OPNET TECHNOLOGIES INC
Form 10-K
June 03, 2011

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

(Mark One)

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

For the fiscal year ended March 31, 2011

OR

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

Commission file number: 000-30931

OPNET TECHNOLOGIES, INC.

(Exact name of registrant as specified in its charter)

DELAWARE	**52-1483235**
(State or other jurisdiction of	**(I.R.S. Employer**
Incorporation or organization)	**Identification No.)**

7255 Woodmont Avenue, Bethesda, Maryland 20814-7900

(Address of principal executive offices) (Zip Code)

Registrant s telephone number, including area code: (240) 497-3000

Securities registered pursuant to Section 12(b) of the Act: Common Stock, $0.001 par value

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

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. YES ¨ NO x

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 ¨ NO x

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

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

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

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

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

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

The aggregate market value of the voting stock held by non-affiliates of the registrant, computed using the closing sale price of the registrant s Common Stock on September 30, 2010, as reported on the NASDAQ Global Select Market, was approximately $209,970,798. Shares of Common Stock held by each officer and director and by each person who owns 5% or more of the outstanding Common Stock have been excluded because such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily conclusive for other purposes.

The number of shares of the registrant s Common Stock outstanding on May 31, 2011 was 22,308,857.

DOCUMENTS INCORPORATED BY REFERENCE

Certain portions of the registrant s definitive Proxy Statement for the 2011 Annual Meeting of Stockholders are incorporated by reference into Part III of this Form 10-K.

OPNET TECHNOLOGIES, INC.

ANNUAL REPORT ON FORM 10-K

FOR THE FISCAL YEAR ENDED MARCH 31, 2011

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PART I

Forward Looking Information

This Annual Report contains forward-looking statements that involve substantial risks and uncertainties. You can identify these statements by forward-looking words such as anticipate, believe, could, estimate, expect, intend, may, plan, potential, should, and would should read statements that contain these words carefully because they discuss our future expectations, contain projections of our future results of operations or of our financial position, or state other forward-looking information. We believe that it is important to communicate our future expectations to our investors. However, there may be events in the future that we are not able to predict accurately or control. The factors listed in this Annual Report on Form 10-K under Risk Factors, as well as any cautionary language in this Annual Report on Form 10-K, provide examples of risks, uncertainties, and events that may cause our actual results to differ materially from the expectations we describe in our forward-looking statements. You should also carefully review the risks outlined in other documents that we file from time to time with the Securities and Exchange Commission, including our Quarterly Reports on Form 10-Q that we will file in fiscal 2012.

The forward-looking statements provided in this Annual Report on Form 10-K represent our expectations as of June 3, 2011. We anticipate that subsequent events and developments may cause our expectations to change. However, while we may elect to update this forward-looking information at some point in the future, we specifically disclaim any obligation to do so. This forward-looking information should not be relied upon as representing our expectations as of any date subsequent to June 3, 2011.

Fiscal Year Convention

The years ended March 31, 2011, 2010, and 2009, are referred to as fiscal 2011, fiscal 2010, and fiscal 2009, respectively, in this Annual Report on Form 10-K.

ITEM 1. BUSINESS

In this Annual Report on Form 10-K, or Annual Report, the Company , we, us, and our refer to OPNET Technologies, Inc. and its wholly-owned and wholly-controlled subsidiaries unless the context otherwise indicates.

OPNET Technologies, Inc. is a provider of application and network performance management solutions. Our software products address application performance management, or APM, network operations, capacity management, and network research and development. Our customers include corporate enterprises, government and defense agencies, network service providers, and network equipment manufacturers. Our software products and related services are designed to help our customers make better use of resources, reduce operational problems and improve competitiveness.

In many business environments, applications that were once largely static for long intervals must now be managed as dynamic systems due to the rapid rate of change affecting all of their components. Dynamic aspects of service delivery include: change in the network infrastructure, which is shared among all applications; change in the computing infrastructure, especially with the deployment of server virtualization; and finally, the business-driven need to rapidly deploy new functionality and bug fixes into the code of the application itself.

Within this rapidly evolving, complex environment, traditional approaches to managing the performance of applications and networks are no longer sufficient to empower information technology, or IT, to provide the requisite level of service to the enterprise. These traditional approaches provide the ability to monitor, record, and alert on basic health and status metrics of the individual elements that constitute the service delivery infrastructure. However, traditional approaches fall short for two fundamental reasons: the information that is gathered is insufficiently fine-grained; and there is an absence of the analytical tools needed to combine and correlate the many sources of information to deliver actionable information.

OPNET differentiates itself from other providers of application and network performance management by offering solutions that directly tackle the challenges that have emerged in IT service management. Central to OPNET s approach is its High Definition blueprint for APM, which describes both technology architecture and go-to-market strategy, highlighting differentiating characteristics of OPNET s approach. OPNET s High Definition APM offerings embody the critical attributes of an effective APM solution, and are characterized by the following;

Breadth: Applications are implemented across many functional domains in the IT infrastructure. All of these domains affect application performance. An APM solution with breadth provides visibility into all or most of these areas.

Depth: The nature of the collected data is also a key determinant of APM functional scope. Depth is the high resolution part of High Definition. It means that the collected information is rich enough to characterize problems, uncover behavioral patterns, and isolate the root cause of performance issues. OPNET s APM approach emphasizes a combined analysis of two types of data: performance data and forensic data. Performance data consists of metrics recorded over time; this data is also frequently aggregated over regular time intervals. Forensic data digs deeper into the inner workings of transactions as they proceed through the infrastructure. Forensic information includes code level traces, such as method calls and their parameters; detailed resource tracking, such as memory allocations; and deep packet inspection of network traffic.

Analytics: Breadth and depth multiply to yield a challenge: vast quantities of data. Putting that data to work to solve problems requires advanced tools. OPNET calls these tools Analytics : an array of algorithms and techniques for extracting useful information from data collected by the APM instrumentation. OPNET has been a pioneer in introducing advanced, yet practical, analytics in APM solutions.

Integration: To address each of the domains of an application requires specialized tools. These tools, by their nature, have different workflows and manipulate different types of information. However, using the tools in a coordinated fashion delivers support and efficiency to APM users. OPNET s integrated solution suite provides workflows that transition between domains contextually, as well as true correlation and data fusion.

Low overhead: All of these capabilities become impractical to deploy if they impose overhead that noticeably degrades application performance. OPNET has specialized in developing zero-overhead passive monitoring and low-overhead agent-based technologies to collect data for its APM solutions. All of OPNET s APM solutions are designed for production environments.

We believe our software products appeal to a broad customer base, including corporate enterprises, government and defense agencies, network service providers, and network equipment manufacturers, empowering them to make better use of resources, rapidly troubleshoot operational problems, and improve competitiveness.

We market focused software products for each of our target markets. We sell our products to both Fortune 1000 and mid-size companies. Some examples of our customers include:

Corporate enterprises, such as Amgen, BNP Paribas, Canadian Broadcasting Corporation, Del Monte Food Corporation, Ergon Energy, GameStop, GlaxoSmithKline, Healthcare Partners, Hyundai Securities, infoUSA, International Rescue Committee, Jostens, Kuwait International Bank, Major League Baseball, Manpower Midway USA, Midway USA, Moody s, National Collegiate Athletic Association, Omnicom Media Group, Philadelphia Stock Exchange, Starwood Hotels & Resorts, United Arab Shipping Company, and Visteon;

Government agencies, such as the California Highway Patrol CHiPs, Florida Department of Education, Federal Bureau of Investigations, the Federal Communications Commission, the Internal Revenue Service, the United States Department of Defense, the United States Department of Homeland Security, and the United States Government Printing Office;

Service providers, such as Asia Pacific Telecom Group, British Telecom, France Telecom, Cox Communications, NTT, Telus, and WilTel; and

Network equipment manufacturers, such as Cisco Systems, Ericsson, Research in Motion, and Samsung.

Industry Background

Growth and Increased Complexity of Networks and Dependence on Applications

Organizations rely on enterprise software applications and networks to successfully execute their strategies. The increasing use of applications, such as enterprise resource planning, business intelligence, corporate intranets, e-mail, web meetings, virtualization, portals, web services, voice over IP, wireless, and streaming multimedia has resulted in significant growth in underlying network and application infrastructures. In addition, the proliferation and widespread adoption of the Internet and web services architectures have expanded the role of networks beyond organizational boundaries.

Enterprises and service providers must now manage the convergence of voice, data, and video traffic over traditional, wireless, and optical architectures by integrating numerous existing and emerging technologies. The complexity is exacerbated by the current corporate regulatory environment, which requires improved management processes and documentation. As a result of these factors, businesses and government entities are forced to confront significant challenges related to the cost, risk, and performance of IT.

IT infrastructures are sophisticated, dynamic systems that evolve on a daily basis. Applications are typically distributed across many clients, servers, and network segments. New and enhanced business applications are regularly being deployed and re-deployed. The geographic distribution of users relative to IT services shifts due to the consolidation of organizations and resources. Traffic levels exhibit steady growth, necessitating constant evaluation of and improvements to the underlying network infrastructure in order to maintain business and application performance. However, due to the dependencies among network, server, and application configurations, it is very difficult for IT professionals to identify the true root cause of performance problems when they occur. The data required to diagnose problems is often difficult to obtain, and processes for analyzing this data are often manual and time consuming, requiring significant experience and expertise. When an end-user experiences performance problems with an important business application, the challenge facing a typical IT manager is to determine: whether there is enough bandwidth available; whether the database server has enough capacity; whether network routing protocols are tuned properly; whether protocols on the client and server are likewise tuned properly; and whether the application was designed and implemented efficiently with end-user performance in mind.

Within this rapidly evolving, complex environment, traditional approaches to managing the performance of IT services are no longer sufficient to empower IT to provide the requisite level of service to the enterprise. These traditional approaches provide the ability to monitor, record, and alert on basic health and status metrics of the individual elements that constitute the service delivery infrastructure. However, these traditional approaches fall short for two fundamental reasons: the information that is gathered is insufficiently fine-grained; and there is an absence of analytical tools needed to combine and correlate the many sources of information to deliver actionable information.

Without a clear understanding of the source of problems and the specific changes required to solve them, IT managers resort to uninformed decision-making that often results in wasteful spending on unnecessary and ineffective server and network upgrades. IT professionals need software products that enable them to focus their time and resources in the right places when problems occur in distributed enterprise applications, and to maximize the use of existing infrastructure. Further, since modifications to infrastructure have the potential to cause service level degradation or even network failures, there is a growing need to plan and implement network changes in a controlled manner, taking into account the potential consequences of each action.

Market Opportunity for OPNET Software Products

Organizations need application and network management software products that possess the analytics required to overcome the limitations of traditional tools for rapidly detecting and resolving complex problems and proactively preventing problems from occurring. OPNET software products are focused on these areas. Our software products have embedded knowledge and operational understanding of applications, networks, and systems for quickly troubleshooting problems and automatically predicting the impact of changes. We believe business executives and IT professionals require software products like ours to:

- ensure fast response times for mission critical applications, including customer-facing web-based applications;
- reduce down time of mission critical applications;
- reduce operating and capital costs;
- increase business productivity; and
- manage risk, enabling faster deployment of critical, IT-dependent strategic business initiatives.

We believe the value proposition from OPNET software products apply to a broad range of potential customers including:

- large and medium-sized enterprises that rely on IT to conduct business;
- government/defense agencies;

- service providers, including telecommunications carriers, internet service providers, or ISPs, and managed service providers, or MSPs; and

- network equipment manufacturers.

Enterprises require analytics for more effectively identifying the root causes of application performance problems, ensuring the successful deployment of new applications, auditing device configurations for security and policy compliance, validating changes, and performing critical operational and strategic planning functions.

Government and defense agencies have needs similar to those of enterprises, service providers, and network equipment manufacturers. These agencies also sometimes require specialized services to support large projects that incorporate OPNET s technology. United States government customers, including the Department of Defense, utilize our software and professional services to take advantage of our extensive expertise and intellectual property in applications, networking, and protocols. For the Department of Defense, our software products and related services are used for both application and network performance management, as well as for analyzing and developing communications technologies for network-centric transformational programs. Our ability to model and simulate end-to-end application and network performance is valuable in determining the impact of tactical or strategic changes to networks, planning for contingencies, and evaluating the impact of new network technologies and protocols. In addition, our software products are scalable and address large, complex military systems and networks, such as mobile networks, with a variety of operationally proven, advanced predictive performance techniques.

Service providers require analytics for optimizing their investments in network infrastructure, more effectively troubleshooting network issues, ensuring network configuration integrity and security, planning for services based on new technologies including wireless and optical, and making better use of network resources to increase competitiveness.

Network equipment manufacturers require advanced modeling and simulation software products for accelerating network research and development, reducing time-to-market for new technologies, developing custom network design and analysis software, and for reducing sales cycles for sophisticated technology products.

OPNET Software Products

Our software products use a variety of advanced technologies to support the analysis of application, network, and server performance under a wide range of current and planned or modeled operating conditions. Many OPNET software products share a significant amount of core software based on an open architecture. Our software architecture enables us to create new software more efficiently, to foster interoperability of our software products, and to provide interfaces to a wide range of external data sources including third party management tools and network topology, traffic, and configuration information. We also deliver extensive cross-product integration, to enable our users to realize added value when products are deployed together.

The following sections summarize the OPNET software product portfolio by target market:

Primary Target Market: Enterprise IT (Corporate and Government/Defense)

- *AppCapacity Xpert,* formerly called IT Guru Systems Planner, was introduced in December 2006. It provides capacity planning for servers, including planning for migration from physical-to-virtual server environments.

- *AppInternals Xpert* was first introduced in December 2004. AppInternals Xpert delves into the complex software frameworks and operating systems of modern servers to extract large amounts of performance and forensic data to support all aspects of APM from the server perspective. AppInternals Xpert can provide analysis for any type of application, but particularly excels in Java and .NET environments. It continuously monitors thousands of system and application metrics and automatically detects and ranks performance and behavior anomalies. Its patented correlation technology automatically reveals relationships among metrics, highlighting the corresponding causal connections between components, resources, and code-level behavior in order to perform root cause analysis. AppInternals Xpert uses patented technology to automatically provide deep instrumentation in application code with very low overhead.

AppMapper Xpert was introduced in January 2011. AppMapper Xpert automatically produces run-time application maps, identifying the underlying application components and infrastructure components that enable a production application. This dynamic model of the application, captured at the time of execution, is essential for troubleshooting application performance problems. It also provides critical information to improve a host of other operational workflows, such as configuration and change management, and data center virtualization and consolidation. AppMapper Xpert provides visibility into the interaction between applications and the underlying infrastructure, enabling IT organizations to effectively assess and respond to events and conditions that affect application service levels.

AppResponse Xpert, previously called Ace Live, was introduced in December 2007. AppResponse Xpert is an appliance-based solution that continuously monitors and analyzes end-user experience for all users and transactions. The solution also supports in-depth monitoring and analysis of the underlying network, a domain that is vital to comprehensive APM. AppResponse Xpert leverages the central role of the network in transporting transaction data to obtain vital information about relationships among clients and servers, and also among server tiers. This information is useful for performance analysis and troubleshooting in AppResponse Xpert and also for application discovery and dependency mapping functions performed by AppMapper Xpert. On-board analytics extract transactions from application flows and break down application response time, identifying which parts of the infrastructure are contributing most to delays. Add-on modules provide analytics for voice over IP, or VOIP, and Netflow.

AppSQL Xpert was introduced in September 2010. AppSQL Xpert provides deep visibility into database performance through real-time monitoring of a broad range of metrics, with drilldowns to fine-grained forensic database transaction data for troubleshooting. It performs detailed tracking of database usage for trending and performance optimization. It also detects database policy violations, such as unauthorized access and suspicious usage patterns. AppSQL Xpert provides analysis of database performance while offering an agentless approach that imposes zero overhead on database operation.

