certain disclosures are required in the notes to the financial statements. The requirements are effective for fiscal years ending after December 15, 2006 and will be applied retrospectively to all periods presented in our December 31, 2006 consolidated financial statements pursuant to the requirements of SFAS No. 154, Accounting Changes and Error Corrections (SFAS No. 154). We are currently evaluating the impact that the adoption of SFAS No. 158, in accordance with SFAS No. 154, will have on our consolidated financial statements.

(2) Hofmans Acquisition

In July 2006, we acquired Hofmans Machinefabriek, a manufacturer of outdoor cleaning equipment based in Schaijk, The Netherlands, for a purchase price of \$8,603 in cash, subject to certain post-closing adjustments. The results of Hofmans operations have been included in the consolidated financial statements since July 3, 2006, the date of acquisition. The purchase price allocation is preliminary and may be adjusted based on the final determination of the fair value of assets acquired and liabilities assumed, primarily based on independent appraisals. These adjustments are not expected to be material. The components of the purchase price have been allocated as follows:

| | |
|------------------------------|----------|
| Net tangible assets acquired | \$ 2,305 |
| Identified intangible assets | 3,509 |
| Goodwill | 2,789 |
| | <hr/> |
| | \$ 8,603 |
| | <hr/> |

(3) Inventories

Inventories are valued at the lower of cost or market. Inventories at September 30, 2006 and December 31, 2005 consisted of the following:

| September 30, 2006 | December 31, 2005 |
|-----------------------|----------------------|
|-----------------------|----------------------|

| | September 30, 2006 | December 31, 2005 |
|--|-------------------------------|------------------------------|
| | <u> </u> | <u> </u> |
| Inventories carried at LIFO: | | |
| Finished goods | \$ 38,427 | \$ 35,539 |
| Raw materials, production parts and work-in-process | 20,670 | 17,642 |
| LIFO reserve | (24,827) | (24,060) |
| | <u> </u> | <u> </u> |
| Total LIFO inventories | 34,270 | 29,121 |
| | <u> </u> | <u> </u> |
| Inventories carried at FIFO: | | |
| Finished goods | 18,507 | 18,286 |
| Raw materials, production parts and work-in-process | 8,643 | 5,259 |
| | <u> </u> | <u> </u> |
| Total FIFO inventories | 27,150 | 23,545 |
| | <u> </u> | <u> </u> |
| Total inventories | \$ 61,420 | \$ 52,666 |
| | <u> </u> | <u> </u> |

The LIFO reserve approximates the difference between LIFO carrying cost and replacement cost.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands, except per share data)

(4) Supplemental Cash Flow Information

Income taxes paid during the nine months ended September 30, 2006 and 2005 were \$10,461 and \$4,696, respectively. Interest costs paid during the nine months ended September 30, 2006 and 2005 were \$195 and \$504, respectively.

(5) Accumulated Other Comprehensive Income (Loss)

We report accumulated other comprehensive income (loss) as a separate item in the shareholders' equity section of the balance sheet. Comprehensive income (loss) is comprised of the net earnings and other comprehensive income (loss). For the three and nine months ended September 30, 2006 and 2005, other comprehensive income (loss) consisted of foreign currency translation adjustments. The reconciliations of net earnings to comprehensive income (loss) are as follows:

| Three Months Ended September 30 | | Nine Months Ended September 30 | |
|--|------|---|------|
| <u> </u> | | <u> </u> | |
| 2006 | 2005 | 2006 | 2005 |

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|--|--|-------------------|---|-------------------|
| | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| Net earnings | \$ 7,922 | \$ 6,260 | \$ 21,512 | \$ 16,501 |
| Foreign currency translation adjustments | (223) | (274) | 1,502 | (2,506) |
| Comprehensive income (loss) | \$ 7,699 | \$ 5,986 | \$ 23,014 | \$ 13,995 |

(6) Earnings Per Share Computation

The computations of basic and diluted earnings per share are as follows:

| | | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|--|----------------------------|--|-------------------|---|-------------------|
| | | <u> </u> | <u> </u> | <u> </u> | <u> </u> |
| | | 2006 | 2005 | 2006 | 2005 |
| Weighted average shares outstanding | Basic | 18,579 | 17,942 | 18,526 | 17,983 |
| | Dilutive share equivalents | 398 | 204 | 416 | 197 |
| Weighted average shares outstanding | Diluted | 18,977 | 18,146 | 18,942 | 18,180 |
| Net earnings | | \$ 7,922 | \$ 6,260 | \$ 21,512 | \$ 16,501 |
| Earnings per share | Basic | \$ 0.43 | \$ 0.35 | \$ 1.16 | \$ 0.92 |
| Earnings per share | Diluted | \$ 0.42 | \$ 0.35 | \$ 1.14 | \$ 0.91 |
| Antidilutive securities excluded from diluted earnings per share calculation | | 88 | 803 | 98 | 833 |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands, except per share data)

(7) Segment Reporting

We operate in one reportable segment that consists of the design, manufacture and sale of products used primarily in the maintenance of nonresidential surfaces. Our products are sold in North America, Europe, and other international markets including the Middle East, Asia, Japan, Latin America and Australia. The following table sets forth net sales by geographic area (net of intercompany sales):

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---------------------|--|-------------------|---|-------------------|
| | 2006 | 2005 | 2006 | 2005 |
| North America | \$ 94,938 | \$ 93,876 | \$ 286,049 | \$ 269,137 |
| Europe | 35,790 | 29,433 | 103,187 | 90,884 |
| Other International | 14,962 | 14,511 | 42,881 | 40,876 |
| Total | \$ 145,690 | \$ 137,820 | \$ 432,117 | \$ 400,897 |

