

HARMAN INTERNATIONAL INDUSTRIES INC /DE/
Form 10-Q
November 09, 2006

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**
Washington, D.C. 20549

Form 10-Q

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended **September 30, 2006**

Commission File Number: **1-9764**

Harman International Industries, Incorporated

(Exact name of registrant as specified in its charter)

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

11-2534306
*(I.R.S. Employer
Identification No.)*

1101 Pennsylvania Avenue, NW, Suite 1010
Washington, DC
(Address of principal executive offices)

20004
(Zip code)

(202) 393-1101
(Registrant's telephone number, including area code)

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of October 31, 2006, 65,264,950 shares of common stock, par value \$.01, were outstanding.

**Harman International Industries, Incorporated and Subsidiaries
Form 10-Q**

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References to "Harman International," the "Company," "we," "us," and "our" in this Form 10-Q refer to Harman International Industries, Incorporated and its subsidiaries unless the context requires otherwise.

Forward-Looking Statements

This report contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and 21E of the Securities Exchange Act of 1934. You should not place undue reliance on these statements. Forward-looking statements include information concerning possible or assumed future results of operations, capital expenditures, the outcome of pending legal proceedings and claims, including environmental matters, goals and objectives for future operations, including descriptions of our business strategies and purchase commitments from customers. These statements are typically identified by words such as “believe,” “anticipate,” “expect,” “plan,” “intend,” “estimate” and similar expressions. We base these statements on particular assumptions that we have made in light of our industry experience, as well as our perception of historical trends, current conditions, expected future developments and other factors that we believe are appropriate under the circumstances. As you read and consider the information in this report, you should understand that these statements are not guarantees of performance or results. They involve risks, uncertainties and assumptions. In light of these risks and uncertainties, there can be no assurance that the results and events contemplated by the forward-looking statements contained in, or incorporated by reference into, this report will in fact transpire.

You should carefully consider the risks described below and the other information in this report. Our operating results may fluctuate significantly and may not meet our expectations or those of securities analysts or investors. The price of our stock would likely decline if this occurs. Factors that may cause fluctuations in our operating results include, but are not limited to, the following:

- automobile industry sales and production rates and the willingness of automobile purchasers to pay for the option of a premium audio system and/or a multi-functional infotainment system;
- changes in consumer confidence and spending;
- fluctuations in currency exchange rates and other risks inherent in international trade and business transactions;
- the ability to satisfy contract performance criteria, including technical specifications and due dates;
- the loss of one or more significant customers, including our automotive manufacturer customers;
- competition in the automotive, consumer or professional markets in which we operate;
- model-year changeovers in the automotive industry;
- changes in general economic conditions and specific market conditions;
- our ability to enforce or defend our ownership and use of intellectual property;
- our ability to effectively integrate acquisitions;
- strikes, work stoppages and labor negotiations at our facilities, or at a facility of one of our significant customers; or work stoppages at a common carrier or a major shipping location;
- the outcome of pending or future litigation and administrative claims, including patent and environmental matters; and
- world political stability.

Although we believe that these forward-looking statements are based on reasonable assumptions, you should be aware that many factors could affect our actual financial results or results of operations and could cause actual results to differ materially from those expressed in the forward-looking statements. As a result, the forgoing factors should not be construed as exhaustive and should be read together with the other cautionary statements included in this and other reports we file with the Securities and Exchange Commission, including the information in Item 1A, “Risk Factors” of Part I to our Annual Report on Form 10-K for the fiscal year ended June 30, 2006.