AppTelemetry Xpert was introduced as APM Element Insight in June 2010. AppTelemetry Xpert uses remote instrumentation interfaces, such as SNMP to capture performance information from infrastructure components which may otherwise be difficult to access, including servers, application components, network devices, and vendor-specific management systems. AppTelemetry Xpert supplies this data, on both a historical and real-time basis, to the rest of OPNET s APM solution suite for a more complete picture of end-to-end application performance.

AppTransaction Xpert, formerly called ACE Analyst, was first introduced in May 2000. AppTransaction Xpert is a powerful tool for detailed analysis of individual transactions. In today s complex application architectures, a single transaction can involve many tiers and require thousands of messages to traverse the network. This solution, which processes and merges traces taken in the production environment, makes extensive use of visualization and analytics to accelerate troubleshooting in production, as well as pre-deployment testing and prediction. In production, the combination of AppResponse Xpert and AppTransaction Xpert provides a seamless workflow that spans monitoring, alerting, triage, root cause diagnosis, and remediation guidance. In pre-deployment, AppTransaction Xpert is our solution for application network readiness testing.

IT Guru Network Planner was first introduced in August 1998 as IT Guru. It provides predictive network capacity planning and design optimization, as well as validation of network configuration changes.

IT Sentinel was first introduced in August 2004. IT Sentinel provides automatic and continuous network configuration integrity and security auditing, and proactive change validation.

nCompass for Enterprises was first introduced in September 2003 as NETCOP. It provides enterprises with centralized, real-time visibility of network topology, traffic, and status in a single, integrated view. nCompass for Enterprises provides a unified view to quickly recognize the impact of network events, and assisted troubleshooting to rapidly resolve problems.

VNE Server was first introduced in June 2002. VNE Server, or Virtual Network Environment Server, automatically maintains a detailed, near real-time data model of the production IT network. VNE Server includes a suite of adapters that obtain topology, traffic, and other information from network devices as well as a broad range of third-party data sources. VNE Server automates the data collection process for other OPNET products, including IT Guru Network Planner and SP Guru Network Planner. VNE Server capabilities are included in IT Sentinel and SP Sentinel.

Primary Target Market: Network Service Providers (both Commercial and Government/Defense)

SP Guru Network Planner was first introduced in June 2001. SP Guru Network Planner is built on the IT Guru Network Planner product, and contains analytics that are valuable to service providers for planning, network design optimization, and validation of configuration changes. SP Guru Network Planner includes modeling and analysis technologies for IP, MPLS, and ATM networks, and when combined with SP Guru Transport Planner, provides a single environment for network-level and optical transport-level analysis.

SP Guru Transport Planner, formerly WDM Guru*,* was first introduced in December 2001. SP Guru Transport Planner is an optical network-planning product for designing resilient, cost-efficient optical networks. SP Guru Transport Planner is also sold to network equipment manufacturers.

nCompass for Service Providers was first introduced in September 2003 as NETCOP. nCompass for Service Providers provides centralized, real-time visibility of network topology, traffic, and status in a single, integrated view. nCompass for Service Providers provides a unified view to quickly recognize the impact of network events, and assisted troubleshooting to rapidly resolve problems.

SP Sentinel was first introduced in August 2004. SP Sentinel provides automated and continuous network configuration integrity and security auditing for service providers, and proactive change validation.

AppResponse Xpert is used by service providers who deliver managed network and data center services to enterprises to ensure application performance.

Primary Target Market: Network R&D Organizations (Defense and Equipment Manufacturers)

OPNET Modeler was OPNET s first product, introduced in 1987. OPNET Modeler is a network modeling and simulation product. It enables users to evaluate how networking equipment, communications technologies, systems, and protocols will perform under simulated network conditions.

Modeler Wireless Suite is based on OPNET Modeler, and incorporates additional functionality germane to wireless network R&D organizations.

Modeler Wireless Suite for Defense is based on OPNET Modeler, and incorporates additional functionality that supports unique network R&D undertaken by the defense community.

OPNET Modules

We develop and sell a variety of software modules that provide additional functions to our application and network management software products.

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OPNET Model Libraries

The model libraries are used by OPNET software to simulate and analyze major networking technologies and communication protocols. These libraries provide the building blocks used to generate models of networks. A network model consists of software objects that correspond to the devices, computers, and links that constitute the actual network of interest. The behavior of these objects is controlled by models of devices, computers, applications, communication protocols, and links. *IT Guru Network Planner, IT Guru Systems Planner, IT Netcop, IT Sentinel, SP Guru Network Planner, SP Netcop, SP Sentinel,* and *OPNET Modeler* include extensive libraries of popular and emerging networking technologies and communication protocols, such as TCP/IP, hypertext transfer protocol, or HTTP, open shortest path first routing, or OSPF, asynchronous transfer mode, or ATM, frame relay, IP-QoS, 802.11, or Wi-Fi, and 802.16, or WiMAX. Some of our model libraries are included in our base products and others are available for an additional fee as modules.

Our product agreements provide our customers with perpetual and term licenses for use by a specified number of concurrent users or for use by an unlimited number of concurrent users.

Customers

For fiscal 2011, 2010, and 2009 we generated 25.9%, 22.5%, and 21.1%, respectively, of our total revenue from customers located outside the United States. No single customer accounted for 10% or more of revenue for fiscal 2011, 2010 or 2009. Note 16 to our consolidated financial statements presents information regarding revenue generated in the United States and internationally.

We derive a substantial portion of our revenue from sales directly or indirectly to United States government agencies. For fiscal 2011, 2010 and 2009, revenue from transactions with United States government agencies was approximately 32.5%, 39.9%, and 35.3%, respectively, of our total revenue. Government sales are subject to a variety of risks, including appropriation of funds by the United States Congress, termination for convenience, contract renegotiations/extensions and a decline in government spending.

Sales and Marketing

We sell our software products and related services through our direct sales force, our international subsidiaries, alliances with third parties called the SYNERGY program, third-party distributors, and value-added resellers, or VARs. To date, VARs have not accounted for more than 10% of our revenue. In North America, our direct sales force accounts for the majority of our sales. As of March 31, 2011, our sales and marketing teams consisted of 186 employees, including 96 quota-carrying and inside salespersons located in our headquarters in Bethesda, Maryland and our domestic offices in Cary, North Carolina; Dallas, Texas; Nashua, New Hampshire; and Santa Clara, California; our overseas subsidiaries in Paris, France; Slough, United Kingdom; Mainz, Germany; Ghent, Belgium; and Singapore; and our branch office in Beijing, China.

Our international sales activities are also supported by 79 VARs that offer our products in Australia, Austria, Brazil, Finland, France, Germany, Greece, India, Indonesia, Israel, Japan, Netherlands, New Zealand, Norway, Poland, Romania, Russia, South Africa, South Korea, Spain, Sweden, Switzerland, Turkey and the United Kingdom. Our marketing division works internally with our engineering and sales teams to develop customer value propositions and product messages, and externally with various third parties to develop brand awareness and leads for sales. Our external marketing activities are aimed at existing customers, new customer prospects, the media, and industry analysts. These include:

- participation in industry tradeshows;
- technology seminars and user group meetings;
- advertisements in trade journals and online;
- direct mailings;

- product collateral development and maintaining OPNET s website;
- free software for academic use at universities;
- specialized product sales support;
- specialized sales support with OPNET resellers;
- briefings with industry analysts; and
- a variety of public relations activities.

For thirteen of the past fourteen years, we have sponsored OPNETWORK, an international technology conference convened in Washington, D.C. that focuses on application and network management for professionals in all areas of networking and information technology. OPNETWORK 2010, which was held in August 2010, included approximately 600 hours of classes, labs, and panels led by OPNET employees and outside experts. Not including OPNET employees, more than 1,800 IT and engineering professionals participated in the conference. We did not hold the event in 2009 due to travel restrictions imposed on many of our users in response to the economic climate. We intend to hold OPNETWORK again in August 2011.

Service and Support

Our service and support offerings include:

- consulting services;
- product updates, technical support and services, which includes product updates and training services on a when-and-if available basis for customers with current maintenance agreements, and technical support by telephone, e-mail or fax; and
- training for customers without current maintenance agreements, which includes courses that enable our customers to more effectively use our products.

We offer consulting services to assist our clients, facilitate the adoption of our software products, and to provide installation services for our product offerings. Installation services are performed by our consulting staff, which consists of software development engineers, quality assurance engineers, technical documentation specialists, and project managers. Some customers also choose to engage our consulting services for troubleshooting application performance problems, network planning, network design, communication protocol design and customization services. As of March 31, 2011, our consulting staff consisted of 86 employees.

Our customers may purchase product updates, technical support and services, all of which except technical support are provided on a when-and-if available basis under our maintenance agreement. Payments for product updates, technical support and services whether on an initial order or on a renewal order, are generally made in advance and are nonrefundable.

Product updates consist of the right to unspecified software updates on a when-and-if-available basis and customers typically purchase this right in connection with the initial product purchase. Product updates, technical support and services may be renewed upon expiration of each contract term purchased, which is generally one year. Customers can purchase product updates separately from technical support and services. Customers purchasing technical support are still required to purchase periodic unspecified product updates.

We provide customer support from our support center at our headquarters in Bethesda, Maryland, as well as from support staff in France, the United Kingdom and Singapore. We have designed and implemented a comprehensive information system to ensure that customer inquiries are addressed promptly, tracked until fully resolved, and recorded for future reference. Reports on the overall responsiveness of the technical support infrastructure, and the status of pending customer inquiries, are provided regularly to our technical support staff, technical support management, and executive management.

We have a core team of 20 technical support staff supplemented by a limited number of product developers and consultants who perform technical support on a rotational basis. We believe this staffing approach maximizes the access customers have to the best available product expertise, while providing product developers with direct customer feedback, which in turn helps us improve our software products.

We regularly offer training courses to our customers to assist them in maximizing the benefit they receive from using our products. Our training classes cover a broad range of topics. Training classes are offered at our headquarters in Bethesda, Maryland, our facilities in Santa Clara, California; Cary, North Carolina; Paris, France; and Slough, United Kingdom; and at our customers locations under separate contracts. As of March 31, 2011, our full-time training staff consisted of 5 employees.

Research and Development

We believe that our ability to enhance our current software products and create new software products in response to the needs of our customer base is an important factor for our future success. Accordingly, we intend to continue to commit significant resources to product research and development. We expect to accomplish a large part of our software product improvements and new software product development through internal development efforts. New capabilities may also be integrated into our product lines through the acquisition of technologies or businesses, or the licensing of externally developed technologies.

Our total research and development expense for fiscal 2011, 2010, and 2009 was approximately $34.7 million, $32.0 million, and $30.8 million, respectively. Our research and development efforts to date have been conducted at our offices in Bethesda, Maryland; Cary, North Carolina; Nashua, New Hampshire; Santa Clara, California: and Ghent, Belgium. All related costs have been expensed as incurred. As of March 31, 2011, our research and development staff consisted of 217 engineers and technical professionals.

Our research and development efforts are directed at increasing our revenue by expanding the scope of our software products and service offerings to address additional customer requirements. Our existing customers provide a meaningful source of information regarding customer requirements, which we use in order to guide our future research and development activities. In addition, we invest in third-party research and analysis of trends in our industry and our product markets in an effort to proactively reflect these trends in our future software products.

Competition

The market for our software products and related services is evolving rapidly and is highly competitive. We believe that this market is likely to become more competitive as the demand for intelligent application and network management software products continues to increase. Although we believe that none of our competitors offer software products that are identical to ours, we are subject to current and potential competition from:

- software and hardware vendors with application and network performance management offerings, such as Computer Associates, Hewlett-Packard, Compuware Corporation, IBM Tivoli, NetScout Systems, and Quest Software;
- consultants who offer advisory services related to application and network performance management; and
- customers who develop their own application and network management capabilities, either internally or through outsourcing.

Also, it is possible that other vendors as well as some of our customers or distributors may develop and market competitive products in the future. Many of our current and potential competitors are larger and have substantially greater financial and technical resources than we do. We believe the principal competitive factors affecting the market for our software products and related services are the following:

- scope, quality, and cost-effectiveness of application and network management software products;

industry knowledge and expertise embedded in the software;

the interoperability of software products with existing network management software products;

product performance, accuracy, technical features, ease of use, and price;

customer service and support;

consultants who offer advisory services related to application and network performance management; and

customers who develop their own application and network management capabilities, either internally or through outsourcing.

Intellectual Property

We rely on a combination of copyright, trademark, patent, and trade secret laws, confidentiality agreements, and contractual provisions to protect our intellectual property. However, we believe that these laws and agreements afford us only limited protection. Despite our efforts to protect and oversee our intellectual property rights, there may be unauthorized parties who encroach upon our proprietary rights. In addition, the laws of some foreign countries do not provide as much protection of our proprietary rights as do the laws of the United States.

We currently hold registered trademarks in the United States for all of our primary marks, including OPNET, OPNETWORK, IT Guru, IT Sentinel, Netbiz, NetMapper, OPNET Modeler, SP Guru, SP Sentinel, VNE Server, WDM Guru, OPNET LoadScaler, OPNET TestCreator, OPNET Panorama, and OPNET nCompass. We have pending applications and additional registrations in the United States for many of our other marks including Ace Live Insights, Know Your Network, Service Insight and NetOne. We also hold additional registered and unregistered trademarks in the United States and around the world and register those marks when and where appropriate. We expect to add new marks to our trademark portfolio and maintain our current portfolio commensurate with the continued use of existing registered and unregistered marks, especially our house mark OPNET. We have applied for and obtained numerous registrations for our marks in foreign countries. For the term OPNET, we hold registrations in the following countries: Benelux, France, Germany, Japan, the Peoples Republic of China, Taiwan, Spain and the United Kingdom and have additional applications pending in Italy and Spain. Other trademarks or service marks appearing in this Annual Report on Form 10-K are the property of their respective holders.

In addition, we have 46 patents granted by the United States Patent and Trademark Office. Our patents will expire between 2018 and 2029. We also have 65 pending United States patent applications that, if granted, would expire approximately 20 years from their respective filing dates. Seven of these are provisional patent applications for which we expect to pursue non-provisional applications within the next year. With regard to foreign patent protection, we have one patent granted by the European Patent Office and eight pending European patent applications. Additionally, we plan on pursuing one more European patent application within the next year. We believe that, because of the rapid pace of change in our industry, intellectual property protection for our products and the knowledge, abilities, and experience of our employees will be significant factors for our future success.

Executive Officers and Directors of the Registrant

Our executive officers and directors, and their ages as of June 3, 2011, are as follows:

Name	Age	Position
Marc A. Cohen	47	Chairman of the Board and Chief Executive Officer
Alain J. Cohen	44	President, Chief Technology Officer and Director
Mel F. Wesley	39	Vice President and Chief Financial Officer

Set forth below is information regarding the professional experience for each of our executive officers and directors. These executive officers and directors were elected to serve until their successors have been elected. Marc A. Cohen and Alain J. Cohen are brothers. There is no other family relationship between any of our other executive officers or between any of these officers and any of our directors.

Marc A. Cohen, one of our founders, has served as our Chairman of the Board since our inception in 1986 and as our Chief Executive Officer since 1994. From 1986 to 1992, Mr. Cohen was also a consultant with Booz Allen Hamilton Inc., or Booz Allen, an international management and consulting company. Mr. Cohen received a bachelor s degree in engineering science from Harvard University and a master s degree in electrical engineering from Stanford University. Mr. Cohen also serves as a Trustee and as a member of the Board of Directors of the Dana-Farber Cancer Institute in Boston, Massachusetts.

Alain J. Cohen, one of our founders, has served as our President and Chief Technology Officer and as a member of our Board of Directors since our inception in 1986. Mr. Cohen received a bachelor s degree in electrical engineering from the Massachusetts Institute of Technology, or M.I.T.