(8) Goodwill and Intangible Assets

The following table summarizes the activity during the nine months ended September 30, 2006 for goodwill and other intangible assets:

| | Goodwill | Other Intangibles |
|------------------------------------|------------------|------------------------------|
| Balance, December 31, 2005 | \$ 22,253 | \$ 1,502 |
| Additions | 2,789 | 3,509 |
| Amortization expense | | (379) |
| Foreign currency fluctuations | 696 | 72 |
| Balance, September 30, 2006 | \$ 25,738 | \$ 4,704 |

The additions to goodwill and other intangible assets in the first nine months of 2006 were based on the purchase price allocation of the Hofmans acquisition in July 2006, as discussed in Note 2. The other intangible assets, consisting of technology, a customer list and an order book, are amortized over useful lives of two to 22 years, 15 years and eight months, respectively based on the provisions of SFAS No. 142, Goodwill and Other Intangible Assets.

(9) Stock-Based Compensation

On January 1, 2006, we adopted SFAS No. 123(R), Share-Based Payment Revised 2004 (SFAS No. 123(R)), using the modified prospective transition method. Under this method, stock-based employee compensation cost is recognized using the fair-value based method for all new awards granted after January 1, 2006. Compensation costs for vested stock options and awards that were outstanding as of the adoption date are being recognized, beginning January 1, 2006, over the requisite service period based on the grant-date fair value of those options and awards as previously calculated under the pro-forma disclosures pursuant to SFAS No. 123, Accounting for Stock-Based Compensation (SFAS No. 123).

As of September 30, 2006, we had six plans which are described in Note 13 of the 2005 Annual Report on Form 10-K. The 1999 Directors Restricted Plan, 1997 Directors Option Plan and 1999 Stock Incentive Plan currently allow for stock-based compensation grants as of September 30, 2006. A maximum of 4,700 shares can be awarded under these plans; 538 shares were available for issuance under current and future equity compensation awards as of September 30, 2006.

Stock Option and Stock Appreciation Right Awards

We determined the fair value of our stock option awards using the Black-Scholes option pricing model. The following weighted-average assumptions were used to value the stock options granted during the nine months ended September 30, 2006 and 2005:

| | <u>2006</u> | <u>2005</u> |
|-----------------------------|-------------|-------------|
| Expected life in years | 6 | 4 |
| Risk-free interest rate | 4.9% | 4.1% |
| Expected volatility | 37.7% | 27.3% |
| Expected dividend yield | 2.0% | 2.2% |
| Weighted-average fair value | \$ 8.73 | \$ 4.00 |

Stock options were granted for 40 and 24 shares during the nine months ended September 30, 2006 and 2005, respectively.

The expected life selected for stock options granted during the nine-month period represents the period of time that the stock options are expected to be outstanding based on historical data of stock option holder exercise and termination behavior for similar grants. The risk-free interest rate for periods within the contractual life of the stock option is based on the U.S. Treasury rate over the expected life at the time of grant. Expected volatilities are based upon historical volatility of our stock over a period equal to the expected life of each stock option grant. Dividend yield is estimated over the expected life based on our dividend policy and historical dividends paid.

The total intrinsic value of stock options exercised during the nine months ended September 30, 2006 and 2005 was \$2,767 and \$260, respectively. The total grant date fair value of stock options vested during the nine months ended September 30, 2006 and 2005 was \$1,210 and \$2,144, respectively. At September 30, 2006, the aggregate intrinsic value of shares outstanding and exercisable was \$8,048 and \$7,678, respectively.

Employee stock option awards prior to 2005 include a reload feature for options granted to key employees. This feature allows employees to exercise options through a stock-for-stock exercise using mature shares and employees are granted a new stock option (reload option) equal to the number of shares of common stock used to satisfy both the exercise price of the option and the tax withholding requirements. The reload options granted have an exercise price equal to the fair market value of the common stock on the grant date. Stock options granted in conjunction with reloads vest immediately and have a term equal to the remaining life of the initial grant.

New stock option awards granted during the first nine months of 2006 vest one-third each year over a three-year period and have a ten-year contractual term. These grants do not contain a reload feature. Compensation expense equal to the grant date fair value is recognized for these awards over the vesting period. Compensation expense is fully recognized for reload stock options as of the reload date.

In addition to stock options, we also grant cash-settled stock appreciation rights to employees in certain foreign locations. Stock appreciation rights outstanding were 18 as of September 30, 2006. No new stock appreciation rights were granted during the first nine months of 2006.

Compensation expense related to stock options and stock appreciation rights was \$770 for the nine-month period ended September 30, 2006. As of September 30, 2006, there was unrecognized compensation cost for unvested options and rights of \$690 of which \$164 is expected to be recognized during the remainder of 2006 and the remaining \$526 during 2007, 2008 and 2009.

The following table summarizes activity related to stock options and stock appreciation rights under our employee and non-employee director equity compensation plans during the nine months ended September 30, 2006:

| | Outstanding | Weighted-Average Exercise Price |
|-----------------------------------|--------------------|--|
| Outstanding at December 31, 2005 | 2,053 | \$ 19.15 |
| Granted | 40 | 25.95 |
| Exercised | (382) | 18.58 |
| Forfeited | (44) | 21.21 |
| Expired | (46) | 17.79 |
| | <u>1,621</u> | <u>\$ 19.43</u> |
| Outstanding at September 30, 2006 | 1,621 | \$ 19.43 |
| | <u>1,435</u> | <u>\$ 19.03</u> |
| Exercisable at September 30, 2006 | 1,435 | \$ 19.03 |