Part I. FINANCIAL INFORMATION**Item 1. Financial Statements**

Condensed Consolidated Balance Sheets
Harman International Industries, Incorporated and Subsidiaries
(\$000s omitted except share amounts)

| | September 30, 2006 | June 30, 2006 |
|-------------------------------------------------------------------------------------------------------------------------------------------------------|--------------------------|------------------|
| | (Unaudited) | |
| Assets | | |
| Current assets | | |
| Cash and cash equivalents | \$ 134,983 | 291,758 |
| Receivables (less allowance for doubtful accounts of \$8,935 at September 30, 2006 and \$8,738 at June 30, 2006) | 461,004 | 444,474 |
| Inventories | 379,299 | 344,957 |
| Other current assets | 179,915 | 168,168 |
| Total current assets | 1,155,201 | 1,249,357 |
| Property, plant and equipment, net | 501,448 | 521,935 |
| Goodwill | 381,517 | 381,219 |
| Other assets | 197,532 | 202,150 |
| Total assets | \$ 2,235,698 | 2,354,661 |
| Current liabilities | | |
| Short-term borrowings | \$ 2,786 | 1,751 |
| Current portion of long-term debt | 16,989 | 16,337 |
| Accounts payable | 251,672 | 320,327 |
| Accrued liabilities | 398,618 | 414,093 |
| Income taxes payable | 123,967 | 116,493 |
| Total current liabilities | 794,032 | 869,001 |
| Borrowings under revolving credit facility | 150,108 | 159,900 |
| Senior notes | 2,917 | 19,566 |
| Minority interest | 2,427 | 2,716 |
| Other non-current liabilities | 75,424 | 75,314 |
| Shareholders' equity | | |
| Preferred stock, \$.01 par value. Authorized 5,000,000 shares; none issued and outstanding | --- | --- |
| Common stock, \$.01 par value. Authorized 200,000,000 shares; issued and outstanding 82,808,778 at September 30, 2006 and 82,754,909 at June 30, 2006 | 827 | 827 |
| Additional paid-in capital | 549,202 | 544,871 |
| Accumulated other comprehensive income (loss): | | |
| Unrealized loss on hedging derivatives | (1,829) | (3,267) |
| Minimum pension liability adjustment | (11,785) | (11,789) |
| Cumulative foreign currency translation adjustment | 58,368 | 64,280 |
| Retained earnings | 1,199,859 | 1,144,070 |
| Less common stock held in treasury (17,611,282 shares at September 30, 2006 and 16,690,182 at June 30, 2006) | (583,852) | (510,828) |
| Total shareholders' equity | 1,210,790 | 1,228,164 |
| Total liabilities and shareholders' equity | \$ 2,235,698 | 2,354,661 |

See accompanying notes to condensed consolidated financial statements.

Condensed Consolidated Statements of Operations
Harman International Industries, Incorporated and Subsidiaries
(000s omitted except per share amounts)
(Unaudited)

| | Three months ended September 30, | |
|--------------------------------------------------|-------------------------------------|---------|
| | 2006 | 2005 |
| Net sales | \$ 825,543 | 754,648 |
| Cost of sales | 538,254 | 488,353 |
| Gross profit | 287,289 | 266,295 |
| Selling, general and administrative expenses | 200,371 | 188,102 |
| Operating income | 86,918 | 78,193 |
| Other expenses: | | |
| Interest expense, net | 139 | 3,839 |
| Miscellaneous, net | 861 | 614 |
| Income before income taxes and minority interest | 85,918 | 73,740 |
| Income tax expense, net | 29,635 | 19,773 |
| Minority interest | (325) | --- |
| Net income | \$ 56,608 | 53,967 |
| Basic earnings per share | \$ 0.86 | 0.82 |
| Diluted earnings per share | \$ 0.85 | 0.79 |
| Weighted average shares outstanding – basic | 65,517 | 66,117 |
| Weighted average shares outstanding – diluted | 66,676 | 68,477 |

See accompanying notes to condensed consolidated financial statements.