Mel F. Wesley has served as our Vice President and Chief Financial Officer since July 2005. Mr. Wesley served as our Acting Chief Financial Officer from December 2004 to July 2005 and our Corporate Controller from June to December 2004. From August 2003 to June 2004, Mr. Wesley served as Corporate Controller for SteelCloud, Inc., a publicly traded corporation that provides design, development and manufacturing of network appliances and infrastructure server products. From October 2000 to August 2003, Mr. Wesley served as an Assistant Controller for Learning Tree International, Inc., a publicly traded corporation that provides training to information technology professionals and managers. Mr. Wesley received a bachelor s degree in accounting and a master of business administration from George Mason University. Mr. Wesley is also licensed as a Certified Public Accountant in Virginia.

Employees

As of March 31, 2011, we had 578 full-time employees, 518 of whom were located in the United States. The 578 full-time employees included 186 in sales and marketing, 86 in professional services and support, 247 in engineering, research and development, and 59 in general and administrative functions. Our employees are not represented by a collective bargaining agreement and we consider our relations with our employees to be good.

Corporate Information

We are a Delaware corporation that was incorporated in November 1988, our principal executive office is located at 7255 Woodmont Avenue, Bethesda, Maryland 20814-7900 and our telephone number is (240) 497-3000. Our website address is www.opnet.com. The information on our website is not incorporated by reference into this Annual Report on Form 10-K and should not be considered to be a part of this Annual Report on Form 10-K. Our website address is included in this Annual Report on Form 10-K as an inactive textual reference only.

Availability of SEC Reports

Our website address is www.opnet.com. We make available free of charge on our website our Annual Reports on Form 10-K, Quarterly Reports on Form 10-Q and Current Reports on Form 8-K, and amendments to these reports, as soon as reasonably practicable after we electronically file such material with, or furnish such material to, the Securities and Exchange Commission, or SEC.

We file our reports with the SEC electronically via the SEC s Electronic Data Gathering, Analysis and Retrieval system, or EDGAR. The SEC maintains a website that contains reports, proxy and information statements, and other information regarding companies that file electronically with the SEC via EDGAR. The address of this website is www.sec.gov.

Any reports, statements or other information that we file with the SEC may be read or copied at the SEC s Public Reference Room at 100 F Street, N.E., Room 1580, Washington, D.C. 20549. Copies of these documents can be requested upon payment of a duplicating fee, by writing to the SEC. Please call the SEC at 1 (800) SEC-0300 for further information on the operation of the Public Reference Room. Upon request, we make available free of charge, electronic or paper copies of any reports, statements or other information that we file with the SEC.

Code of Business Conduct and Ethics

On May 4, 2004 we adopted a code of business conduct and ethics for all directors, officers, and employees pursuant to Section 406 of the Sarbanes-Oxley Act of 2002. The Code of Business Conduct and Ethics is available on our website at www.opnet.com. Suspected violations of this Code may be reported on a confidential or anonymous basis by facsimile or by e-mail to our General Counsel and to the Chairman of the Audit Committee of the Board of Directors. We intend to disclose any amendment to, and any waiver from, any provision of this Code that applies to any director, the Chief Executive Officer, Chief Financial Officer, or any other executive officer and that relates to any element of this Code enumerated in Item 406(b) of Regulation S-K, on Form 8-K.

ITEM 1A. RISK FACTORS

The following important factors, among others, could cause actual results to differ materially from those indicated by forward-looking statements made in this Annual Report and presented elsewhere by management from time to time. You should consider carefully the following information before making an investment in our securities.

General instability in the economy, including concerns regarding the after-effects of the global recession, or unfavorable economic conditions in a particular region, business or industry sector, may cause our customers to postpone or forego technology investments and could have other impacts, any of which could hurt our business, financial results and cash flow.

Our products are designed to enhance our customers ability to manage their applications and networks. However, general instability in the economy, including concerns regarding the after-effects of the global recession, or a general slowdown in the global economy, or in a particular region, or business or industry sector, such as the financial services sector, or tightening of credit markets, could cause our customers to:

- have difficulty accessing credit sources;
- delay contractual payments; or
- postpone or forego decisions to purchase our products and services, or maintain them at originally purchased levels.

The global economy appears to be recovering from a severe recession, which hurt our product and services revenue in fiscal 2010 and fiscal 2009. Despite what appears to be a trend toward recovery, we cannot provide any assurance that instability in the global economy will end or not become more severe. The longer this global economic instability persists, the greater the probability that these factors could hurt our business, financial results and cash flow.

Our operating results may fluctuate significantly as a result of factors outside of our control, including current economic conditions, which could cause the market price of our stock to decline.

Our operating results have fluctuated in the past, and are likely to fluctuate significantly in the future. Our financial results may as a consequence fall short of the expectations of public market analysts or investors, which could cause the price of our common stock to decline. Our revenue and operating results may vary significantly from quarter to quarter due to a number of factors, many of which are beyond our control. Factors that could affect our operating results include:

- general economic conditions, which can affect our customers purchasing decisions, the length of our sales cycle, and our customers ability to pay us on time, if at all;
- the timing of large orders;
- changes in the proportion of software arrangements requiring contract accounting;
- changes in the mix of our sales, including the mix between higher margin software products and maintenance and lower margin professional services, and the proportion of our product sales requiring us to make royalty payments;
- the timing and amount of our marketing, sales, and product development expenses;
- the cost and time required to develop new software products;

the introduction, timing, and market acceptance of new products introduced by us or our competitors;

changes in network technology or in applications, which could require us to modify our products or develop new products;

- changes in our pricing policies or those of our competitors; and

- the timing and size of potential acquisitions by us.

We expect to make significant expenditures in all areas of our business, particularly sales and marketing operations, in order to promote future growth. Because the expenses associated with these activities are relatively fixed in the short term, we may be unable to adjust spending quickly enough to offset any unexpected shortfall in revenue growth or any decrease in revenue levels. In addition, our revenue in any quarter depends substantially on orders we receive and ship in that quarter. We typically receive a significant portion of orders in any quarter during the last month of the quarter, and we cannot predict whether those orders will be placed and shipped in that period. If we have lower revenue than we expect, we may not be able to respond quickly enough to reduce our operating expenses. Therefore, any significant shortfall in revenue or delay of customer orders could have an immediate adverse impact on our operating results in that quarter.

For all of these reasons, quarterly comparisons of our financial results are not necessarily meaningful, and you should not rely on them as an indication of our future performance.

If we do not successfully expand our sales force, we may be unable to increase our sales.

We sell our products primarily through our direct sales force, and we must expand the size of our direct sales force to increase revenue. If we are unable to hire or retain qualified sales personnel, if newly hired personnel fail to develop the necessary skills to be productive, or if they reach productivity more slowly than anticipated, our ability to increase our revenue and grow our business could be compromised. Our sales people require a long period of time to become productive, typically three to nine months. The time required to reach productivity, as well as the challenge of attracting, training, and retaining qualified candidates, may make it difficult to expand our direct sales force. Further, we may not generate sufficient sales to offset the increased expense resulting from growing our direct sales force, or we may be unable to manage a larger direct sales force.

The market for intelligent network management software is new and evolving, and if this market does not develop as anticipated, our revenue could decline.

We derive all of our revenue from the sale of products and services that are designed to allow our customers to manage the performance of applications and networks. Accordingly, if the market for intelligent application and network management software does not continue to grow, we could face declining revenue, which could ultimately lead to our becoming unprofitable. The market for intelligent application and network management software products is evolving. Therefore, we cannot accurately assess the size of the market and may be unable to identify an effective distribution strategy, the competitive environment that will develop, and the appropriate features and prices for products to address the market. If we are to be successful, our current and potential customers must recognize the value of intelligent network management software products, decide to invest in the management of their networks, and, in particular, adopt and continue to use our software products.

Our customers are primarily in four target groups and our operating results may be adversely affected by changes in one or more of these groups.

Our software products and related services are designed to meet the needs of enterprises, United States government agencies, service providers, and network equipment manufacturers, and we market our software products and related services to those four customer groups. Consequently, our financial results depend, in significant part, upon the economic conditions of enterprises, United States government agencies, service providers, and network equipment manufacturers. An economic downturn or adverse change in the regulatory environment or business prospects for one or more of these customer groups may decrease our revenue or lower our growth rate.

A decline in information technology spending may result in a decrease in our revenue or lower our growth rate.

A decline in the demand for information technology among our current and prospective customers may result in decreased revenue or a lower growth rate for us because our sales depend, in part, on our customers budgets for new or additional information technology systems and services. A continued economic downturn may cause our customers to reduce or eliminate information technology spending and force us to lower prices of our software products and related services, which would substantially reduce the number of software products we sell and the average sales price for these products. Accordingly, we cannot be certain that we will be able to increase or maintain our revenue.

Our sales to United States government agencies subject us to special risks that could adversely affect our business.

We derive a substantial portion of our revenue from sales directly or indirectly to United States government agencies. Transactions with United States government agencies accounted for approximately 32.5%, 39.9%, and 35.3% of our total revenue for fiscal 2011, 2010, and 2009, respectively. Government sales entail a variety of risks including:

Government contracts are subject to the approval of appropriations by the United States Congress to fund the expenditures by the agencies under these contracts. Congress often appropriates funds for government agencies on a yearly basis, even though their contracts may call for performance over a number of years.

A significant decline in government expenditures generally, or a shift in budget priorities away from agencies or programs that we support, could cause a material decline in our government business. In particular, a decline in government spending on information technology or related services could hurt our government business.

A portion of our products and services are included on a General Services Administration, or GSA schedule. We believe that the GSA schedule facilitates our sales to United States government agencies. The loss of the GSA schedule covering our products and services could adversely affect our results of operations.

We must comply with complex federal procurement laws and regulations in connection with government contracts, which may impose added costs on our business.

Some of our government business requires that we maintain facility security clearances, and requires some of our employees to maintain individual security clearances. If we were to lose these clearances, our government business might decline.

The federal government audits and reviews the performance of federal contractors on contracts, pricing practices, cost structure, and compliance with applicable laws, regulations, and standards. An audit of our work could result in a finding that we overcharged the government, which could result in an adjustment to our previously reported operating results. If a government audit uncovers improper or illegal activities, we may be subject to civil and criminal penalties and administrative sanctions, including termination of contracts, forfeiture of profits, suspension of payments, fines, and suspension or debarment from doing business with United States federal government agencies.

Many of our government contracts are firm fixed-price contracts. To the extent that the assumptions we have used in pricing these contracts prove inaccurate, we could incur and accrue losses on contracts, which would adversely affect our operating results.

A portion of our sales to the United States government are made indirectly as a subcontractor to another government contractor, referred to as the prime contractor, who has the direct relationship with the government. We also team with prime contractors to bid on competitive government opportunities

for which we hope to serve as a subcontractor. If prime contractors lose existing business on which we serve as a subcontractor, or fail to win the competitive bids on which we team with them, our government business would be hurt.

We could face expense and delay if any of our competitors, or competitors of the prime contractors to which we serve as a subcontractor, protest or challenge contract awards made to us or to our prime contractors pursuant to competitive bidding.

Federal government contracts contain provisions and are subject to laws and regulations that provide government clients with rights and remedies not typically found in commercial contracts. These rights and remedies allow government clients, among other things, to terminate existing contracts, with short notice, for convenience without cause; reduce or modify contracts or subcontracts; and claim rights in products, systems, and technology produced by us.

Our lengthy and variable sales cycle makes it difficult to predict operating results.

It is difficult for us to forecast the timing and recognition of revenue from sales of our products because prospective customers often take significant time evaluating our products before purchasing them. The period between initial customer contact and a purchase by a customer may vary from one month to more than a year. During the sales process, the customer may decide not to purchase or may reduce proposed orders of our products for various reasons, including changes in budgets and purchasing priorities. Our prospective customers routinely require education regarding the use and benefit of our products. This may also lead to delays in receiving customers orders.

Our ability to increase our sales may be impaired if we do not expand and manage our indirect distribution channels.

To increase our sales, we must, among other things, further expand and manage our indirect distribution channels, which consist of alliances with third parties called the SYNERGY program, third-party distributors, and value-added resellers, or VARS. If we are unable to expand and manage our relationships with our indirect distributors, our indirect distributors are unable or unwilling to market and sell our products effectively, or we lose existing indirect distributor relationships, we might not be able to increase our revenue. Our indirect distributors have no obligation to market or purchase our products. In addition, they could partner with our competitors, bundle or resell competitors products, or internally develop products that compete with our products.

We may not be able to successfully manage our expanding operations, which could impair our ability to operate profitably.

We may be unable to operate our business profitably if we fail to manage our growth. Our growth has sometimes strained, and may in the future continue to strain, our managerial, administrative, operational, and financial resources and controls. We plan to continue to expand our operations and increase the number of our full-time employees. Our ability to manage growth may depend in part on our ability to continue to enhance our operating, financial, and management information systems. Our personnel, systems, and controls may not be adequate to support our growth. In addition, our revenue may not continue to grow at a sufficient rate to absorb the costs associated with a larger overall employee base.

If we are unable to introduce new and enhanced products on a timely basis that respond effectively to changing technology, our revenue may decline.

Our market is characterized by rapid technological change, changes in customer requirements, frequent new product and service introductions and enhancements, and evolving industry standards. If we fail to develop and introduce new and enhanced products on a timely basis that respond to these changes, our products could become obsolete, demand for our products could decline and our revenue could fall. Advances in network management technology, software engineering, and simulation technology, or the emergence of new industry standards, could lead to new competitive products that have better performance, more features, or lower prices than our products and could render our products unmarketable.

***Our future revenue is substantially dependent upon our existing customers continuing to license additional products, renew maintenance agreements, and purchase additional services*.**

Our existing customers have traditionally generated additional revenue from consulting services, renewed maintenance agreements, and the purchase of additional software products, which represent the majority of our annual revenue. The maintenance agreements are generally renewable at the option of the customers and there are no mandatory payment obligations or obligations to license additional software. In addition, customers may decide not to purchase additional products or services. If our existing customers fail to renew their maintenance agreements or fail to purchase additional products or services, our revenue could decrease.

Increases in professional services revenue as a percentage of total revenue could decrease overall margin.

We realize significantly lower margin on professional service revenue than we do on other types of revenue. As a result, if professional services revenue increases as a proportion of total revenue, our gross margin will be lower. Although professional services revenue has been declining as a percentage of revenue, accounting for 15.0%, 21.2%, and 23.3% of our total revenue for fiscal 2011, 2010, and 2009, respectively, this trend may not continue.

If we fail to retain our key personnel and attract and retain additional qualified personnel, we might not be able to maintain our current level of revenue.

Our future success and our ability to maintain our current level of revenue depend upon the continued service of our executive officers and other key sales and research and development personnel. The loss of any of our key employees, in particular Marc A. Cohen, our Chairman of the Board and Chief Executive Officer, who is also our principal sales executive, and Alain J. Cohen, our President and Chief Technology Officer, could also adversely affect our ability to pursue our growth strategy. We do not have employment agreements or any other agreements that obligate any of our officers or key employees to remain with us.

We must also continue to hire highly qualified individuals, particularly software engineers and sales and marketing personnel. Our failure to attract and retain technical personnel for our product development, consulting services, and technical support teams may limit our ability to develop new products or product enhancements. Competition for these individuals is intense, and we may not be able to attract and retain additional highly qualified personnel in the future. In addition, limitations imposed by federal immigration laws and the availability of visas could impair our ability to recruit and employ skilled technical professionals from other countries to work in the United States.

Our international operations subject our business to additional risks, which could cause our sales or profitability to decline.

In fiscal 2011, 25.9% of our revenue, or $38.3 million, was generated from customers outside the United States. In fiscal 2010, 22.5% of our revenue, or $28.4 million, was generated from customers outside the United States. In fiscal 2009, 21.1% of our revenue, or $26.0 million, was generated from customers outside the United States. We plan to increase our international sales activities, but these plans are subject to a number of risks that could cause our sales to decline or could otherwise cause a decline in profitability. These risks include:

- difficulty in attracting distributors that will market and support our software products effectively;

- greater difficulty in accounts receivable collection and longer collection periods;
- the need to comply with varying employment policies and regulations that could make it more difficult and expensive to manage our employees if we need to establish more direct sales or support staff outside the United States;
- potentially adverse tax consequences;
- the effects of currency fluctuations; and
- political and economic instability.