The following table summarizes information concerning outstanding and exercisable stock options and stock appreciation rights as of September 30, 2006:

| Range of Exercise Prices Between | Number Outstanding | Weighted-Average Remaining Contractual Life (Years) | Weighted-Average Exercise Price | Number Exercisable | Weighted-Average Exercise Price |
|---|---------------------------|--|--|---------------------------|--|
| \$12.55-15.04 | 36 | 2.2 | \$ 13.85 | 36 | \$ 13.85 |
| 15.05-17.54 | 608 | 4.7 | 16.53 | 608 | 16.53 |
| 17.55-20.04 | 208 | 2.8 | 17.95 | 197 | 17.94 |
| 20.05-22.54 | 516 | 5.4 | 21.29 | 439 | 21.38 |
| 22.55-25.04 | 166 | 6.0 | 23.88 | 81 | 23.91 |
| \$25.05-27.55 | 87 | 4.8 | 25.97 | 74 | 25.85 |
| | <u>1,621</u> | <u>4.7</u> | <u>\$ 19.43</u> | <u>1,435</u> | <u>\$ 19.03</u> |

| Range of Exercise Prices Between | Number Outstanding | Weighted- Average Remaining Contractual Life (Years) | Weighted- Average Exercise Price | Number Exercisable | Weighted- Average Exercise Price |
|---|-------------------------------|---|---|-------------------------------|---|
|---|-------------------------------|---|---|-------------------------------|---|

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands, except per share data)

Restricted Share Awards

The following table summarizes the activity during the nine months ended September 30, 2006 for unvested restricted share awards:

| | Unvested Shares | Weighted- Average Grant Date Fair Value |
|--------------------------------|----------------------------|--|
| Unvested at December 31, 2005 | 19 | \$ 19.68 |
| Granted | 65 | 26.23 |
| Vested | (2) | 21.66 |
| Forfeited | (10) | 24.41 |
| Unvested at September 30, 2006 | 72 | \$ 24.71 |

Restricted share awards typically have a two- or three-year vesting period from the effective date of grant. The total fair value of shares vested during the nine months ended September 30, 2006 and 2005 was \$47 and \$777, respectively. Compensation expense related to restricted stock was \$444 and \$274 for the nine-month periods ended September 30, 2006 and 2005, respectively. As of September 30, 2006, there was \$895 of total unrecognized compensation cost related to unvested shares, of which \$181 is expected to be recognized during the remainder of 2006, and the remaining \$714 during 2007, 2008 and 2009.

Performance Share Awards

We also grant performance share awards to key employees as a part of our management compensation program. These awards are earned based upon achievement of certain financial performance targets. We determine the fair value of these awards as of the date of grant and recognize the expense over a three-year performance period. The compensation expense for these awards was \$1,196 for the nine months ended September 30, 2006.

During November 2005, we also granted a performance share award, which vests and is earned upon achieving certain total shareholder return targets over a five-year performance period. The maximum number of shares of common stock issuable upon payout of the award is 40. Compensation cost is based on the fair value of this award as of the date of grant and recognized over the derived requisite service period of three years. Compensation expense related to this award was \$106 for the nine-month period ended September 30, 2006. As of September 30, 2006, there was \$307 of total unrecognized compensation cost related to this award, of which \$36 is expected to be recognized during the remainder of 2006, and the remaining \$271 during 2007 and 2008.

Share-Based Liabilities

As of September 30, 2006, we had \$1,759 in total share-based liabilities recorded on our balance sheet. During the nine-month period ended September 30, 2006, we paid out \$1,739 related to 2005 share-based liability awards.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)

(In thousands, except per share data)

Prior to the adoption of SFAS No. 123(R), we accounted for stock-based compensation using the intrinsic value method prescribed in Accounting Principles Board (APB) Opinion No. 25, Accounting for Stock Issued to Employees. As we adopted SFAS No. 123(R) using the modified prospective approach, prior period net earnings and basic and diluted earnings per share have not been restated. The pro forma effects of recognizing the estimated fair value of stock-based compensation as previously calculated under SFAS No. 123 for the three and nine months ended September 30, 2005 are summarized below:

| | Three Months Ended September 30, 2005 | Nine Months Ended September 30, 2005 |
|---|--|---|
| Net earnings as reported | \$ 6,260 | \$ 16,501 |
| Add: Stock-based compensation cost determined under intrinsic value method included in net earnings, net of related tax effects | 526 | 735 |
| Deduct: Stock-based employee compensation expense determined under fair value-based method, net of related tax effects | (658) | (1,420) |
| Net earnings pro forma | <u>\$ 6,128</u> | <u>\$ 15,816</u> |
| Earnings per share: | | |
| Basic as reported | \$ 0.35 | \$ 0.92 |
| Basic pro forma | \$ 0.34 | \$ 0.88 |
| Diluted as reported | \$ 0.35 | \$ 0.91 |

| | Three Months Ended September 30, 2005 | Nine Months Ended September 30, 2005 |
|-------------------|--|---|
| Diluted pro forma | \$ 0.34 | \$ 0.87 |

(10) Guarantees

We record a liability for warranty claims at the time of sale. The amount of the liability is based on the trend in the historical ratio of claims to sales, the historical length of time between the sale and resulting warranty claim, new product introductions and other factors. Warranty periods on machines generally range from one to four years. The changes in warranty reserve balances for the nine months ended September 30, 2006 and 2005 were as follows:

| | September 30, 2006 | September 30, 2005 |
|-------------------------------|-------------------------------|-------------------------------|
| Beginning balance | \$ 6,146 | \$ 6,180 |
| Additions charged to expense | 5,824 | 5,899 |
| Change in estimate | 153 | (80) |
| Foreign currency fluctuations | 78 | (97) |
| Claims paid | (5,803) | (5,456) |
| Ending balance | \$ 6,398 | \$ 6,446 |

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands, except per share data)

Certain operating leases for vehicles contain residual value guarantee provisions, which would become due at the expiration of the operating lease agreement if the fair value of the leased vehicles is less than the guaranteed residual value. Of those leases that contain residual value guarantees, the aggregate residual value at lease expiration is approximately \$10,600 of which we have guaranteed approximately \$8,100. As of September 30, 2006, we have recorded a liability for the estimated end of term loss related to this residual value guarantee of \$894 for certain vehicles within our fleet. Our fleet also contains vehicles we estimate will settle at a gain. Gains on these vehicles will be recognized at the end of the lease term.