Condensed Consolidated Statements of Cash Flows
Harman International Industries, Incorporated and Subsidiaries
(\$000s omitted)
(Unaudited)

| | Three months ended September 30, | |
|-----------------------------------------------------------------------------------|-------------------------------------|----------|
| | 2006 | 2005 |
| Cash flows from operating activities: | | |
| Net income | \$ 56,608 | 53,967 |
| Adjustments to reconcile net income to net cash provided by operating activities: | | |
| Depreciation and amortization | 29,863 | 32,571 |
| (Gain)/loss on disposition of assets | 1,378 | (52) |
| Stock option expense | 3,697 | 3,879 |
| Changes in working capital, net of acquisition/disposition effects: | | |
| Decrease (increase) in: | | |
| Receivables | (18,940) | 3,724 |
| Inventories | (36,464) | (20,117) |
| Other current assets | (12,633) | (13,531) |
| Increase (decrease) in: | | |
| Accounts payable | (67,214) | (51,631) |
| Accrued liabilities | (12,086) | 15,236 |
| Income taxes payable | 8,468 | 4,366 |
| Other operating activities | 2,710 | 2,793 |
| Net cash provided by (used in) operating activities | \$ (44,613) | 31,205 |
| Cash flows from investing activities: | | |
| Payment for purchase of companies, net of cash acquired | \$ (2,130) | (7,522) |
| Proceeds from asset dispositions | 389 | 202 |
| Capital expenditures | (12,430) | (21,392) |
| Other items, net | 2,145 | (1,332) |
| Net cash used in investing activities | \$ (12,026) | (30,044) |
| Cash flows from financing activities: | | |
| Net increase (decrease) in short-term borrowings | \$ 1,053 | (414) |
| Net borrowings (repayments) under revolving credit facility | (8,567) | 65,000 |
| Repayment of long-term debt | (13,168) | --- |
| Other decrease in long-term debt | (2,397) | (80) |
| Repurchase of common stock | (73,024) | (75,273) |
| Dividends paid to shareholders | (819) | (827) |
| Exercise of stock options | 634 | (1,337) |
| Net cash used in financing activities | \$ (96,288) | (12,931) |
| Effect of exchange rate changes on cash | (3,848) | (527) |
| Net decrease in cash and cash equivalents | (156,775) | (12,297) |
| Cash and cash equivalents at beginning of period | \$ 291,758 | 291,214 |
| Cash and cash equivalents at end of period | \$ 134,983 | 278,917 |
| Supplemental disclosure of cash flow information: | | |
| Interest paid | \$ 2,109 | 6,160 |
| Income taxes paid | \$ 20,877 | 13,452 |
| Supplemental schedule of non-cash investing activities: | | |
| Fair value of assets acquired | \$ --- | 9,258 |
| Cash paid for the assets | --- | 6,133 |
| Liabilities assumed | \$ --- | 3,125 |

See accompanying notes to condensed consolidated financial statements.

HARMAN INTERNATIONAL INDUSTRIES, INCORPORATED AND SUBSIDIARIESNotes to Condensed Consolidated Financial Statements
(Unaudited)**Note 1. Basis of Presentation**

Our unaudited, condensed consolidated financial statements at September 30, 2006 and for the three months ended September 30, 2006 and 2005, have been prepared pursuant to rules and regulations of the Securities and Exchange Commission ("SEC"). These unaudited condensed consolidated financial statements do not include all information and footnote disclosures included in our audited financial statements. In the opinion of management, the accompanying unaudited, condensed consolidated financial statements include all adjustments, consisting of normal recurring adjustments and accruals, necessary to present fairly, in all material respects, the consolidated financial position, results of operations and cash flows for the periods presented. Operating results for the three months ended September 30, 2006 are not necessarily indicative of the results that may be expected for the full fiscal year ending June 30, 2007 due to seasonal, economic and other factors.

Where necessary, information for prior periods has been reclassified to conform to the consolidated financial statement presentation for the corresponding periods in the current fiscal year.

These unaudited condensed consolidated financial statements should be read in conjunction with our audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the fiscal year ended June 30, 2006.