We expect to face increased competition, which could cause us to lose sales, resulting in lower profitability.

Increasing competition in our market could cause us to lose sales and become unprofitable. We believe that the market for intelligent application and network management software is likely to become more competitive as it evolves and the demand for intelligent application and network management software products continues to increase. At least one of our current competitors and many of our potential competitors are larger and have substantially greater financial and technical resources than we do. In addition, it is possible that other vendors as well as some of our customers or distributors may develop and market software products that compete with our software products in the future.

If our products contain errors and we are unable to correct those errors, our reputation could be harmed and our customers could demand refunds from us or assert claims for damages against us.

Our software products could contain significant errors or bugs that may result in:

- the loss of or delay in market acceptance and sales of our products;
- the delay in introduction of new products or updates to existing products;
- diversion of our resources;
- injury to our reputation; and
- increased support costs.

Bugs may be discovered at any point in a product s life cycle. We expect that errors in our products may be found in the future, particularly in new product offerings and new releases of our current products.

Because our customers use our products to manage networks that are critical to their business operations, any failure of our products could expose us to product liability claims. In addition, errors in our products could cause our customers networks and systems to fail or compromise their data, which could also result in liability to us. Product liability claims brought against us could divert the attention of management and key personnel, could be expensive to defend, and may result in adverse settlements and judgments.

Our software products rely on our intellectual property, and any failure to protect our intellectual property could enable our competitors to market products with similar features that may reduce our revenue and could allow the use of our products by users who have not paid the required license fee.

If we are unable to protect our intellectual property, our competitors could use our intellectual property to market products similar to our products, which could reduce our revenue. In addition, we may be unable to prevent the use of our products by persons who have not paid the required license fee, which could reduce our revenue. Our success and ability to compete depends substantially upon the internally-developed technology that is incorporated in our products. Policing unauthorized use of our products is difficult, and we may not be able to prevent misappropriation of our technology, particularly in foreign countries where the laws may not protect our proprietary rights as fully as those in the United States. Others may circumvent the patents, copyrights, and trade secrets we own. In the ordinary course of business, we enter into a combination of confidentiality, non-competition, and non-disclosure agreements with our employees.

These measures afford only limited protection and may be inadequate, especially because our employees are highly sought after and may leave our employ with significant knowledge of our proprietary information. In addition, any confidentiality, non-competition and non-disclosure agreements we enter into may be found to be unenforceable, or our copy protection mechanisms embedded in our software products could fail or could be circumvented.

Our products employ technology that may infringe on the proprietary rights of others, and, as a result, we could become liable for significant damages.

We expect that our software products may be increasingly subject to third-party infringement claims as the number of competitors in our industry segment grows and the functionalities of products in different industry segments overlap.

Regardless of whether these claims have any merit, they could:

- be time-consuming to defend;
- result in costly litigation;
- divert our management s attention and resources;
- cause us to delay or cease product shipments; or
- require us to enter into royalty or licensing agreements.

These royalty or licensing agreements may not be available on terms acceptable to us, or at all. A successful claim of product infringement against us or our failure or inability to license the infringed or similar technology could adversely affect our business because we would not be able to sell the affected product without redeveloping it or incurring significant additional expense.

As with other software vendors, we may be required to delay revenue recognition into future periods, which could adversely affect our operating results.

We have in the past had to, and in the future may have to, defer recognition of product revenue due to several factors, including whether:

- product arrangements include undelivered elements for which we do not have vendor specific evidence of fair value;
- we must deliver services for significant customization, enhancements and modifications of our products;
- the transaction involves material acceptance criteria or there are other identified product-related issues;
- the transaction involves contingent payment terms or fees; or

we are required to accept extended payment terms.

Because of the factors listed above and other specific requirements under accounting principles generally accepted in the United States of America for software revenue recognition, we must have very precise terms in our product arrangements in order to recognize revenue when we initially deliver products or perform services. Negotiation of mutually acceptable terms and conditions can extend the sales cycle, and sometimes we do not obtain terms and conditions that permit revenue recognition at the time of delivery.

If we undertake acquisitions, they may be expensive and disruptive to our business and could cause the market price of our common stock to decline.

We have historically pursued acquisitions as a key part of our business strategy. We may continue to acquire or make investments in companies, products or technologies if opportunities arise. Any acquisition could be expensive, disrupt our ongoing business, distract our management and employees, and adversely affect our financial results and the market price of our common stock. We may not be able to identify suitable acquisition or investment candidates, and if we do identify suitable candidates, we may not be able to make these acquisitions or investments on commercially acceptable terms or at all. If we make an acquisition, we could have difficulty integrating the acquired technology, employees, or operations. In addition, the key personnel of the acquired company may decide not to work for us.

We also expect that we would incur substantial expenses if we acquire other businesses or technologies. We might use cash on hand, incur debt, or issue equity securities to pay for any future acquisitions. If we issue additional equity securities, our stockholders could experience dilution and the market price of our stock may decline.

Our products are subject to changing computing environments, including operating system software and hardware platforms, which could render our products obsolete.

The evolution of existing computing environments and the introduction of new popular computing environments may require us to redesign our products or develop new products. Computing environments, including operating system software and hardware platforms, are complex and change rapidly. Our products are designed to operate in currently popular computing environments. Due to the long development and testing periods required to adapt our products to new or modified computing environments, our research and development efforts could be distracted and we could experience significant delays in product releases or shipments, which could result in lost revenue and significant additional expense.

The impairment of a significant amount of goodwill on our balance sheet could result in a decrease in earnings and, as a result, our stock price could decline.

In the course of our operating history, we have acquired assets and businesses. Some of our acquisitions have resulted in the recording of a significant amount of goodwill on our financial statements. We had approximately $15.4 million of goodwill recorded on our balance sheet as of March 31, 2011. The goodwill reflects the fact that the fair value of the net tangible assets acquired in past acquisitions was less than the purchase price. We may not realize the full value of the goodwill. We evaluate goodwill for impairment on an annual basis or more frequently if events and circumstances suggest that the asset may be impaired. If goodwill is determined to be impaired, we will write off the unrecoverable portion as a charge to our earnings. If we acquire new assets and businesses in the future, we may record additional goodwill. The possible write-off of the associated goodwill could negatively impact our future earnings and, as a result, the market price of our common stock could decline.

The price of our common stock may decrease due to market volatility.

The market price of our common stock has historically been volatile and has fluctuated significantly. The market price of our common stock may continue to fluctuate in response to a number of factors, some of which are beyond our control. Trading activity of our stock has historically been relatively thin, in part as a result of officers and directors and institutional stockholders holding a significant percentage of our stock. In addition, the market price of securities of technology companies have been volatile and have experienced fluctuations that often have been unrelated or disproportionate to the operating performance of these companies. Also, broad market fluctuations could adversely impact the market price of our common stock, which in turn could cause impairment of goodwill that could materially and adversely impact our financial condition and results of operations.

It is not uncommon when the market price of a stock has been volatile for holders of that stock to institute securities class action litigation against the company that issues that stock. If any of our stockholders brought such a lawsuit against us, even if the lawsuit is without merit, we could incur substantial costs defending the lawsuit beyond any insurance coverage which we may have for such risks. Such a lawsuit could also divert the time and attention of our management.

The Board may decide that future dividends will be in amounts that are different than the amounts we have historically paid or may decide to suspend or discontinue the payment of cash dividends altogether.

The declaration of cash dividends in the future is subject to final determination each quarter by the Board based on a number of factors, including our financial performance and available cash resources, our cash requirements and alternative uses of cash that the Board may conclude would represent an opportunity to generate a greater return on investment for us.

ITEM 1B. UNRESOLVED STAFF COMMENTS

Not applicable.

ITEM 2. PROPERTIES

Our corporate office and principal facilities are located in Bethesda, Maryland and consist of approximately 82,000 square feet of office space held under two leases. The lease for 60,000 square feet expires on January 31, 2021, exclusive of renewal options, and the lease for 22,000 square feet expires on January 31, 2016, exclusive of renewal options. We also lease office space in the following locations: Cary, North Carolina; Dallas, Texas; Santa Clara, California; Nashua, New Hampshire; Colorado Springs, Colorado; Ghent, Belgium; Paris, France; Slough, United Kingdom; Singapore; Beijing China; and Mainz, Germany.

ITEM 3. LEGAL PROCEEDINGS

We are involved in various claims and legal proceedings arising from our normal operations. We do not regard any of those matters to be material.

ITEM 4. REMOVED AND RESERVED

PART II

ITEM 5. MARKET FOR REGISTRANT S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES

Market for Common Stock

Our common stock began trading on the NASDAQ Stock Market on August 2, 2000, under the symbol OPNT. The following table sets forth, on a per share basis, for the indicated periods, the intra-day high and low sale prices of our common stock as reported by the NASDAQ Stock Market.

Quarter ended	High	Low
June 30, 2009	$ 10.75	$ 6.92
September 30, 2009	11.56	8.24
December 31, 2009	12.70	10.01
March 31, 2010	16.20	11.70
June 30, 2010	17.12	14.46
September 30, 2010	19.60	13.01
December 31, 2010	27.28	16.80
March 31, 2011	39.00	24.38

Number of Stockholders of Record

As of May 31, 2011, we had approximately 106 holders of record of common stock. Because many of these shares are held by brokers and other institutions on behalf of stockholders, we are unable to estimate the total number of stockholders represented by these holders of record.

Securities Authorized for Issuance Under Equity Compensation Plans

The following table provides information regarding our current equity compensation plans as of March 31, 2011.

Equity Compensation Plan Information

Plan Category	Number of securities to be issued upon exercise of outstanding options (a)	Weighted-average exercise price of outstanding options	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a))
Equity compensation plans approved by security holders	1,131,997	$ 9.42	2,877,325(1)(2)
Equity compensation plans not approved by security holders			
Total	1,131,997	$ 9.42	2,877,325

(1) In addition to being available for future issuance upon exercise of options that may be granted after March 31, 2011, all of the remaining 2,198,337 shares under our Amended and Restated 2010 Stock Incentive Plan, or the 2010 Plan, may instead be issued in the form of restricted stock, stock appreciation rights or other stock-based awards.

(2)

Includes 678,988 shares issuable under our 2000 Employee Stock Purchase Plan, including shares issuable in connection with the current offering period which ends on July 31, 2011. Also includes 2,198,337 shares issuable under the 2010 Plan. Under the 2010 Plan, beginning with the 2011 calendar year, the number of shares available for issuance automatically increases on the first trading day of each calendar year by an amount equal to the lesser of (i) 3% of the shares of common stock outstanding on the last trading day of the preceding calendar year, or (ii) an amount determined by the Board of Directors, or the Board, in either case not to exceed an annual increase of 1,000,000 shares. See Note 2, Stock-Based Compensation, in the accompanying notes to our consolidated financial statements for more information.

Dividends

We did not declare or pay any dividends in fiscal 2009. The following table summarizes our quarterly cash dividend payments for fiscal 2011 and 2010 and our one-time special dividend payment in November of 2010:

Declaration Date	Stockholder Record Date	Payment Date	Amount per Share
May 13, 2009	June 15, 2009	June 29, 2009	$0.09
July 30, 2009	September 15, 2009	September 29, 2009	$0.09
October 28, 2009	December 15, 2009	December 30, 2009	$0.09
January 27, 2010	March 15, 2010	March 30, 2010	$0.09
May 5, 2010	June 15, 2010	June 30, 2010	$0.10
August 4, 2010	September 14, 2010	September 29, 2010	$0.10
October 27, 2010	November 14, 2010	November 30, 2010	$0.75
October 27, 2010	December 7, 2010	December 21, 2010	$0.10
January 26, 2011	March 16, 2011	March 30, 2011	$0.10

The declaration of cash dividends in the future is subject to final determination each quarter by the Board based on a number of factors, including our financial performance and available cash resources, our cash requirements and alternative uses of cash that the Board may conclude would represent an opportunity to generate a greater return on investment for us. The Board may decide that future dividends will be in amounts that are different than the amount described above or may decide to suspend or discontinue the payment of cash dividends altogether.

Stock Repurchase Plan

<u>Issuer Repurchases of Equity Securities</u>

Period	Total Number of Shares Purchased	Average Price Paid per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs (1)	Maximum Number of Shares That May Yet Be Purchased Under the Plans or Programs
January 1 31, 2011				488,164
February 1 28, 2011	9,524	$ 30.40	9,524	478,640
March 1 31, 2011				478,640
Total	9,524	$ 30.40	9,524	478,640

(1) On January 31, 2005, we announced a stock repurchase program pursuant to which we are authorized to purchase up to 1,000,000 shares of common stock from time to time on the open market or in privately negotiated transactions. This program does not have a specified termination date. On February 4, 2008, we announced that our Board approved an increase of an additional 1,000,000 shares under our stock repurchase program. Any repurchased shares will be available for use in connection with our stock plans or other corporate purchases. As of March 31, 2011, we had repurchased 1,521,360 shares of common stock under this program.

ITEM 6. SELECTED CONSOLIDATED FINANCIAL DATA

The following selected consolidated financial data should be read in conjunction with our consolidated financial statements and the related notes and Management s Discussion and Analysis of Financial Condition and Results of Operations included elsewhere in this Annual Report. The statement of operations data for the years ended March 31, 2011, 2010, and 2009, and the balance sheet data as of March 31, 2011 and 2010, are derived from our audited consolidated financial statements included in this Annual Report. The balance sheet data as of March 31, 2009, 2008 and 2007 and the statement of operations data for the years ended March 31, 2008 and 2007 are derived from our consolidated financial statements that are not included in this Annual Report. Historical results are not necessarily indicative of results that may be expected for any future period.

	Year Ended March 31, (in thousands, except per share data)				
	2011	2010	2009	2008	200
ement rations n:					
enue:					
uct	$ 72,392	$ 52,252	$ 51,211	$ 38,838	$ 43,1
uct tes, nical ort and ces	53,392	47,264	43,067	34,787	28,(
essional ces	22,202	26,831	28,601	27,721	23,8
l nue	147,986	126,347	122,879	101,346	95,1
of nue:					
uct	9,293	5,983	3,536	1,035	6
uct tes, nical ort and ces	5,260	4,859	4,665	4,514	3,2
essional ces	16,183	19,328	20,911		

o January 31, 2014 for the four quarters then ended, and thereafter, $4.1 million

· Capital Expenditures. Borrowers shall not during any fiscal year make capital expenditures in an amount exceeding $1 million in the aggregate

· The Company is in compliance with all loan covenants of the Senior Debt at October 31, 2014.

· Other Covenants

o Standard Financial reporting requirements as defined

o Limitation on amounts that can be advanced to or on behalf of Brazilian operations, limited to one aggregate total of $200,000 for the term of the loan

o Limitation on total net cash investment in foreign subsidiaries of a maximum of $1.0 million per annum

The amount outstanding as of October 31, 2014 under the Senior Lender Facility was $5.1 million.

Borrowings in UK and Subsequent Event

On December 19, 2013 the Company and its UK subsidiary entered into a one-year extension of its existing financing facility with HSBC Invoice Finance (UK) Ltd., ("HSBC") pursuant to the same terms as disclosed in the Company's Form 8-K filed with the SEC on February 25, 2013, except for: the facility limit was increased from £1,000,000 (approximately US $1.6 million) to £1,250,000 (approximately USD $2.0 million at current exchange rates), and the prepayment percentage (advance rate) was increased from 80% to 85% of eligible receivables; more fully described in the Company's Form 8-K which was filed on December 23, 2013. The balance outstanding under this facility at October 31, 2014 was the equivalent of USD $0.5 million and is included in short-term borrowings on the balance sheet. The per annum interest rate repayment rate was 3.44% and the term was for a minimum period of one year renewable on December 19, 2014.