(11) Retirement Benefit Plans

As of September 30, 2006, we had four defined benefit retirement plans and a postretirement medical plan, which are described in Note 9 of the 2005 Annual Report on Form 10-K.

We contributed \$181 and \$277 during the third quarter and \$300 and \$664 for the first nine months of 2006 to our pension benefit plans and to our postretirement medical benefit plan, respectively. We expect to contribute a total of approximately \$300 and \$900 to our pension benefit plans and to our postretirement medical benefit plan in 2006,

respectively.

The components of the net periodic cost for the three and nine months ended September 30, 2006 and 2005 were as follows:

| | Three Months Ended September 30 | | Nine Months Ended September 30 | |
|---|--|---------------|---|---------------|
| | 2006 | 2005 | 2006 | 2005 |
| Pension Benefits: | | | | |
| Service cost | \$ 260 | \$ 243 | \$ 770 | \$ 845 |
| Interest cost | 571 | 520 | 1,693 | 1,570 |
| Expected return on plan assets | (746) | (718) | (2,223) | (2,184) |
| Recognized actuarial gain | (2) | (28) | (6) | (116) |
| Amortization of transition obligation | 14 | (5) | 40 | (17) |
| Amortization of prior service cost | 142 | 142 | 425 | 428 |
| Foreign currency | (16) | | 157 | |
| Net periodic cost | \$ 223 | \$ 154 | \$ 856 | \$ 526 |
| Postretirement Medical Benefits: | | | | |
| Service cost | \$ 38 | \$ 55 | \$ 114 | \$ 159 |
| Interest cost | 191 | 222 | 574 | 630 |
| Recognized actuarial gain | 19 | 42 | 56 | 127 |
| Amortization of prior service cost | (130) | (130) | (389) | (390) |
| Net periodic cost | \$ 118 | \$ 189 | \$ 355 | \$ 526 |

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ITEM 2 - 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.

Net earnings for the third quarter of 2006 were up 26.5% to \$7.9 million, or \$0.42 per diluted share, compared to the third quarter of 2005. Net earnings were impacted by:

Growth in net sales of 5.7%.

A 0.8% decrease in selling and administrative (S&A) expenses.

An increase in other income, net of \$1.0 million.

A 1.3 percentage point decrease in gross margin to 41.6%.

Net earnings for the nine months ended September 30, 2006 increased 30.4% to \$21.5 million, or \$1.14 per diluted share, compared to the same period in 2005. Net earnings were impacted by:

Growth in net sales of 7.8%.

An increase of 16.3% in research and development expenses.

A 4.3% increase in S&A expenses.

An increase in interest income, net of \$0.6 million.

An increase in other income, net of \$1.9 million.

A decrease in the effective tax rate of approximately 3 percentage points.

In July 2006 we acquired Hofmans Machinefabriek (Hofmans) for \$8.6 million in cash. The acquisition of Hofmans, a manufacturer of outdoor cleaning equipment based in Schaijk, The Netherlands, complements our current suite of products in the European market. The acquisition is further discussed in Note 2 to the condensed consolidated financial statements. The operations of Hofmans have been included in our results of operations since July 3, 2006, the date of acquisition.

During the first quarter of 2006, we adopted SFAS No. 123(R) Share-Based Payment-Revised 2004 (SFAS 123(R)). SFAS No. 123(R) requires compensation costs relating to share-based payment transactions, including employee stock options, be recognized in the financial statements. We applied the modified prospective approach to transition in our adoption of this standard. Compensation cost related to the unvested portion of awards outstanding as of the adoption date is based on the grant-date fair value of those awards as calculated under the original provisions of SFAS No. 123. As a result of the adoption of SFAS No. 123(R), S&A expenses for the three and nine months ended September 30, 2006 included an expense of \$0.3 million (\$0.2 million after-tax or \$0.01 per diluted share) and an expense of \$0.8 million (\$0.5 million after-tax or \$0.03 per diluted share), respectively, related to stock options.

During the fourth quarter of 2005, we launched initiatives to establish a manufacturing facility in China and rationalize our global manufacturing footprint. For the nine months ended September 30, 2006, Tennant has spent approximately \$1.7 million pretax, or \$0.07 per diluted share, on these initiatives. We currently expect to incur approximately \$3.1 million pretax, or \$0.12 per share, in 2006.