Note 2. Inventories

Inventories consist of the following:

| (\$000s omitted) | September 30, 2006 | June 30, 2006 |
|------------------|-----------------------|------------------|
| Finished goods | \$ 168,635 | 147,663 |
| Work in process | 51,188 | 45,954 |
| Raw materials | 159,476 | 151,340 |
| Total | \$ 379,299 | 344,957 |

Inventories are stated at the lower of cost or market. Cost is determined principally by the first-in, first-out method. The valuation of inventory requires us to make judgments and estimates regarding obsolete, damaged or excess inventory as well as current and future demand for our products. The estimates of future demand along with analysis of usage data that we use in the valuation of inventory are the basis for our inventory reserves and have an effect on our results of operations. We calculate inventory reserves using a combination of a lower of cost or market analysis, an analysis of historical usage data, forecast demand data and historical disposal rates. Lower of cost or market analysis is typically applied to those items of inventory that represent a substantial portion of the total value of inventory on-hand. The high-value units typically represent a small percentage of the total inventory items, so identification of obsolescence or valuation reserve requirements for the balance of the inventory on-hand is accomplished using either historical or forecast usage to identify slow-moving or obsolete items.

Note 3. Warranty Liabilities

We warrant our products to be free from defects in materials and workmanship for a period ranging from one to five years from the date of purchase, depending on the product. The warranty is a limited warranty, and it may impose certain shipping costs on the customer and excludes deficiencies in appearance except for those evident when the product is delivered. Our dealers and warranty service providers normally perform warranty service for loudspeakers and electronics in the field, using parts supplied on an exchange basis by our company. Estimated warranty liabilities are based upon past experience with similar types of products, the technological complexity of certain products, replacement cost and other factors. We take these factors into consideration when assessing the adequacy of our warranty provisions for periods still open to claim.

Details of the estimated warranty liability are as follows:

| (\$000s omitted) | Three months ended | |
|-------------------------------------|--------------------|---------------|
| | September 30, | |
| | 2006 | 2005 |
| Beginning balance (June 30) | \$ 60,768 | 48,582 |
| Warranty provisions | 12,545 | 11,521 |
| Warranty payments (cash or in-kind) | (9,830) | (7,681) |
| Ending balance | <u>\$ 63,483</u> | <u>52,422</u> |

The warranty liabilities are included in accrued liabilities.

Note 4. Comprehensive Income

The components of comprehensive income are as follows:

| (\$000s omitted) | Three months ended | |
|--------------------------------------|--------------------|---------------|
| | September 30, | |
| | 2006 | 2005 |
| Net income | \$ 56,608 | 53,967 |
| Other comprehensive income (loss): | | |
| Foreign currency translation | (5,912) | (3,634) |
| Unrealized gains on hedging | 1,438 | 500 |
| Minimum pension liability adjustment | 4 | 15 |
| Total comprehensive income | <u>\$ 52,138</u> | <u>50,848</u> |

The components of accumulated other comprehensive income (loss) as of September 30, 2006 and June 30, 2006 and the activity for the three months ended September 30, 2006 are presented below:

| (\$000s omitted) | Unrealized loss on hedging derivatives | Minimum pension liability adjustment | Cumulative foreign currency translation adjustment | Accumulated other comprehensive income (loss) |
|-----------------------------------------------------------|-------------------------------------------------|-----------------------------------------------|----------------------------------------------------------------|--------------------------------------------------------|
| June 30, 2006 | \$ (3,267) | (11,789) | 64,280 | 49,224 |
| Foreign currency translation adjustments | --- | --- | (5,912) | (5,912) |
| Change in fair value of foreign currency cash flow hedges | 1,438 | --- | --- | 1,438 |
| Minimum pension liability adjustment | --- | 4 | --- | 4 |
| September 30, 2006 | <u>\$ (1,829)</u> | <u>(11,785)</u> | <u>58,368</u> | <u>44,754</u> |