On December 3, 2014, the Company and its UK subsidiary further amended the terms of its existing financing facility with HSBC to provide for (i) a one-year extension of the maturity date of the existing financing facility to December 3, 2015, (ii) an increase in the facility limit from £1,250,000 (approximately USD $2.0 million) to £1,500,000 (approximately USD $2,350,000), and (iii) a decrease in the annual interest rate margin from 3.46% to 3.0%. In addition, pursuant to a letter agreement, dated December 5, 2014, the Company agreed that £400,000 (approximately USD $623,000) of the note payable by the UK subsidiary to the Company shall be subordinated in priority of payment to the subsidiary's obligations to HSBC under the financing facility.

Canada Loan

In September 2013 the Company refinanced its loan with the Development Bank of Canada (BDC) for a principal amount of approximately US $1.1 million. Such loan is for a term of 240 months at a per annum interest rate of 6.45% with fixed monthly payments of US $7,620 (C$8,529) including principal and interest. It is collateralized by a mortgage on the Company's warehouse in Brantford, Ontario. The amount outstanding at October 31, 2014 is US $0.96 million which is included in long-term portion of Canada and Brazil loan on the balance sheet, net of current maturities of $50,000.

China Loan

On March 27, 2014, the Company’s China subsidiary, Weifang Lakeland Safety Products Co., Ltd (“WF”), and Weifang Rural Credit Cooperative Bank (“WRCCB”) completed an agreement to obtain a line of credit for financing in the amount RMB 8,000,000 (approximately US $1.3 million), with interest at 120% of the benchmark rate supplied by WRCCB (which is currently 5.6%). The effective per annum interest rate is currently 6.72%. The loan is collateralized by inventory owned by WF. WRCCB had hired a professional firm to supervise WF’s inventory flow, which WF paid RMB 40,000 (approximately US $6,501). The balance under this loan outstanding at October 31, 2014 was RMB 8,000,000 (approximately US $1.3 million) and is included in short-term borrowings on the consolidated balance sheet. There are no covenant requirements in this loan. The loans are comprised of several loans with due dates ranging from June 18, 2014 to January 11, 2016.

On October 11, 2014, the Company’s China subsidiary, Weifang Lakeland Safety Products Co., Ltd (“WF”), and Bank of China Anqiu Branch completed an agreement to obtain a line of credit for financing in the amount RMB 5,000,000 (approximately US $0.8 million), with interest at 123% of the benchmark rate supplied by Bank of China Anqiu Branch (which is currently 6.0%). The effective per annum interest rate is currently 7.38%. The loan is collateralized by inventory owned by WF. The balance under this loan outstanding at October 31, 2014 was RMB 5,000,000 (approximately US $0.8 million) and is included in short-term borrowings on the consolidated balance sheet. The line of credit is due within a one year period.

Brazil Loans

Brazil has long-term borrowing of R$ 39,506 (US $16,163) that are included in long-term portion of Canada and Brazil loans on the balance sheet, short-term borrowing of R$ 2.7 million (US $1.1 million) that are included in short-term borrowings on the balance sheet, and accrued interest of R$ 195,000 (US $79,781). Brazil loans are collateralized by receivables, officer guarantee, and customer contracts. Monthly interest rates range from 1.40% to 2.50%.

7. Equity Financing

On October 29, 2014, the Company completed a private placement, pursuant to a Securities Purchase Agreement dated as of October 24, 2014, for the issuance and sale of 1,110,000 shares of its common stock, at a purchase price of

$10.00 per share, to a number of institutional and other accredited investors, for gross proceeds of $11,100,000. Proceeds from the private placement, following the payment of offering-related expenses, were used by the Company to fully repay its 12% subordinated term loan (the “Subordinated Debt”) with the Junior Lender in the approximate amount of $3.6 million. The early extinguishment of the Subordinated Debt, however, has resulted in a one-time pretax NON-CASH charge of approximately $1.6 million for the remaining unamortized OID on the Subordinated Debt and a pretax NON-CASH charge of approximately $0.6 million for the remaining unamortized fees paid at the closing of the June 2013 Subordinated Debt financing. The balance of the proceeds will continue to be used for working capital and general corporate purposes, including supporting the increased demand for the Company’s safety products due to the EBOLA crisis. Pending such usage, the Company has and intends to continue to temporarily pay down a portion of its Senior Debt with AloStar Bank of Commerce.

In connection with the private placement, the Company entered into a Registration Rights Agreement with the investors on October 24, 2014 pursuant to which it is required to file a registration statement with the Securities and Exchange Commission to register the resale of the shares of common stock sold to the investors within 30 calendar days of the date of such agreement. Such registration statement was filed on November 21, 2014.

At the closing of the private placement, the Company paid Craig-Hallum Capital Partners LLC, the exclusive placement agent for the private placement, a cash fee of $777,000 (equal to 7% of the gross proceeds of the offering), and issued a five-year warrant that is immediately exercisable to purchase up to 55,500 shares of the Company's common stock at an exercise price of $11.00 per share. At the closing there was approximately $132,000 in professional fees incurred. Based on the October 31, 2014 market value of $14.10 the intrinsic value was $3.10 per share.

8. Major Supplier

No supplier accounted for more than 10% of cost of sales during the nine-month period ended October 31, 2014.

9. Employee Stock Compensation

The Company has three share-based payment plans: The Nonemployee Directors Option Plan (the "Directors Plan") (expired in 2012) and two Restricted Stock Plans (the "2009 Equity Plan" and the "2012 Equity Plan"). Both the 2009 Equity Plan and the 2012 Equity Plan have identical structures.

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The below table summarizes the main provisions of each of these plans:

Nonemployee Directors Option Plan	The plan provides for an automatic one-time grant of options to purchase 5,000 shares of common stock to each nonemployee director newly elected or appointed. Options are granted at not less than fair market value, become exercisable commencing six months from the date of grant and expire six years from the date of grant. In addition, all nonemployee directors re-elected to the Company's Board of Directors at any annual meeting of the stockholders will automatically be granted additional options to purchase 1,000 shares of common stock on that date. Such plan expired at December 31, 2012, as to any new awards. Existing options will expire based on individual award dates.
Restricted Stock Plan – employees	Long-term incentive compensation three-year plan. Employees are granted potential share awards at the beginning of the three-year cycle at baseline and maximum amounts. The level of award and final vesting is based on the Board of Director's opinion as to the performance of the Company and management in the entire three-year cycle. All vesting is three-year "cliff" vesting - there is no partial vesting. The valuation is based on the stock price at the grant date and amortized to expense over the three-year period, which approximates the performance period.
Restricted Stock Plan – directors	Long-term incentive compensation three-year plan. Directors are granted potential share awards at the beginning of the three-year cycle at baseline and maximum amounts. The level of award and final vesting is based on the Board of Director's opinion as to the performance of the Company and management in the entire three-year cycle. All vesting is three-year "cliff" vesting - there is no partial vesting. The valuation is based on the stock price at the grant date and amortized to expense over the three-year period, which approximates the performance period.
Matching award program	All participating employees are eligible to receive one share of restricted stock awarded for each two shares of Lakeland stock purchased on the open market. Such restricted shares are subject to three-year time vesting. The valuation is based on the stock price at the grant date and amortized to expense over the three-year period, which approximates the performance period.
Director fee in stock program	All directors are eligible to elect to receive any director fees in shares of restricted stock. Such restricted shares are subject to two-year time vesting. The valuation is based on the stock price at the grant date and amortized to expense over the two-year period. Since the director is giving up cash for unvested shares, the amount of shares awarded is 133% of the cash amount based on the grant date stock price, which approximates the performance period.

The following table represents our stock options granted, exercised and forfeited during the nine-months ended October 31, 2014.

Stock Options	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 31, 2014	24,000	$ 7.47	2.95 years	——
Granted during the nine-months ended October 31, 2014	——	——	——	——
Forfeited during the nine-months ended October 31, 2014	2,000	$ 13.10	——	——
Outstanding at October 31, 2014	22,000	$ 6.96	2.43 years	$ 53,960

Exercisable at October 31, 2014	22,000	$ 6.96	2.43 years	$ 53,960
Reserved for future issuance:	——			
Directors' Plan (expired on December 31, 2012)				

There were no exercises during the nine-months ended October 31, 2014.

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Restricted Stock Plan and Performance Equity Plan

On June 17, 2009, the stockholders of the Company approved the 2009 Equity Plan. A total of 253,000 shares of restricted stock were authorized under this plan. On June 20, 2012, the stockholders of the Company authorized 310,000 shares under the 2012 Equity Plan. Under these restricted stock plans, eligible employees and directors are awarded performance-based restricted shares of the Company common stock. The amount recorded as expense for the performance-based grants of restricted stock are based upon an estimate made at the end of each reporting period as to the most probable outcome of this plan at the end of the three-year performance period (e.g., baseline, maximum or zero). In addition to the grants with vesting based solely on performance, certain awards pursuant to the plan have a time-based vesting requirement, under which awards vest from two to three years after grant issuance, subject to continuous employment and certain other conditions. Restricted stock has voting rights, and the underlying shares are not considered to be issued and outstanding until vested.

Under the 2009 Equity Incentive Plan, the Company has issued 182,859 fully vested shares and there are zero shares remaining unvested as of October 31, 2014. The Company recognizes expense related to performance-based awards over the requisite service period using the straight-line attribution method based on the outcome that is probable.

Under the 2012 Equity Plan, the Company has issued 8,622 fully vested shares as of October 31, 2014. The Company has granted 265,394 restricted stock awards as of October 31, 2014, at maximum performance level. All of these restricted stock awards are nonvested at October 31, 2014 (209,394 shares at “baseline”), and have a weighted average grant date fair value of $6.02. The Company recognizes expense related to performance-based awards over the requisite service period using the straight-line attribution method based on the outcome that is probable.

As of October 31, 2014, unrecognized stock-based compensation expense related to restricted stock awards totaled $0 pursuant to the 2009 Equity Incentive Plan and $295,682 pursuant to the 2012 Equity Incentive Plan, before income taxes, based on the maximum performance award level, net of what has been charged to expense, which was set to maximum on a cumulative basis through October 31, 2014. The cost of these nonvested awards is expected to be recognized over a weighted-average period of three years. The Board has estimated the ultimate performance level at the expiration of the plan to be at maximum, and accordingly, the Company has taken a non-cash charge of $1.0 million reflecting the cumulative amortization of the value of the awarded shares based on grant date market value. This amount reflects the amortization of the total original value at grant date of the restricted shares in question for the period June 20, 2012 through October 31, 2014. Such amount will result in an after-tax charge on earnings per shares ($0.11) for both the three months and nine months ending October 31, 2014. The performance-based awards are not considered stock equivalents for earnings per share (“EPS”) calculation purposes.

Stock-Based Compensation

The Company recognized total stock-based compensation costs of $1,073,187 and $179,002 for the nine-months ended October 31, 2014 and 2013, respectively, of which $20,707 and $13,881 result from the 2009 Equity Plan and $1,052,480 and $165,121 result from the 2012 Equity Plan for the periods ended October 31, 2014 and 2013, respectively, and $0 and $0, respectively, from the Director Option Plan. These amounts are reflected in selling, general and administrative expenses. The total income tax benefit recognized for stock-based compensation arrangements was $386,347 and $64,441 for the years ended October 31, 2014 and 2013, respectively.

Shares under 2009 Equity Plan	Outstanding unvested grants at maximum at beginning of FY15	Granted during FY15 through October 31, 2014	Vested during FY15 through October 31, 2014	Forfeited during FY15 through October 31, 2014	Outstanding unvested grants at maximum at October 31, 2014
Restricted stock grants -employees	——	——	——	——	——
Restricted stock grants - directors	——	——	——	——	——
Matching award program	3,000	——	3,000	——	——
Bonus in stock - employees	——	——	——	——	——
Retainer in stock - directors	1,116	——	1,116	——	——
Total restricted stock plan	4,116	——	4,116	——	——
Weighted average grant date fair value	$ 8.66	——	$ 8.66	——	——

Shares under 2012 Equity Plan	Outstanding unvested grants at maximum at beginning of FY15	Granted during FY15 through October 31, 2014	Vested during FY15 through October 31, 2014	Forfeited during FY15 through October 31, 2014	Outstanding unvested grants at maximum at October 31, 2014
Restricted stock grants – employees	150,500	-----	-----	3,000	147,500
Restricted stock grants – directors	49,500	-----	-----	-----	49,500
Matching award program	3,000	-----	-----	-----	3,000
Bonus in stock - employees	55,189	-----	4,331	-----	50,858
Retainer in stock - directors	14,101	4,726	4,291	-----	14,536
Total restricted stock plan	272,290	4,726	8,622	3,000	265,394
Weighted average grant date fair value	$ 6.00	$ 8.16	$ 6.25	$ 6.44	$ 6.02

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10. ***Segment Data***

Domestic and international sales are as follows in millions of dollars:

	Three Months Ended October 31,				Nine Months Ended October 31,			
	2014		2013		2014		2013	
	Unaudited				Unaudited			
Domestic	$13.00	51.8 %	$11.47	50.3 %	$37.16	50.8 %	$35.65	51.6 %
International	12.09	48.2 %	11.32	49.7 %	36.05	49.2 %	33.51	48.4 %
Total	$25.09	100.0%	$22.79	100.0%	$73.21	100.0%	$69.16	100.0%

We manage our operations by evaluating each of our geographic locations. Our North American operations include our facilities in Alabama (primarily the distribution to customers of the bulk of our products and manufacturing of our chemical suit and fire protective products), and Mexico (primarily disposable, glove, chemical suit, woven, and high visibility production). We also maintain two manufacturing companies in China (primarily disposable, chemical and woven suit production), a wovens manufacturing facility in Brazil and a small manufacturing facility in Argentina. We evaluate the performance of these entities based on operating profit, which is defined as income before income taxes, interest expense and other income and expenses. We have sales forces in Canada, Europe, Latin America, India, Russia, Kazakhstan and China, which sell and distribute products shipped from the United States, Mexico, Brazil or China. The table below represents information about reported segments for the periods noted therein:

	Three Months Ended October 31, (in millions of dollars)		Nine Months Ended October 31, (in millions of dollars)	
	Unaudited		Unaudited	
	2014	2013	2014	2013
Net Sales:				
USA	$ 14.76	$ 12.40	$ 40.47	$ 37.60
Other foreign	4.55	2.44	11.43	8.67
Europe (UK)	3.27	2.92	9.79	8.85
Mexico	0.85	0.90	2.62	2.35
China	9.96	11.17	33.28	32.53
Brazil	1.55	1.91	5.10	5.40
Corporate	0.35	0.37	1.52	1.46
Less intersegment sales	(10.20)	(9.32)	(31.00)	(27.70)
Consolidated sales	$ 25.09	$ 22.79	$ 73.21	$ 69.16
External Sales:				
USA	$ 13.00	$ 11.47	$ 37.16	$ 35.65
Other foreign	3.79	2.22	10.17	7.17
Europe (UK)	3.27	2.92	9.79	8.85
Mexico	0.38	0.38	1.08	0.88
China	3.10	3.90	9.91	11.29

Brazil	1.55	1.90	5.10	5.32
Consolidated external sales	$ 25.09	$ 22.79	$ 73.21	$ 69.16
Intersegment Sales:				
USA	$ 1.76	$ 0.93	$ 3.31	$ 1.95
Other foreign	0.76	0.22	1.26	1.50
Mexico	0.47	0.52	1.54	1.47
China	6.86	7.27	23.37	21.24
Brazil	——	0.01	——	0.08
Corporate	0.35	0.37	1.52	1.46
Consolidated intersegment sales	$ 10.20	$ 9.32	$ 31.00	$ 27.70