Historical Results

The following compares the historical results of operations for the three- and nine-month periods ended September 30, 2006 and 2005 in dollars and as a percentage of net sales (dollars in thousands, except earnings per diluted share):

| | Three Months Ended September 30 | | | | Nine Months Ended September 30 | | | |
|-------------------------------------|---------------------------------|-------|------------|-------|--------------------------------|-------|------------|--------|
| | 2006 | % | 2005 | % | 2006 | % | 2005 | % |
| Net sales | \$ 145,690 | 100.0 | \$ 137,820 | 100.0 | \$ 432,117 | 100.0 | \$ 400,897 | 100.00 |
| Cost of sales | 85,073 | 58.4 | 78,706 | 57.1 | 248,902 | 57.6 | 229,349 | 57.2 |
| Gross profit | 60,617 | 41.6 | 59,114 | 42.9 | 183,215 | 42.4 | 171,548 | 42.8 |
| Research and development expenses | 5,536 | 3.8 | 4,937 | 3.6 | 16,166 | 3.7 | 13,906 | 3.5 |
| Selling and administrative expenses | 45,212 | 31.0 | 45,576 | 33.1 | 137,864 | 31.9 | 132,172 | 33.0 |
| Profit from operations | 9,869 | 6.8 | 8,601 | 6.2 | 29,185 | 6.8 | 25,470 | 6.4 |
| Interest income, net | 251 | 0.2 | 364 | 0.3 | 1,421 | 0.3 | 779 | 0.2 |
| Other income (expense), net | 977 | 0.7 | (62) | 0.0 | 1,112 | 0.3 | (748) | 0.2 |
| Profit before income taxes | 11,097 | 7.6 | 8,903 | 6.5 | 31,718 | 7.3 | 25,501 | 6.4 |
| Income tax expense | 3,175 | 2.2 | 2,643 | 1.9 | 10,206 | 2.4 | 9,000 | 2.2 |
| Net earnings | \$ 7,922 | 5.4 | \$ 6,260 | 4.5 | \$ 21,512 | 5.0 | \$ 16,501 | 4.1 |
| Earnings per diluted share | \$ 0.42 | | \$ 0.35 | | \$ 1.14 | | \$ 0.91 | |

Net Sales

Consolidated net sales increased 5.7% to \$145.7 million for the third quarter of 2006, while net sales increased 7.8% to \$432.1 million for the nine months ended September 30, 2006. The growth in net sales was driven by price increases and volume growth in equipment; service, parts and consumables; and specialty surface coatings. Direct foreign currency exchange effects had a favorable impact on net sales of approximately 1% for the third quarter of 2006. Direct foreign currency exchange effects had a negligible impact on net sales during the first nine months of

2006.

The following table sets forth the net sales by geographic area for the three- and nine-month periods ended September 30, 2006 and 2005 and the percentage change from the prior year (dollars in thousands):

| | Three Months Ended September 30 | | | Nine Months Ended September 30 | | |
|---------------------|---------------------------------|------------|------|--------------------------------|------------|------|
| | 2006 | 2005 | % | 2006 | 2005 | % |
| North America | \$ 94,938 | \$ 93,876 | 1.1 | \$ 286,049 | \$ 269,137 | 6.3 |
| Europe | 35,790 | 29,433 | 21.6 | 103,187 | 90,884 | 13.5 |
| Other International | 14,962 | 14,511 | 3.1 | 42,881 | 40,876 | 4.9 |
| Total | \$ 145,690 | \$ 137,820 | 5.7 | \$ 432,117 | \$ 400,897 | 7.8 |

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North America

North American net sales increased 1.1% to \$94.9 million for the third quarter of 2006 compared to the same period in 2005. Increases in North American net sales in the third quarter 2006 were driven primarily by overall price increases and growth in service and parts and consumables, offset by lower volumes of equipment sold during the quarter. Increases in both price and volume account for the growth in service and parts and consumables. Direct foreign currency translation effects from the strengthening Canadian dollar increased North American net sales by approximately 1% for the third quarter of 2006 compared to the same period in 2005.

North American net sales increased 6.3% to \$286.0 million for the nine months ended September 30, 2006 compared to the same period in 2005. The increase in the nine months ended September 30, 2006 was driven by overall price increases and volume growth driven in part by continued success with new products. Direct foreign currency translation effects from the strengthening Canadian dollar increased North American net sales by approximately 1% for the first nine months of 2006 compared to the same period in 2005.

Europe

Europe's net sales for the three and nine months ended September 30, 2006 increased 21.6% to \$35.8 million and 13.5% to \$103.2 million, respectively, compared to the same periods in 2005. The acquisition of Hofmans as previously discussed contributed approximately 6% and approximately 2% to the overall sales growth in the three- and nine-month periods ended September 30, 2006, respectively. The remaining increase in both periods' net sales was primarily driven by growth in equipment sales due to increased demand driven by continued success with new product sales including a third quarter shipment of a large order to a new customer. Growth in service and parts and consumables, due to expanded market coverage, also contributed to the increase, as well as overall price increases. Direct foreign currency translation effects increased European net sales by approximately 5% during the third quarter of 2006 and decreased European net sales by approximately 2% for first nine months of 2006, as compared to the same periods in 2005.

Other International

In Other International markets, net sales for the third quarter of 2006 totaled \$15.0 million, up 3.1% from the third quarter of 2005. Other International net sales were up 4.9% to \$42.9 million during the first nine months of 2006. Overall growth in net sales was primarily driven by growth in service and parts and consumables. Increased demand, due in part to expanded market coverage, also contributed to the increase in net sales. Direct foreign currency translation exchange effects decreased sales in Other International markets by approximately 1% and 2% in the third quarter and first nine months of 2006, respectively, as compared to the same periods in 2005.

Gross Profit

Gross profit margin was 41.6% for the third quarter of 2006 compared with 42.9% for 2005. Gross profit margin was 42.4% for the first nine months of 2006 compared with 42.8% for 2005. During both the third quarter and for the first nine months of 2006, higher material costs offset the benefits of increased sales volume, price increases and cost reduction initiatives. The Hofmans acquisition, startup manufacturing costs in China and the product mix of equipment sales during the third quarter also contributed to the decreased gross profit margin for the third quarter of 2006 as compared to third quarter of 2005.

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Operating Expenses

Research & Development

Research and development (R&D) expenses in the third quarter of 2006 increased 12.1% to \$5.5 million from \$4.9 million in 2005. R&D expenses as a percentage of net sales were 3.8% for the third quarter of 2006 compared to 3.6% in the comparable quarter last year.