Note 5. Earnings Per Share

The following table presents the calculation of basic and diluted earnings per common share outstanding:

| (000s omitted except per share amounts) | Three months ended September 30, | | | |
|-------------------------------------------|----------------------------------|----------------|---------------|----------------|
| | 2006 | | 2005 | |
| | <u>Basic</u> | <u>Diluted</u> | <u>Basic</u> | <u>Diluted</u> |
| Net income | <u>\$ 56,608</u> | <u>56,608</u> | <u>53,967</u> | <u>53,967</u> |
| Weighted average shares outstanding | 65,517 | 65,517 | 66,117 | 66,117 |
| Employee stock options | --- | <u>1,159</u> | --- | <u>2,360</u> |
| Total weighted average shares outstanding | <u>65,517</u> | <u>66,676</u> | <u>66,117</u> | <u>68,477</u> |
| Earnings per share | <u>\$ 0.86</u> | <u>0.85</u> | <u>0.82</u> | <u>0.79</u> |

Certain options were outstanding and not included in the computation of diluted earnings per share because the assumed exercise of these options would have been antidilutive. Options to purchase 1,338,043 shares of our common stock with exercise prices ranging from \$75.22 to \$126.94 per share during the quarter ended September 30, 2006, were outstanding and not included in the computation of diluted earnings per share because the exercise of these options would have been antidilutive.

Options to purchase 751,265 shares of our common stock at prices ranging from \$75.22 to \$126.94 per share during the quarter ended September 30, 2005 were outstanding and not included in the computation of diluted earnings per share because the exercise of these options would have been antidilutive.

Note 6. Stock Options

On September 30, 2006, we had one share-based compensation plan with shares available for future grants, the 2002 Option Plan, which is described below. Share-based compensation expense was \$3.7 million and \$3.9 million for the quarters ended September 30, 2006 and 2005, respectively, and has been recorded in selling, general and administrative expense for the quarters ended September 30, 2006 and 2005. The total income tax benefit recognized in the income statement for share-based compensation arrangements was \$1.0 million and \$1.1 million for the quarters ended September 30, 2006 and 2005, respectively.

Fair Value Determination

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model, which uses the assumptions noted in the following table.

| | Three months ended September 30, | |
|-----------------------------|----------------------------------|--------|
| | 2006 | 2005 |
| Expected volatility | 36.0% – 42.0% | 38.0% |
| Weighted-average volatility | 39.4% | 38.0% |
| Expected annual dividend | \$0.05 | \$0.05 |
| Expected term (in years) | 1.55 – 7.65 | 4.24 |
| Risk-free rate | 4.6% – 5.0% | 3.9% |

Groups of option holders (directors, executives and non-executives) that have similar historical behavior are considered separately for valuation purposes. Expected volatilities are based on historical closing prices of our common stock over the expected option term. We use historical data to estimate option exercises and employee terminations within the valuation model. The expected term of options granted is derived using the option valuation model and represents the estimated period of time from the date of grant that the option is expected to remain outstanding. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant.

Stock Option Activity

A summary of option activity under our stock option plans as of September 30, 2006 and changes during the quarter is presented below:

| | Shares | Weighted average exercise price | Weighted average remaining contractual term (years) | Aggregate intrinsic value (\$000s omitted) |
|-----------------------------------|------------------|------------------------------------------|--------------------------------------------------------------------|-----------------------------------------------------|
| Outstanding at June 30, 2006 | 3,299,720 | \$ 47.04 | | |
| Granted | 254,000 | 78.07 | | |
| Exercised | (47,210) | 15.74 | | |
| Forfeited or expired | <u>(85,200)</u> | 84.61 | | |
| Outstanding at September 30, 2006 | <u>3,421,310</u> | <u>48.84</u> | <u>6.39</u> | <u>\$ 124,833</u> |
| Exercisable at September 30, 2006 | <u>1,937,840</u> | <u>\$ 30.34</u> | <u>5.02</u> | <u>\$ 104,732</u> |

The weighted-average grant-date fair value of options granted during the quarters ended September 30, 2006 and 2005 was \$34.43 and \$29.08, respectively. The total intrinsic value of options exercised during the quarters ended September 30, 2006 and 2005 was \$3.1 million and \$16.9 million, respectively.