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	Three Months Ended October 31, (in millions of dollars) Unaudited		Nine Months Ended October 31, (in millions of dollars) Unaudited	
	2014	2013	2014	2013
Operating Profit (Loss):				
USA	$ 2.65	$ 1.07	$ 5.11	$ 4.20
Other foreign	0.16	(0.03)	0.40	——
Europe (UK)	0.27	0.09	0.80	0.56
Mexico	(0.05)	0.05	(0.26)	(0.03)
China	0.54	1.05	2.80	2.65
Brazil	(0.59)	(1.93)	(1.19)	(3.74)
Corporate	(2.35)	(1.25)	(5.06)	(3.61)
Less intersegment profit	0.07	(0.08)	0.15	——
Consolidated operating profit (loss)	$ 0.70	$ (1.03)	$ 2.75	$ 0.03
Depreciation and Amortization Expense:				
USA	$ 0.04	$ 0.05	$ 0.13	$ 0.16
Other foreign	0.02	0.04	0.06	0.12
Europe (UK)	0.01	——	0.02	0.02
Mexico	0.01	0.01	0.04	0.04
China	0.05	0.08	0.16	0.20
Brazil	0.04	0.09	0.18	0.28
Corporate	0.15	0.19	0.44	0.42
Less intersegment	(0.01)	(0.01)	(0.02)	(0.01)
Consolidated depreciation & amortization expense	$ 0.31	$ 0.45	$ 1.01	$ 1.23
Interest Expense:				
USA (shown in Corporate)	$ ——	$ ——	$ ——	$ ——
Other foreign	0.03	0.02	0.05	0.08
Europe (UK)	0.01	0.02	0.03	0.04
Mexico	——	0.03	——	0.07
China	0.03	——	0.03	——
Brazil	0.19	0.34	0.50	0.87
Corporate	0.44	0.33	1.41	0.74
Less intersegment	——	(0.09)	——	(0.41)
Consolidated interest expense	$ 0.70	$ 0.65	$ 2.02	$ 1.39
Income Tax Expense (Benefits):				
USA (shown in Corporate)	$ ——	$ ——	$ ——	$ ——
Other foreign	0.17	0.15	0.33	0.29
Europe (UK)	0.06	0.02	0.16	0.04
Mexico	0.01	——	(0.06)	0.01
China	0.19	0.25	0.68	0.73
Corporate	(0.16)	(0.04)	(0.16)	(3.91)
Less intersegment	0.01	(0.05)	0.03	(0.26)
Consolidated income tax expense (benefit)	$ 0.28	$ 0.33	$ 0.98	$ (3.10)

	October 31, 2014 (in millions of dollars) Unaudited	January 31, 2014 (in millions of dollars) Unaudited
Total Assets:*		
USA	$ 34.50	$ 28.88
Other foreign	19.02	15.09
Europe (UK)	6.10	4.83
Mexico	3.90	3.73
China	30.46	30.12
India	(1.29)	(1.19)
Brazil	10.63	6.92
Corporate	(16.56)	(4.63)
Consolidated assets	$ 86.76	$ 83.75
Property and Equipment:		
USA	$ 2.34	$ 2.42
Other foreign	1.96	2.06
Europe (UK)	0.08	0.06
Mexico	2.06	2.09
China	2.53	2.64
India	0.06	0.03
Brazil	1.74	1.86
Corporate	1.00	0.91
Consolidated property and equipment	$ 11.77	$ 12.07
Capital Expenditures:		
USA	$ 0.04	$ 0.08
Other foreign	0.01	0.07
Europe (UK)	0.03	0.01
Mexico	0.03	0.01
China	0.08	0.44
India	0.02	——
Brazil	0.01	0.09
Corporate	0.18	0.13
Consolidated capital expenditures	$ 0.40	$ 0.83
Goodwill:		
USA	$ 0.87	$ 0.87
Consolidated goodwill	$ 0.87	$ 0.87

* Negative assets and negative amounts in interest expense reflect intersegment accounts eliminated in consolidation

11. Income Taxes

Income Tax Audits

The Company is subject to US federal income tax, as well as income tax in multiple US state and local jurisdictions and a number of foreign jurisdictions. The Company has received notice from the IRS on March 21, 2011, that it will shortly commence an audit for the FY09 tax return. There have been no further communications from the IRS since.

Our four major foreign tax jurisdictions are China, Brazil, UK and Canada. Chinese tax authorities have performed limited reviews on all Chinese subsidiaries as of tax years 2008, 2009, 2010, 2011, 2012, and 2013 with no significant issues noted. We believe our tax positions are reasonably stated as of October 31, 2014. On August 20, 2013, Weifang Lakeland Safety Products Co., Ltd., one of our Chinese operations, was notified by the local tax authority that it would conduct an audit on income tax and transfer pricing and the tax inspector took all accounting documents of 2011, 2012, and 2013, back to the tax bureau. Management believes there will not be a material exposure from these audits. Our operations in the UK have just become profitable on a cumulative basis and as such are now subject to UK taxation. This is the initial year of taxability. Management is not aware of any exposure in the UK.

Lakeland Protective Wear, Inc., our Canadian subsidiary, follows Canada tax regulatory framework recording its tax expense and tax deferred assets or liabilities. As of this statement filing date, we believe the Lakeland Protective Wear, Inc.’s tax situation is reasonably stated in accordance with accounting principles generally accepted in the United States of America, and we do not anticipate future tax liability.

The Company’s Brazilian subsidiary is currently under a tax audit, which raised some issues regarding the tax impact related to the merger in 2008 and the goodwill resulting from the structure which was set up at the Company's Brazilian counsel's suggestion. This structure is relatively common in acquisitions of Brazilian operations made by non-Brazilian companies. In general, acquisitions with this structure have survived challenge by the taxing authorities in Brazil. The cumulative amount of tax benefits recognized on the Company’s books through October 31, 2014, resulting from the tax deduction of the goodwill amortization, is now zero, net of the deferred tax valuation reserve. This results from the goodwill which had been on the Brazilian books which, for Brazilian tax purposes, is eligible for tax write-off over a five-year period dating from November 2008. The Company’s Brazilian subsidiary has received notice from the Brazilian tax authorities of a claim totaling approximately US $1.0 million (R$ 2,265,728) consisting of tax of approximately US $127,000 (R$ 280,416) and the remainder in interest and penalty. Management believes it is probable it will ultimately prevail in this claim and as such no provision has been recorded.

Except in Canada and partially in China, it is our practice and intention to reinvest the earnings of our non-US subsidiaries in their operations. As of October 31, 2014, the Company had not made a provision for US or additional foreign withholding taxes on approximately $16.6 million of the excess of the amount for financial reporting over the tax basis of investments in foreign subsidiaries that are essentially permanent in duration. Generally, such amounts become subject to US taxation upon remittance of dividends and under certain other circumstances. If theses earnings were repatriated to the US, the deferred tax liability associated with these temporary differences would be approximately $2.9 million at October 31, 2014.

In China, a dividend of $1.3 million was declared and paid in July 2014 from Weifang Lakeland Safety Products Co., Ltd. (“Weifang”) and in August 2014 a dividend of $450,000 was declared from Weifang Meiyang Protective Products Co., Ltd. (“Meiyang”) and paid in October 2014. The Company’s Board of Directors has instituted a plan to pay annual dividends of $1.0 million from Weifang’s future profits and 33% of Meiyang’s future profits starting in the next fiscal year. All other retained earnings are expected to be reinvested indefinitely.

Change in Accounting Estimate/Valuation Allowance

We record net deferred tax assets to the extent we believe these assets will more likely than not be realized. In making such determination, we considered all available positive and negative evidence, including scheduled reversals of deferred tax liabilities, projected future taxable income, tax planning strategies and recent financial operations. The valuation allowance was zero at October 31, 2014 and January 31, 2014.

Income Tax Expense

Income tax expenses consist of federal, state and foreign income taxes. Income tax expenses were $1.0 million for the nine months ended October 31, 2014, as compared to an income tax benefit of $3.1 million for the nine months ended October 31, 2013. Income taxes included a non-cash charge of $77,000 for the dividend paid by Meiyang to the US in October 2014, a non-cash charge of $350,000 for the tax effect of the change in the performance level of the 2012 Restricted Stock plan from zero to maximum and $170,000 of non-cash charges in fiscal 2015 for additional US taxes on UK and Canada income. Income taxes also reflect the write-off of $1.6 million relating to the remaining unamortized original issue discount on the subordinated debt repayment which is not deductible for tax purposes.

12. Derivative Instruments and Foreign Currency Exposure

The Company is exposed to foreign currency risk. In the third quarter of FY14, the Company established a foreign exchange facility with Wells Fargo Bank, N.A. Such contracts are largely timed to expire with the last day of the fiscal quarter, with a new contract purchased on the first day of the following quarter, to match the operating cycle of the Company. The Company has continued its currency hedging in China. We designated the forward contracts as derivatives but not as hedging instruments, with loss and gain recognized in current earnings. In the nine-months ended October 31, 2014, the Company had a gain on foreign exchange in China of $9,260 included in operating expenses on the accompanying statement of operations.

The Company accounts for its foreign exchange derivative instruments by recognizing all derivatives as either assets or liabilities at fair value, which may result in additional volatility in both current period earnings and other comprehensive income as a result of recording recognized and unrecognized gains and losses from changes in the fair value of derivative instruments.

We have two types of derivatives to manage the risk of foreign currency fluctuations. We enter into forward contracts with financial institutions to manage our currency exposure related to net assets and liabilities denominated in foreign currencies. Those forward contract derivatives, not designated as hedging instruments, are generally settled quarterly. Gain and loss on those forward contracts are included in current earnings. There were no outstanding forward contracts at October 31, 2014 or 2013.

We enter into cash flow hedge contracts with financial institutions to manage our currency exposure on future cash payments denominated in foreign currencies. The effective portion of gain or loss on cash flow hedges is reported as a component of accumulated other comprehensive income. The notional amount of these contracts was $2.3 million and $0.0 million at October 31, 2014 and 2013, respectively. The corresponding asset and income which is recorded in other comprehensive income is immaterial to the consolidated financial statements at October 31, 2014 and 2013.

13. VAT Tax Issue in Brazil

Please see footnote 10 of the Company's Annual Report on Form 10-K for the year ended January 31, 2014 for a more detailed discussion.

The Bahia state tax auditors filed several claims for VAT taxes. The claims assert that the state VAT taxes are owed to the state of domicile of the ultimate importer/user and disregarded the fact that the VAT taxes had already been paid to the neighboring state.

Once the arrangement with the Bahia State Tax Department is completed, the formal judicial process could take from 5 to 10 years. The Company believes there is a strong likelihood that another amnesty would be offered by the state prior to such completion.

The Company has accepted amnesty for a smaller claim which will result in 8 monthly payments of about US $19,000 (R$ 42,000) which reflects abatement of 80% of penalty and interest. An accrual of US $153,000 has been charged to expense in Q4FY14 and US $82,000 (R$ 189,000) is included in Other Accrued Expenses on the consolidated balance sheet as of October 31, 2014.

In December 2013, the Company learned of a different VAT tax claimed by the State of Sao Paulo for a tax in the amount of approximately US $45,000 and the total claim including interest and penalty totaling approximately US $200,000. In July 2014 management settled this claim for an amount of US $75,000 (R$ 172,000) net present value which will be paid in 120 monthly installments of R$ 4,500 fixed with no interest or monetary depreciation. An amount of US $75,000 (R$ 172,000) has been charged to expense in Q2FY14.

A table summarizing all four different VAT claims remaining open and their status is listed below:

Principal R$	Interest & Penalty R$	Total R$	Approximate for Totals US $	Loss Possibility	Strategy	Collateral
305,897	491,271	797,168	$ 352,000	Remote	To await Judicial Process and negotiate judicial deposit	New Land
573,457	1,098,475	1,671,932	737,000	Remote	To await Judicial Process and negotiate judicial deposit	Plant
6,209,836	6,653,585	12,863,421	5,673,000	Probable	To await Judicial Process and negotiate judicial deposit	-
402,071	770,133	1,172,204	517,000	Remote	To await Judicial Process and negotiate judicial deposit	New Land
7,491,261	9,013,464	16,504,725	$ 7,279,000			

The R$ 6,209,836 for the larger VAT claim is intended to be paid into the next amnesty and as such is included on the condensed consolidated balance sheet as a long-term liability of US $3,361,774 as of October 31, 2014.

14. Brazil Management and Share Purchase Agreement-Arbitration Award and Settlement Agreement

Lakeland Industries, Inc. and its wholly-owned subsidiary, Lakeland Brasil S.A. (“Lakeland Brasil” and together with Lakeland Industries, Inc., “Lakeland”) were parties to an arbitration proceeding in Brazil involving Lakeland and two former officers (the “former officers”) of Lakeland Brasil. On May 8, 2012, Lakeland received notice of an arbitral award in favor of the former officers.

On September 11, 2012, Lakeland and the former officers entered into a settlement agreement (“Settlement Agreement”) which fully and finally resolved all alleged outstanding claims against Lakeland which are settled through the arbitration proceeding. Pursuant to the Settlement Agreement, the Company agreed to a payment schedule to the former officers with a balance remaining as of October 31, 2014 of $4.25 million in US dollars consisting of 17 consecutive quarterly installments remaining of US $250,000 ending on December 31, 2018. Lakeland is current with all obligations pursuant to the Settlement Agreement. There is no interest payable. This amount is shown on the accompanying consolidated balance sheet as $1,000,000 current maturity of arbitration settlement and $3,103,784 long-term portion ($174,351 of imputed interest).

In addition, pursuant to the Settlement Agreement, as additional security for payment of the Settlement Amount, Lakeland Brasil agreed to grant the former officers a second mortgage interest on certain of its property in Brazil, which mortgage is expressly behind the lien securing the payment of tax debts to a state within Brazil related to certain notices of tax assessment on such property. Lakeland also agreed to become a co-obligor, in lieu of a guarantor, for payment of the Settlement Amount.

15. Lakeland Brazil Consulting Agreement

Lakeland Brasil S.A. ("Lakeland Brazil"), a wholly-owned subsidiary of the Company, and Multiplica Soluções Empresariais Ltda. ("Consultant"), a private equity turnaround specialist in Brazil, have entered into a Business Consultancy Agreement (the "Consultancy Agreement"), effective as of August 27, 2014 (the "Effective Date"). Under the Consultancy Agreement, among other things, Consultant shall provide Lakeland Brazil with assistance in securing financing, which financing may include loan guarantees by Consultant to various financial institutions on behalf of Lakeland Brazil, structuring and cash flow management services, assistance in negotiation of VAT tax issues, and placing a full-time financial analyst at the office of Lakeland Brazil. The Consulting Agreement also provides for the formation of a Managing Committee, consisting of one representative of Lakeland Brazil and one representative of Consultant. The Managing Committee discusses and makes determinations of strategies relating to payment of invoices, financing of accounts receivable, factoring, and negotiations with suppliers and banks. The term of the Consultancy Agreement is twelve (12) months commencing as of the Effective Date and may be extended for an additional twelve (12) months upon agreement of the parties, subject to earlier termination as provided therein. The Effective Date was triggered by Lakeland Brazil's securing several financial lending facilities with Brazilian lenders that is collateralized by the assets of Consultant. The proceeds of the lending facility are being used by Lakeland Brazil to alleviate cash flow constraints.

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Pursuant to the Consultancy Agreement, Consultant shall be paid the greater of (i) R$25,000 (Twenty Five Thousand reals) (approximately US $11,000) per month or (ii) 10% (ten percent) of earnings before interest, taxes, depreciation, and amortization of Lakeland Brazil, calculated as of the last day of each calendar quarter in accordance with the Consultancy Agreement. In addition, if during the term of the Consultancy Agreement there is a sale of all of the outstanding capital stock of Lakeland Brazil, Consultant shall be entitled to a commission of 10% of the Net Proceeds (as such term is defined in the Consultancy Agreement) of such sale transaction. The financial analyst shall be paid a fee of R$12,000 (Twelve Thousand reals) (approximately US $5,000) per month.

The financial obligations and other agreements and covenants of Lakeland Brazil or the Company relating to the Company's current financing arrangement with Alostar Bank are not in any way be implicated or otherwise affected by the provisions of the Consultancy Agreement.

16. Goodwill

There was no change in the carrying amount of goodwill during Q3 fiscal year 2015.