R&D expenses for the nine months ended September 30, 2006 were \$16.2 million, up 16.3% from \$13.9 million in 2005. R&D expenses as a percentage of net sales were 3.7% year-to-date 2006 compared to 3.5% in the comparable period last year, which is in line with our target of investing 3-4% of net sales annually in R&D.

R&D expenses for both the three- and nine-month periods ended September 30, 2006 increased as compared to the same periods in 2005 mainly due to investment in new products including product development for the China manufacturing facility.

Selling & Administrative

Selling and administrative expenses in the third quarter of 2006 decreased 0.8% to \$45.2 million from \$45.6 million in 2005. The decrease in selling and administrative expenses is primarily due to a decrease in performance-based incentive compensation and lower medical costs. These decreases were partially offset by general inflationary increases, increased fuel costs and additional costs to support the strategic initiatives including expansion in China and increased global market coverage. Performance-based incentive compensation was lower in the third quarter of 2006 due to accrual reductions due to management changes and lower relative performance compared to the prior year.

For the nine months ended September 30, 2006, S&A expenses increased 4.3% to \$137.9 million from \$132.2 million in the comparable period last year. The increase in S&A expenses for the nine-month period was due to general inflationary increases, increased fuel costs and additional costs to support strategic initiatives.

S&A expenses as a percentage of net sales were 31.0% for the third quarter of 2006 compared with 33.1% in the third quarter last year. S&A expenses as a percentage of net sales for the nine months ended September 30, 2006 were 31.9%, down from 33.0% in the comparable period last year. The decrease as a percentage of net sales for both the three- and nine-month periods was primarily due to improved sales leverage, partially offset by the cost increases described above.

Interest Income, Net

Interest income, net was \$0.3 million in the third quarter of 2006 compared to \$0.4 million in the third quarter of 2005 and \$1.4 million for the nine months ended September 30, 2006 compared to \$0.8 million for the nine months ended September 30, 2005. The decrease for the three-month period was due in part to increased interest expense on higher deferred compensation plan balances, higher average debt levels and commitment fees in Europe. The increase for the nine-month period was primarily a result of higher average levels of cash and cash equivalents as well as short-term investments invested between periods.

Other Income (Expense), Net

Other income (expense), net increased \$1.0 million and \$1.9 million, respectively, for the three- and nine- month periods ended September 30, 2006 as compared to the same periods in 2005. The increase in both the three- and nine-month periods was primarily due to contributions made to the Tennant Foundation during 2005 which have not been repeated in 2006, as well as increased ESOP income due to a higher average stock price in 2006 than 2005 and fluctuations in foreign currency exchange rates.

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Income Taxes

The effective tax rates for the third quarter were 28.6% for 2006 and 29.7% for 2005. The decrease in the effective tax rate between quarters was primarily related to the resolution in the third quarter of several outstanding state and federal tax matters and the mix in expected full-year taxable earnings by country.

The year-to-date effective tax rates were 32.2% for 2006 and 35.3% for 2005. The decreases in the effective tax rate on a year-to-date basis were primarily related to a refund from a state tax protective claim, the resolution of several outstanding state and federal tax matters and the mix in expected full-year taxable earnings by country.

Our effective tax rate for the full year is subject to change and may be impacted by changes to our forecasts of operating profit in total or by taxing jurisdiction, or to changes in the tax laws and regulations.

Liquidity and Capital Resources

The debt-to-total-capitalization ratio was 1.9% at September 30, 2006 versus 2.0% at December 31, 2005. Cash, cash equivalents and short-term investments totaled \$45.1 million at September 30, 2006, compared to \$41.3 million at

December 31, 2005. We believe that the combination of cash, short-term investments, internally generated funds and available financing sources are more than sufficient to meet our cash requirements for the next year.

OPERATING ACTIVITIES Operating activities provided \$27.7 million of cash during the nine months ended September 30, 2006. Cash provided by operating activities was primarily driven by year-to-date net earnings, a decrease in receivables and a reduction in accounts payable and employee compensation and benefits and other accrued expenses. The decrease in receivables was due to a slight deterioration in collections and seasonality of sales volumes. The reduction in accounts payable and employee compensation and benefits and other accrued expenses was due to payments of 2005 performance-based incentives, annual rebates, sales incentives and profit sharing as well as timing of accounts payable payments. An increase in inventory levels due to a build up of inventory to support new products launched and to support the fourth quarter 2006 expected shipments also impacted operating activities and days inventory on hand for the nine months ended September 30, 2006.

In the comparable 2005 period, operating activities provided cash of \$30.0 million. Cash provided by operating activities for the nine months ended September 30, 2005 was primarily driven by strong year-to-date net earnings, an increase in accrued expenses and a decrease in receivables. The increase in accounts payable, accrued expenses and deferred revenues was primarily attributable to timing of tax payments and accruals for annual performance-based incentive payments. The decrease in receivables was primarily due to seasonality of sales volumes. Partially offsetting these sources of cash was an increase in inventory levels and decreases in other current/noncurrent assets and liabilities. The inventory level increases were due to a build up of inventory to support new products launched and to support the fourth quarter 2005 expected shipments. The decrease in other current/noncurrent assets and liabilities is primarily a result of a large, lump-sum payment of deferred compensation.

Management evaluates how effectively we utilize two of our key operating assets, receivables and inventories, using Accounts Receivable Days Sales Outstanding (DSO) and Days Inventory on Hand (DIOH), on a FIFO basis. These metrics are as follows (in days):

| | September 30, 2006 | December 31, 2005 | September 30, 2005 |
|------|-------------------------------|------------------------------|-------------------------------|
| DSO | 64 | 61 | 62 |
| DIOH | 91 | 82 | 93 |

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INVESTING ACTIVITIES Investing activities used \$31.0 million of cash during the first nine months of 2006, including capital expenditures of \$13.2 million. We currently anticipate full-year capital spending to be in the range of approximately \$18 to \$23 million. We purchased short-term investments totaling \$10.0 million during the first nine months of 2006 due to our increased cash position. Other significant uses of cash related to investing activities for the nine-month period ended September 30, 2006 include the European acquisition of Hofmans Machinefabriek as further discussed in Note 2.

During the nine-month period ended September 30, 2005, investing activities used \$5.4 million of cash, including capital expenditures of \$12.9 million and sales of short-term investments of \$6.1 million.

FINANCING ACTIVITIES Net cash used by financing activities was \$3.0 million during the first nine months of 2006. The issuance of common stock driven by employee stock option exercises generated \$6.7 million of cash during the first nine months of 2006. Repurchases of common stock under our share repurchase program totaled \$2.8 million and dividends paid to shareholders totaled \$6.3 million during the first nine months of 2006.

During the first nine months of 2005, significant uses of cash included a \$5.9 million dividend payment, a \$5.0 million scheduled debt repayment and \$3.5 million of repurchases of common stock under our share repurchase program.

New Accounting Pronouncements

In June 2006, the FASB issued Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. The requirements are effective for fiscal years beginning after December 15, 2006. Although we are still evaluating the impact that the adoption of FIN 48 will have on our consolidated financial statements, we do not believe it will have a material impact.

In September 2006, the SEC issued SAB No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements* (SAB No. 108). Due to diversity in practice among registrants, SAB No. 108 expresses SEC staff views regarding the process by which misstatements in financial statements are evaluated for purposes of determining whether financial statement restatement is necessary. SAB No. 108 is effective for fiscal years ending after November 15, 2006. We are currently evaluating the impact, if any, that SAB No. 108 will have on our results from operations and financial position.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements* (SFAS No. 157). SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles, and expands disclosures about fair value measurements. The requirements are effective for fiscal years beginning after November 15, 2007. We are currently evaluating the impact that the adoption of SFAS No. 157 will have on our consolidated financial statements.

In September 2006, the FASB issued SFAS No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans* (SFAS No. 158). SFAS No. 158 requires an employer to recognize in its balance sheet the funded status of a benefit plan. Gains or losses and prior service costs or credits that arise during the period as a component of other comprehensive income are required to be recognized. In addition, the measurement date of defined benefit plan assets and obligations must coincide with the year end date and certain disclosures are required in the notes to the financial statements. The requirements are effective for fiscal years ending after December 15, 2006 and will be applied retrospectively to all periods presented in our December 31, 2006 consolidated financial statements pursuant to the requirements of SFAS No. 154, *Accounting Changes and Error Corrections* . We are currently evaluating the impact that the adoption of SFAS No. 158, in accordance with SFAS No. 154, will have on our consolidated financial statements.

Foreign Currency Risk

Due to the global nature of our operations, we are subject to exposures resulting from foreign currency exchange fluctuations in the normal course of business. Our primary exchange rate exposure is with the Euro, the Canadian dollar, the Australian dollar, the British pound, the Chinese yuan and the Japanese yen against the U.S. dollar. The direct financial impact of foreign currency exchange includes the effect of translating profits from local currencies to U.S. dollars, the impact of currency fluctuations on the transfers and purchases of goods between Tennant operations in the United States and abroad and transaction gains and losses. In addition to the direct financial impact, foreign currency exchange has an indirect financial impact on our results, including the effect on sales volumes within local economies and the impact of pricing actions taken as a result of foreign exchange rate fluctuations. Because our products are currently manufactured or sourced primarily from the United States, a stronger dollar generally has a negative impact on results from operations outside the United States while a weaker dollar generally has a positive effect. We could experience favorable or unfavorable foreign exchange effects for the remainder of 2006 when compared with historical results.

We periodically enter into various contracts, principally forward exchange contracts, to protect the value of certain of our foreign currency-denominated assets and liabilities and to minimize the earnings effects associated with foreign exchange rate changes on 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.

Commodity Risk

We are subject to exposures resulting from potential cost increases related to our purchases of raw materials or other product components. We do not use derivative commodity instruments to manage our exposures to changes in commodity prices such as steel, oil, gas and other commodities.

Various factors beyond our control affect the price of oil and gas, including but not limited to worldwide and domestic supplies of oil and gas, political instability or armed conflict in oil-producing regions, the price and level of foreign imports, the level of consumer demand, the price and availability of alternative fuels, domestic and foreign governmental regulation, weather-related factors and the overall economic environment. We purchase petroleum-related component parts for use in our manufacturing operations. In addition, our 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. If the price of oil and gas continue to increase our results could be unfavorably impacted.

We seek to mitigate the risk of future raw material or other product component increases through product pricing and negotiations. The success of these efforts depends upon our ability to increase our selling prices in a competitive market. If the commodity prices remain at their current levels or continue to increase, our results will be unfavorably impacted in 2006.

Other Matters

Management regularly reviews our business operations with the objective of improving financial performance and maximizing our return on investment. As a result of this ongoing process to improve financial performance, we may incur restructuring charges in the future which, if taken, could be material to our financial results.

Additional information on market risk is included in the Management's Discussion and Analysis section of our Annual Report on Form 10-K for the year ended December 31, 2005.

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Cautionary Statement Relevant to Forward-Looking Information

Certain statements contained in this document as well as other written and oral statements made by us from time to time are considered forward-looking statements within the meaning of the Private Securities Litigation Reform Act. These statements do not relate to strictly historical or current facts and provide current expectations or forecasts of future events. Any such expectations or forecasts of future events are subject to a variety of factors. These include factors that affect all businesses operating in a global market as well as matters specific to us and the markets we serve. Particular risks and uncertainties presently facing us include:

Geo-political and economic uncertainty throughout the world.