17. Recent Accounting Pronouncements

The Company considers the applicability and impact of all accounting standards updates (ASUs). No recent accounting pronouncement is expected to have a material impact on the consolidated financial statements.

18. Litigation

From time to time, we are a party to litigation arising in the ordinary course of our business. Other than the proceedings related to the VAT tax issue described in Note 13, we are not currently a party to any litigation or other legal proceedings that we believe could reasonably be expected to have a material adverse effect on our results of operations, financial condition or cash flows.

On June 26, 2014, Lakeland Brazil, a wholly-owned subsidiary of the Company, received notice of a court judgment entered against it in a labor proceeding in Brazil in the amount of approximately US $1,086,000. Based on the advice of Brazilian counsel handling the action, the Company had not anticipated a judgment to be entered against Lakeland Brazil in this proceeding, if at all, in excess of US $45,000 (R$ 100,000), which amount was deemed not material and therefore not previously disclosed.

Lakeland Brazil is working with, and relying upon the advice of, legal counsel and accountants in Brazil and intends to appeal the judgment on the basis that, among other things, the judgment is mathematically incorrect.

Based on review of the case with our new legal counsel and based upon their assessments of our likelihood to prevail on appeal, the Company has taken a charge to earnings in fiscal 2015 of US $380,000, which is our estimate of what the outcome will ultimately be on this case.

19. Brazil Restructuring and Subsequent Event

Management currently intends to restructure its operations in Brazil because of its failure to progress as planned to profitability.

We intend to close the facility in Salvador, Brazil, sell the real estate and then sell off the remaining old corporation and/or its assets together or separately.

When complete, these changes should result in a substantial pretax restructuring charge and is expected to allow a tax deduction in the USA. Such charges are not expected to generate a net loss after taxes and may result in a net gain after taxes in view of the anticipated tax benefit.

We expect this should be consummated anywhere from Q4 FY15 through Q2 FY16, however these negotiations will be complex and may require more time than anticipated in order to maximize shareholder value.

In connection with the restructuring plan, we plan to create two new corporations potentially relocating them to two different states in Brazil that have more advantageous tax policy, more competitive freight rates, and are located closer to our customer base. In so doing we believe we will be able to further reduce operational overhead and improve customer service. We expect one company to import and sell disposable and chemical garments; the other to import and manufacture fire and FR garments.

The proposed restructuring is subject to a number of factors, including without limitation, future operating results in Brazil and the degree of success of selling assets.

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

This Form 10-Q may contain certain "forward-looking" information within the meaning of the Private Securities Litigation Reform Act of 1995. This information involves risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements.

Overview

We manufacture and sell a comprehensive line of safety garments and accessories for the global industrial protective clothing markets. Our products are sold by our in-house sales force and independent sales representatives to a network of over 1,200 North American safety and mill supply distributors, end-users, and distributors internationally. These distributors in turn supply end user industrial customers, such as integrated oil, utilities, chemical/petrochemical, automobile, steel, glass, construction, smelting, janitorial, pharmaceutical and high technology electronics manufacturers. In addition, we supply federal, state and local governmental agencies and departments domestically and internationally, such as municipal fire and police departments, airport crash rescue units, the military, the Department of Homeland Security and the Centers for Disease Control and state and privately owned utilities and integrated oil companies.

We have operated facilities in Mexico since 1995, in China since 1996 and in Brazil since May 2008. Beginning in 1995, we moved the labor intensive sewing operation for our limited use/disposable protective clothing lines to these facilities. Our facilities and capabilities in China and Mexico allow access to a less expensive labor pool than is available in the United States of America and permit us to purchase certain raw materials at a lower cost than they are available domestically. As we have increasingly moved production of our products to our facilities in Mexico and China, we have seen improvements in the profit margins for these products. Our net sales attributable to customers outside the United States of America were $12.1 million and $11.3 million for the three months ended October 31, 2014 and October 31, 2013, respectively.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based upon our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of our consolidated financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, net sales and expenses and disclosure of contingent assets and liabilities. We base estimates on our past experience and on various other assumptions that we believe to be reasonable under the circumstances, and we periodically evaluate these estimates.

We believe the following critical accounting policies affect our more significant judgments and estimates used in the preparation of our condensed consolidated financial statements.

Revenue Recognition. The Company derives its sales primarily from its limited use/disposable protective clothing and secondarily from its sales of high-end chemical protective suits, firefighting and heat protective apparel, gloves and arm guards and reusable woven garments. Sales are recognized when goods are shipped, at which time title and the risk of loss pass to the customer. Some sales in Brazil may be sold on terms with F.O.B. destination, which are recognized when received by the customer. Sales are reduced for sales returns and allowances. Payment terms are generally net 30 days for United States sales and net 90 days for international sales.

Inventories. Inventories include freight-in, materials, labor and overhead costs and are stated at the lower of cost (on a first-in, first-out basis) or market. Inventory is written down for slow-moving, obsolete or unusable inventory.

In the year ended January 31, 2014, the Company implemented a standardized policy for calculating slow-moving inventory outside the US. Previously, the Company wrote-down the inventory value on an individual product analysis basis.

Allowance for Doubtful Accounts. Trade accounts receivable are stated at the amount the Company expects to collect. The Company maintains allowances for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. Management considers the following factors when determining the collectibility of specific customer accounts:

Customer creditworthiness, past transaction history with the customer, current economic industry trends and changes in customer payment terms. Past due balances over 90 days and other less creditworthy accounts are reviewed individually for collectability. If the financial condition of the Company's customers were to deteriorate, adversely affecting their ability to make payments, additional allowances would be required. Based on management's assessment, the Company provides for estimated amounts through a charge to earnings and a credit to a valuation allowance. Balances that remain outstanding after the Company has used reasonable collection efforts are written off through a charge to the valuation allowance and a credit to accounts receivable.

Income Taxes and Valuation Allowances. We are required to estimate our income taxes in each of the jurisdictions in which we operate as part of preparing our consolidated financial statements. This involves estimating the actual current tax in addition to assessing temporary differences resulting from differing treatments for tax and financial accounting purposes. These differences, together with net operating loss carry forwards and tax credits, are recorded as deferred tax assets or liabilities on our balance sheet. A judgment must then be made of the likelihood that any deferred tax assets will be realized from future taxable income. A valuation allowance may be required to reduce deferred tax assets to the amount that is more likely than not to be realized. In the event we determine that we may not be able to realize all or part of our deferred tax asset in the future, or that new estimates indicate that a previously recorded valuation allowance is no longer required, an adjustment to the deferred tax asset is charged or credited to net income in the period of such determination.

Uncertain Tax Positions. In the event the Company determines that it may not be able to realize all or part of our deferred tax assets in the future, or that new estimates indicate that a previously recorded valuation allowance is no longer required, an adjustment to the deferred tax asset is charged or credited to income in the period of such determination. The Company recognizes tax positions that meet a "more likely than not" minimum recognition threshold.

Valuation of Goodwill and Other Intangible Assets. Goodwill and indefinite lived, intangible assets are tested for impairment at least annually; however, these tests may be performed more frequently when events or changes in circumstances indicate the carrying amount may not be recoverable. Goodwill impairment is evaluated utilizing a two-step process as required by US GAAP. Factors that the Company considers important that could identify a potential impairment include: significant underperformance relative to expected historical or projected future operating results; significant changes in the overall business strategy; and significant negative industry or economic trends. The Company measures any potential impairment on a projected discounted cash flow method. Estimating future cash flows requires the Company's management to make projections that can differ materially from actual results.

Impairment of Long-Lived Assets. The Company evaluates the carrying value of long-lived assets to be held and used when events or changes in circumstances indicate the carrying value may not be recoverable. The carrying value of a long-lived asset is considered impaired when the total projected undiscounted cash flows from the asset are separately identifiable and are less than its carrying value. In that event, a loss is recognized based on the amount by which the carrying value exceeds the fair value of the long-lived asset.

Foreign Currency Risks. The functional currency for the Brazil operation is the Brazil Real; the United Kingdom, the Euro; the trading company in China, the RenminBi; the Canada Real Estate, the Canadian dollar; and the Russia operation, the Russian Ruble and Kazakhstan Tenge. All other operations have the US dollar as its functional currency.

Self-Insured Liabilities. We have a self-insurance program for certain employee health benefits. The cost of such benefits is recognized as expense based on claims filed in each reporting period and an estimate of claims incurred but not reported during such period. Our estimate of claims incurred but not reported is based upon historical trends. If more claims are made than were estimated or if the costs of actual claims increase beyond what was anticipated, reserves recorded may not be sufficient, and additional accruals may be required. We maintain separate insurance to cover the excess liability over set single claim amounts and aggregate annual claim amounts.

Loss Contingencies. Certain conditions may exist as of the date the consolidated financial statements are issued, which may result in a loss to the Company but which will only be resolved when one or more future events occur or fail to occur. The Company's management and its legal counsel assess such contingent liabilities, and such assessment inherently involves an exercise of judgment. In assessing loss contingencies related to legal proceedings that are pending against the Company or unasserted claims that may result in such proceedings, the Company's legal counsel evaluates the perceived merits of any legal proceedings or unasserted claims, as well as the perceived merits of the amount of relief sought or expected to be sought therein.

If the assessment of a contingency indicates that it is probable that a material loss has been or is probable of being incurred and the amount of the liability can be estimated, then the estimated liability would be accrued in the Company's condensed consolidated financial statements. If the assessment indicates that a potentially material loss contingency is not probable, but is reasonably possible, or is probable but cannot be estimated, then the nature of the contingent liability, together with an estimate of the range of possible loss if determinable and material, would be disclosed.

Loss contingencies considered remote are generally not disclosed unless they involve guarantees, in which case the nature of the guarantee would be disclosed.

Significant Balance Sheet Fluctuation October 31, 2014, As Compared to January 31, 2014

Cash increased by $2.5 million, borrowings under the revolving credit facility decreased by $7.3 million and subordinated debt, net of OID decreased by $1.5 million due to the completion of the equity private placement in October 2014, a portion of the proceeds of which were used to fully repay the Company's subordinated debt and to temporarily pay down a portion of the Company's senior revolving credit facility. Inventory net of reserves had a decrease of $1.0 million. Accounts receivable increased $1.3 million primarily due to sales volume in the UK and increased volume in chemical and disposable sales in the US. Prepaid income tax increased $1.0 million for tax refunds receivable in Latin America and the UK. Intangibles, prepaid bank fees and other assets, net decreased $1.0 million primarily due to the early extinguishment of the subordinated debt and the corresponding write off of prepaid bank fees. Accounts payable increased $1.3 million for rebates payable in the USA accrued on a calendar year basis, Mexico accounts payable related to Mexico national sales and China purchases resulting from an increase in production capacity to meet worldwide sales requirements. Accrued compensation and benefits increased $1.2 million primarily as a result of payroll accruals in Brazil for a labor dispute and standardization of payroll accruals for international subsidiaries. Other accrued expenses increased $1.0 million due to taxes payable in the UK and Brazil. Short term borrowing increased $1.1 million mainly as China increased production capacity to meet worldwide sales requirements and where extended payment terms with suppliers are negotiable.

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Three Months ended October 31, 2014, As Compared to the Three Months Ended October 31, 2013

Net Sales. Net sales increased to $25.1 million for the three months ended October 31, 2014 compared to $22.8 million for the three months ended October 31, 2013. Sales in the USA increased $2.3 million due primarily to the strong sales levels in the disposables and chemical divisions related to the Company's response to the Ebola crisis. In view of the arising need for protective clothing for persons that may potentially be exposed to the Ebola virus, USA sales of disposables increased by $1.9 million and chemical sales increased $0.8 million. Wovens sales increased $0.1 million while fire protection sales decreased $0.1 million and reflective sales decreased by $0.3 million as a result of the initial conversion volume for one large utility last year which is not replacement orders. Sales in China and to the Asia Pacific Rim were down $1.2 million or 10.9% due to production capacity and timing issues as Company sales were prioritized over external sales during the Ebola crisis. Other contributing factors that reduced China sales revenue were strategic shifts in woven manufacturing from China to other facilities, a shift in China direct billing into the European market to European billing and a general economic weakness in Australia and corresponding sales into that market. Canada sales increased by $0.7 million or 66% and UK sales increased by $0.4 million or 12.0% mostly due to the Company's Ebola sales. Russia and Kazakhstan sales combined increased by $0.2 million, or 45.5% as these locations continue to grow. Latin America sales increased $0.9 million, or 97.3%, primarily due to an improvement in the Company's ability to clear raw materials purchases through Argentine customs. Sales in Brazil decreased $0.4 million due to manufacturing constraints associated with low cash flow. Numbers may not add due to rounding. The increase in sales of Company protective products arising from the Ebola crisis began late in the quarter ended October 31, 2014. Based on orders and sales to date, the Company expects that a greater number of such additive sales will occur in the quarter ended January 31, 2015, and potentially thereafter depending on when the crisis ceases and the ability of the Company to secure additional orders. The Company has substantially increased its capacity to produce these protective garments.

Gross Profit. Gross profit increased $3.6 million, or 70.7%, to $8.6 million for the three months ended October 31, 2014, from $5.0 million for the three months ended October 31, 2013. Gross profit as a percentage of net sales increased to 34.3% for the three months ended October 31, 2014, from 22.1% for the three months ended October 31, 2013. Major factors driving the changes in gross margins were:

- Disposables gross margin increased by 7.5 percentage points as costs were held steady and strong sales were held steady in response to the Ebola crisis.
- Wovens gross margin increased 20.1 percentage points over a very weak third quarter in the previous year resulting from production inefficiencies that have been normalized year to date.
- Reflective gross margins increased 15.6 percentage points as the USA facility was closed and production was moved to our lower cost Mexico facility.
- Canada gross margins increased by 7.5 percentage points resulting from a change in the sales mix and strong sales in response to the Ebola crisis.
- UK gross margins increased 2.0 percentage points as a result of strong sales, product mix and modest price increases for major customers.
- Brazil's gross margins improved 71.5 percentage points as we continue to address manufacturing inefficiencies continue to be addressed and sales and operations are stabilized along with reserves taken in the prior year.

Chile's gross margin increased 1.6 percentage points primarily as a result of very strong sales volume and steady costs.

- Russia's gross margin increased 16.4 percentage points as volume increased and costs were held level.

Operating Expense. Operating expenses increased $1.8 million, or 30.3%, to $7.9 million for the three months ended October 31, 2014 from $6.1 million for the three months ended October 31, 2013. Operating expenses as a percentage of net sales was 31.6% for the three months ended October 31, 2014 up from 26.7% for the three months ended October 31, 2013. The primary factors comprising this increase were a $1.0 million noncash charge for the tax effect of the change in the performance level of the 2012 Restricted Stock Plan from zero to maximum, a $0.3 million increase in commissions as a result of strong sales volume and a $0.4 million increase in currency fluctuation expense in the UK, Latin America and Brazil.

Operating Profit. Operating profit increased to a profit of $0.7 million for the three months ended October 31, 2014, from $(1.0) million for the three months ended October 31, 2013, mainly as a result of strong sales volume and significantly improved gross profit margins. Operating margins were 2.8% for the three months ended October 31, 2014, compared to (4.5%) for the three months ended October 31, 2013.

Interest Expense. Interest expenses increased $0.1 million to $0.7 million for the three months ended October 31, 2014, from $0.6 million for the three months ended October 31, 2013, due to higher balances outstanding in the USA and more borrowing in Brazil at higher local interest rates currently prevailing. As a result of the payoff of the Company's subordinated debt and temporary reduction of senior debt from the proceeds of the Company's October 2014 equity financing, current interest expense has been substantially reduced.

Income Tax Expense. Income tax expense consists of federal, state and foreign income taxes. Income tax expenses were $0.3 million for the three months ended October 31, 2014, as compared to an income tax expense of $0.3 million for the three months ended October 31, 2013. Income taxes included a noncash charge of $77,000 for the dividend paid by Meiyang to the US in October 2014, a noncash charge of $350,000 for the tax effect of the change in the performance level of the 2012 Restricted Stock plan from zero to maximum and $170,000 of noncash charges in fiscal 2015 for additional US taxes on UK and Canada income. Income taxes also reflect the write-off of $1.6 million relating to the remaining unamortized original issue discount on the subordinated debt repayment which is not deductible for tax purposes.