Changes in laws and regulations, including changes in accounting standards and taxation changes, such as the effects of the American Jobs Creation Act of 2004 and the adoption of SFAS No. 123(R), including the timing and method of stock option exercises.

Inflationary pressures.

Potential for increased competition in our business.

Relative strength of the U.S. dollar, which affects the cost of our products sold internationally.

Fluctuations in the cost or availability of raw materials and purchased components.

Success and timing of new products.

Ability to achieve projections of future financial and operating results.

Ability to transition management smoothly into new senior leadership roles.

Successful integration of acquisitions.

Ability to achieve operational efficiencies, including synergistic and other benefits of acquisitions.

Ability to achieve anticipated global sourcing cost-reductions.

Unforeseen product quality problems.

Ability to acquire, retain and protect proprietary intellectual property rights.

Effects of litigation, including threatened or pending litigation.

Price and timing of the sale of our Maple Grove, Minnesota manufacturing facility.

Ability to benefit from production reallocation plans, including benefits from our expansion into China.

Plans for growth.

We caution that forward-looking statements must be considered carefully and that actual results may differ in material ways due to risks and uncertainties both known and unknown. Shareholders, potential investors and other readers are urged to consider these factors in evaluating forward-looking statements and are cautioned not to place undue reliance on such forward-looking statements. For additional information about factors that could materially affect Tennant's results, please see our other Securities and Exchange Commission filings, including the Risk Factors section of our Annual Report on Form 10-K for the year ended December 31, 2005.

We do not undertake to update any forward-looking statement, and investors are advised to consult any further disclosures by us on this matter in our filings with the Securities and Exchange Commission and in other written statements we make from time to time. It is not possible to anticipate or foresee all risk factors, and investors should

not consider that any list of such factors to be an exhaustive or complete list of all risks or uncertainties.

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ITEM 4 Controls and Procedures

Evaluation of disclosure controls and procedures. Based on their evaluation as of the end of the period covered by this report, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934 (the Exchange Act)) are effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in Securities and Exchange Commission rules and forms and is accumulated and communicated to our management, including the principal executive and principal financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

Changes in internal controls. There were no changes in our internal controls over financial reporting during the most recently completed fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

ITEM 1A Risk Factors

There have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2005.

ITEM 2 - Changes in Securities, and Use of Proceeds and Issuer Purchases of Equity Securities

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. These share repurchases are made from time to time in the open market or through privately negotiated transactions, primarily to offset the dilutive effect of shares issued through our stock-based compensation programs. The share and per share data in this Item 2 related to purchases occurring subsequent to July 26, 2006 reflect the two-for-one stock split, and the corresponding increase in shares that may be purchased was approved by the Board of Directors on August 16, 2006. Data related to purchases occurring prior to July 26, 2006 have not been retroactively adjusted to reflect the stock split. There were no purchases in the month of July 2006 following the stock split.

| For the Quarter Ended 9/30/2006 | Total Number of Shares Purchased (1) | Average Price Paid Per Share | Total Number of Shares Purchased as Part of Publicly Announced Plans or | Maximum Number of Shares that May Yet Be Purchased Under the Plans or Programs |
|--|---|-------------------------------------|--|---|
|--|---|-------------------------------------|--|---|

| | | Programs | | | |
|--------------|----------|-----------------|-----------------|--------------|----------------|
| July 1 | 31, 2006 | 5,200 | \$ 47.53 | 5,200 | 281,087 |
| August 1 | 31, 2006 | 11,412 | 25.89 | | 562,174 |
| September 1 | 30, 2006 | | | | 562,174 |
| Total | | 16,612 | \$ 32.66 | 5,200 | 562,174 |

(1) Includes 11,412 shares delivered or attested to in satisfaction of the exercise price and/or withholding obligations by employees who exercised stock options and restricted stock under employee stock compensation plans.

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TENNANT COMPANY
Quarterly Report Form 10-Q

ITEM 6 - Exhibits

Exhibits

| Item # | Description | Method of Filing |
|---------------|---|--|
| 3i | Articles of Incorporation | Incorporated by reference to Exhibit 3i to the Company's report on Form 10-Q for the quarterly period ended June 30, 2006. |
| 3ii | By-Laws | Incorporated by reference to Exhibit 3ii to our Annual Report on Form 10-K for the fiscal year ended December 31, 1999. |
| 10.1 | Consulting Agreement between the Company and Rex L. Carter | Incorporated by reference to Exhibit 10.1 to our Form 8-K filed on August 21, 2006. |
| 10.2 | Services Agreement and Management Agreement between the Company and Karel Huijser | Filed herewith electronically. |
| 10.3 | Schedule of parties to Management and Executive Employment Agreements | Filed herewith electronically. |
| 31.1 | Rule 13a-14(a)/15d-14(a) Certification of CEO | Filed herewith electronically. |
| 31.2 | Rule 13a-14(a)/15d-14(a) Certification of CFO | Filed herewith electronically. |
| 32 | Section 1350 Certifications | Filed herewith electronically. |

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SIGNATURES

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

| | |
|------------------------|---------------------------------------|
| Date: November 6, 2006 | TENNANT COMPANY |
| <hr/> | /s/ H. Chris Killingstad |
| | H. Chris Killingstad |
| | President and Chief Executive Officer |
| Date: November 6, 2006 | /s/ Thomas Paulson |
| <hr/> | <hr/> |
| | Thomas Paulson |
| | Vice President and Chief Financial |
| | Officer |
| | (Principal Financial and Accounting |
| | Officer) |