Net Loss. Net loss increased $(0.7) million to $(2.5) million for the three months ended October 31, 2014 from $(1.8) million for the three months ended October 31, 2013. The net loss for the three months ended October 31, 2014 resulted from a $2.3 million charge to reflect the write-off of OID and unamortized fees resulting from the repayment of the Company's subordinated debt in October 2014, a loss of $0.7 million from operations in Brazil and a noncash charge of $0.7 million net of tax for the change in the performance level of the 2012 Restricted Stock Plan from zero to maximum. In the quarter ended October 31, 2013, the loss from operations in Brazil was $2.1 million.

Nine Months ended October 31, 2014, As Compared to the Nine Months Ended October 31, 2013

Net Sales. Net sales increased $4.0 million, or 5.9%, to $73.2 million for the nine months ended October 31, 2014, from $69.2 million for the nine months ended October 31, 2013. Sales in China and to the Asia Pacific Rim increased by $2.4 million or 7.8% excluding those previous year sales from our Qingdao facility which was sold in June 2013. China sales increased primarily due to growth in the Asia Pacific and China markets. UK sales increased by $0.9 million, or 10.7%. Russia and Kazakhstan sales combined increased $0.2 million or 12.6% as these locations continue to grow. Latin America sales increased $2.0 million, or 77.6%, primarily due to a large sale of fire gear in Ecuador. US domestic sales of disposables increased by $2.9 million and chemical sales increased by $0.2 million mainly due to sales volume associated with the Company's Ebola crisis response, fire protection sales increased $0.9 million as a result of the introduction of new products into the market place, wovens sales decreased $0.5 million and reflective sales decreased by $0.6 million primarily due to the initial conversion volume for one large utility last year which is now replacement sales, for an overall sales gain in the US of $2.9 million, or 7.6%. Sales in Brazil have stabilized under new management but were $0.3 million less than prior year sales. Numbers may not add due to rounding.

Gross Profit. Gross profit increased $5.2 million, or 27.9%, to $23.8 million for the nine months ended October 31, 2014, from $18.6 million for the nine months ended October 31, 2013. Gross profit as a percentage of net sales increased to 32.5% for the nine months ended October 31, 2014, from 26.9% for the nine months ended October 31, 2013. Major factors driving the changes in gross margins were:

- Disposables gross margin remained relatively level at 26.8% as compared to last year of 27.6%.
- Fyrepel gross margin increased by 5.1 percentage points due to higher sales volume.
- Gloves gross margin reflects a large sale of the remaining reserved inventory of Nitrosol gloves.
- Chemical gross margin decreased by 3.7 percentage points resulting from a different sales mix

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- Wovens gross margin increased 6.1 percentage points over a very weak third quarter in the previous year resulting from production inefficiencies that have been normalized year to date.
- UK gross margin was up 1.8 percentage points reflecting higher volume and improved sales mix.
- Reflective gross margins were impacted by a $0.2 million one-time charge for plant relocation.
- Brazil gross margins increased by 40.4 percentage points resulting from resuming normal sales compared with distress pricing and major inventory reserves taken in the previous year and continuing major cost cutting.
- Chile gross margin improved by 19.2 percentage points reflecting a large sale to a fire department in Ecuador.

Operating Expenses. Operating expenses increased $2.4 million, or 13.3%, to $21.0 million for the nine months ended October 31, 2014 from $18.6 million for the nine months ended October 31, 2013. Operating expenses as a percentage of net sales was 28.8% for the nine months ended October 31, 2014 up from 26.9% for the nine months ended October 31, 2013. The primary factors comprising this increase were a $1.0 million noncash charge for the change in the performance level of the 2012 Restricted Stock Plan from zero to maximum, a $0.4 million increase in commission expense resulting from higher volume, a $0.4 million increase in administrative salaries resulting from additional personnel in US, Mexico, UK and Canada for marketing and sales support and three new sales hires in Mexico, and a $0.7 million increase in foreign currency fluctuations in Argentina, Brazil and the UK.

Operating Profit. Operating profit increased to a profit of $2.7 million for the nine months ended October 31, 2014, from $0.0 million for the nine months ended October 31, 2013, mainly as a result of a significant improvement in gross profit margins, improvement of the Brazilian operations resulting from new management's efforts in cost cutting and operating efficiencies, overall improvement in worldwide operations and strong sales volume. Operating margins were 3.8% for the nine months ended October 31, 2014, compared to 0.1% for the nine months ended October 31, 2013.

Interest Expenses. Interest expenses increased $0.6 million to $2.0 million for the nine months ended October 31, 2014, from $1.4 million for the nine months ended October 31, 2013, due to higher balances outstanding in the US and increased borrowing in Brazil at higher local interest rates currently prevailing. Also included in interest expense for fiscal 2015 is a non-cash charge of approximately $0.3 million of amortization of OID on the Subordinated Debt.

Income Tax Expense. Income tax expenses consist of federal, state and foreign income taxes. Income tax expenses were $1.0 million for the nine months ended October 31, 2014, as compared to an income tax benefit of $3.1 million for the nine months ended October 31, 2013. Income taxes included a non-cash charge of $325,000 for the dividend paid by Weifang its Chinese subsidiary in July 2014, and of $77,000 for the dividend paid by its Chinese subsidiary Meiyang to the US in October 2014, a noncash charge of $350,000 for the change in the performance level of the 2012 Restricted Stock Plan from zero to maximum, and $170,000 of non-cash charges in fiscal 2015 for additional US taxes on UK and Canada income. Income taxes also reflect the write-off of $1.6 million relating to the remaining unamortized original issue discount on the subordinated debt repayment which is not deductible for tax purposes. The prior year included a reversal of a deferred tax valuation reserve of $4.5 million.

Net Loss. Net loss increased $(4.4) million to $(2.9) million loss for the nine months ended October 31, 2014, from $1.5 million income for the nine months ended October 31, 2013, mainly due to the charge of $2.3 million for early extinguishment of the Subordinated Debt and the $(0.8) million net loss in Brazil and a noncash charge of $0.7 million net of tax for the change in the performance level of the 2012 Restricted Stock Plan from zero to maximum.

Brazil Restructuring. Management is in the process of planning to restructure its operations in Brazil because of its failure to progress as planned to profitability.

We plan to close the facility in Salvador, Brazil, sell the real estate and then sell off the remaining old corporation and/or its assets together or separately.

We expect these changes to result in a substantial pretax restructuring charge and allow a tax deduction in the USA. Such charges are not expected to generate a net loss after taxes and may result in a net gain after taxes in view of the anticipated tax benefit.

We expect this should be consummated anywhere from Q4 FY15 through Q2 FY16, however these negotiations will be complex and may require more time than anticipated in order to maximize shareholder value.

In connection with the restructuring plan, we plan to create two new corporations potentially relocating them to two different states in Brazil that have more advantageous tax policy, more competitive freight rates, and are located closer to our customer base. In so doing we believe we will be able to further reduce operational overhead and improve customer service. We expect one company to import and sell disposable and chemical garments; the other to import and manufacture fire and FR garments.

The proposed restructuring is subject to a number of factors, including without limitation, future operating results in Brazil and the degree of success of selling assets.

Liquidity and Capital Resources

Cash Flows. As of October 31, 2014, we had cash and cash equivalents of approximately $7.0 million and working capital of $45.5 million. Cash and cash equivalents increased $2.4 million and working capital increased $7.0 million from January 31, 2014 primarily as a result of the net cash proceeds of $6.6 million from the October 2014 private equity financing and cash management. International cash management is affected by local requirements and movements of cash across borders can be slowed down significantly.

Net cash provided by operating activities of $3.2 million for the nine-months ended October 31, 2014 was primarily due to a decrease to inventories of $1.1 million resulting from strong sales volume, the early extinguishment of subordinated debt and write-off of unamortized original issue discount and bank fees of $2.3 million, $0.9 million of non-cash interest expense resulting from amortization of warrant OID and PIK interest, an increase of $1.4 million in accounts payable resulting from capacity production levels, an increase to accrued compensation and benefits of $1.2 million resulting from accruals in Brazil for severance and increased accrued expenses of $1.2 million of primarily foreign income tax. These activities were offset by a decrease in accounts receivables of $1.5 million, an increase in income and VAT prepaid taxes of $1.0 million, reductions of inventory reserves and bad debt provision in a combined total of $0.7 million and a net loss of $2.2 million. Net cash used in financing activities was $(0.2) million in the nine-months ended October 31, 2014, due to net borrowings under the credit agreement, new financing in the US, the early extinguishment of the subordinated debt and China and Brazil new borrowings.

We currently have one Senior credit facility: A $15.0 million revolving credit facility which commenced June 28, 2013, of which we had $5.1 million of borrowings outstanding as of October 31, 2014, expiring on June 30, 2016 at a current per annum rate of 6.25%. Maximum availability in excess of amount outstanding at October 31, 2014 was $9.9 million. Our current credit facility requires, and any future credit facilities may also require, that we comply with specified financial covenants relating to earnings before interest, taxes, depreciation and amortization and others relating to fixed charge coverage ratio and limits on capital expenditures and investments in foreign subsidiaries. Our ability to satisfy these financial covenants can be affected by events beyond our control, and we cannot guarantee that we will meet the requirements of these covenants. These restrictive covenants could affect our financial and operational flexibility or impede our ability to operate or expand our business. Default under our credit facilities would allow the lenders to declare all amounts outstanding to be immediately due and payable. Our lenders, including BDC (our Canadian lender), have a security interest in substantially all of our US and Canadian assets and pledges of 65% of the equity of the Company's foreign subsidiaries, outside Canada. If our lenders declare amounts outstanding under any credit facility to be due, the lenders could proceed against our assets. Any event of default, therefore, could have a material adverse effect on our business. Our current availability under our Credit Facility, coupled with our anticipated operating cash and cash management strategy, is expected to be sufficient to cover our liquidity needs for the next 12 months.

As a use of proceeds from the Equity raise of $11.1 million which closed in October 2014, the remaining principal and accrued PIK interest from this Subordinated Debt was repaid at closing. The early extinguishment of the Subordinated Debt, however, has resulted in a one-time pretax NON-CASH charge of approximately $1.6 million for the remaining unamortized original issue discount on the Subordinated Debt and a pretax NON-CASH charge of approximately $0.6 million for the remaining unamortized fees paid at the closing of the June 2013 Subordinated Debt financing.

Capital Expenditures. Our capital expenditures principally relate to purchases of manufacturing equipment, computer equipment and leasehold improvements. We anticipate FY15 and FY16 capital expenditures not to exceed $1.0 million for each year.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Not applicable

Item 4. Controls and Procedures

Disclosure Controls and Procedures

We conducted an evaluation, under the supervision and with the participation of our management, including the Chief Executive Officer and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the "Exchange Act")) as of October 31, 2014. There are inherent limitations to the effectiveness of any system of disclosure controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective disclosure controls and procedures can only provide reasonable assurance of achieving their control objectives. Based on their evaluation, the Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective as of October 31, 2014 based on the material weaknesses described below.

Management's Report on Internal Control over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act. Our internal control system is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accepted accounting principles generally accepted in the United States of America.

Because of inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions or that the degree of compliance with the policies or procedures may deteriorate.

A material weakness is a deficiency, or a combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis.

Management has assessed the effectiveness of the Company's internal control over financial reporting as of October 31, 2014. In making this assessment, management used the criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) as issued in 1992. Based upon an evaluation performed, our management concluded that our internal control over financial reporting was not effective as of October 31, 2014. We have identified the material weaknesses below:

<u>China</u>

In FY13 the Company determined that there were inadequate controls and procedures in place in China. The Company further determined in Q3 of FY14, partially as a result of the change in management with the International Controller departure in Q2, that the Company's intended remediation was not adequate. Management devoted considerable time in Q3 and Q4 of FY14 to resolving the accounting issues, and management is confident the financial reporting is correct at October 31, 2014. Management intends to further remediate the internal controls in place in China and to make changes as appropriate during FY15, including changes in financial accounting management personnel.

In May and June 2014, the Company hired a new controller for China and also an additional internal auditor. These two new hires are getting acclimated to their position and are in the process of remediating this material weakness.

Brazil

Management determined in FY14 that we did not have adequate internal controls in place in Brazil which constituted a material weakness. The Company has operated without adequate cash resources in Brazil and our loan agreements in the USA precluded us from sending any more cash to Brazil. As a result, we were not able to invest funds in Brazil to improve internal controls until the operation could be returned to profitability. In FY14 we completely changed the senior management in Brazil and recruited and hired a new CEO specializing in turnaround situations who started in September 2013 and recruited a new CFO who started in February 2014. It was not possible to address the internal controls in Brazil until late in Q4 of FY14 at which time the Company engaged an outside CPA firm in Brazil to review the internal controls and procedures. Their report was rendered March 29, 2014. The conclusion of the report was that the design of the activity/process controls does not meet the minimum requirements needed for information security controls. In addition, the report indicated that the controls resulted in high exposure in the areas of purchase, accounting closing, sales, financial, production, payroll, and logistics. Since the material weakness was identified prior to January 31, 2014, action was taken by management such that it did not result in a misstatement for the fiscal year ended January 31, 2014 or for the quarters ended April 30, 2014, July 31, 2014 and October 31, 2014. However, the material weakness in internal controls was not fully remediated before FY14 year-end or by October 31, 2014 and could result in misstatements impacting all accounts and disclosures that would result in a material misstatement of the financial statements that would not be prevented or detected. Accordingly, management has determined that this control deficiency constitutes a material weakness.

Failure of Entity Level Controls

As a result of the multiple material weaknesses identified above regarding financial reporting in international locations, the Company concluded that it does not have sufficient internal controls in place to monitor the internal controls in remote locations. In addition, the Company had not performed a sufficient level of review of the financial information from the foreign subsidiaries to ensure that all general ledger accounts are reconciled and that estimates are properly stated. Since the material weakness was identified prior to January 31, 2014 and all accounts were properly reconciled and reviewed, it did not result in a misstatement for the fiscal year-end January 31, 2014. While the Company believes it has taken the appropriate steps to initiate the remediation of the weaknesses, several of these steps will take time to complete and thus it was unable to complete by October 31, 2014 the remediation of the material weakness from FY13 and others identified in FY14.

Since the Company qualifies as a smaller reporting company, an attestation report of management's assessment of internal control by our independent auditors is not required.

Changes in Internal Control over Financial Reporting

Though the Company has made progress in the remediation of the material weaknesses disclosed above, there have been no changes in the Company's internal control over financial reporting that occurred during the Company's third quarter of fiscal 2015 that has materially affected, or is reasonably likely to materially affect, the Company's internal control over financial reporting:

All internal control testing that cannot be conducted by existing personnel will be outsourced. The internal control program will be monitored/tested in a manner consistent with full Sarbanes-Oxley compliance.

PART II. OTHER INFORMATION

Items 1, 1A, 2, 3, 4 and 5 are not applicable

Item 6. Exhibits:

Exhibits:

31.1 Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32.1 Certification of Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

101.INS XBRL instance Document
101.SCH XBRL Taxonomy Extension Schema Document
101.CAL XBRL Taxonomy Extension Definitions Document
101.DEF XBRL Taxonomy Extension Labels Document
101.LAB XBRL Taxonomy Extension Labels Document
101.PRE XBRL Taxonomy Extension Presentations Document

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

	LAKELAND INDUSTRIES, INC. (Registrant)
Date: December 10, 2014	/s/ Christopher J. Ryan Christopher J. Ryan, Chief Executive Officer, President and Secretary (Principal Executive Officer and Authorized Signatory)
Date: December 10, 2014	/s/Gary Pokrassa Gary Pokrassa, Chief Financial Officer (Principal Accounting Officer and Authorized Signatory)

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