A summary of the status of our nonvested restricted stock shares as of September 30, 2006 and changes during the quarter is presented as follows:

| | Shares | Weighted average grant-date fair value |
|---------------------------------|-----------------|----------------------------------------------|
| Nonvested at June 30, 2006 | 37,000 | \$ 85.36 |
| Granted | --- | --- |
| Vested | --- | --- |
| Forfeited | <u>(25,000)</u> | <u>\$ 86.98</u> |
| Nonvested at September 30, 2006 | <u>12,000</u> | <u>\$ 82.00</u> |

As of September 30, 2006, there was \$0.5 million of total unrecognized compensation cost related to nonvested restricted share-based compensation arrangements granted under the 2002 Option Plan. The weighted average recognition period is 1.88 years. No restricted shares vested in the quarters ended September 30, 2006 and 2005.

Note 7. Business Segment Data

We design, manufacture and market high-quality, high fidelity audio products and electronic systems for the automotive, consumer and professional markets. We organize our businesses into reporting segments based upon the end-user markets served. Our chief operating decision makers evaluate performance and allocate resources primarily based on net sales, operating income and working capital in each of the reporting segments. We report on the basis of three segments: Automotive, Consumer and Professional.

Our Automotive segment designs, manufactures and markets audio, electronic and infotainment systems for vehicle applications primarily to be installed as original equipment by automotive manufacturers. Our automotive products and systems are marketed worldwide under brand names including JBL, Infinity, Harman/Kardon, Becker, Logic 7 and Mark Levinson. Our premium branded audio, video, navigation and infotainment systems are offered to automobile manufacturers through engineering and supply agreements. See Note 12 "Significant Customers."

Our Consumer segment designs, manufactures and markets audio, video and electronic systems for home, mobile and multimedia applications. Our Consumer home products and systems are marketed worldwide under brand names including JBL, Infinity, Harman/Kardon, Lexicon, Mark Levinson and Revel. Our audio and electronic products are offered through audio/video specialty and retail chain stores. Our branded audio products for multimedia applications are focused on retail customers that sell products designed to enhance sound for computers, Apple's iPods and other music control players.

The Professional segment designs, manufactures and markets loudspeakers and electronic systems used by audio professionals in concert halls, stadiums, airports and other public spaces. We also create products for recording, broadcast, cinema and music reproduction applications. Our Professional products are marketed worldwide under brand names including JBL Professional, AKG, Crown, Soundcraft, Lexicon, Digitech, dbx and Studer. We provide high-quality products to the sound reinforcement, music instrument support and broadcast and recording segments of the professional audio market. We offer complete systems solutions for professional installations and users around the world.

The following table reports net sales and operating income (loss) by each reporting segment:

| (\$000s omitted) | Three months ended September 30, | |
|--------------------------|-------------------------------------|----------------|
| | 2006 | 2005 |
| Net sales: | | |
| Automotive | \$ 600,998 | 520,296 |
| Consumer | 93,126 | 111,368 |
| Professional | 131,419 | 122,984 |
| Total | <u>\$ 825,543</u> | <u>754,648</u> |
| Operating income (loss): | | |
| Automotive | \$ 90,168 | 73,937 |
| Consumer | (4,449) | 10,578 |
| Professional | 17,075 | 12,867 |
| Other | (15,876) | (19,189) |
| Total | <u>\$ 86,918</u> | <u>78,193</u> |

Other operating loss is comprised of activity related to our corporate operations, net of reporting segment allocations.

Note 8. Derivatives

We use foreign currency forward contracts to hedge a portion of our forecasted transactions. These forward contracts are designated as foreign currency cash flow hedges and recorded at fair value in the accompanying consolidated balance sheet with a corresponding entry to other accumulated comprehensive income (loss) until the underlying forecasted foreign currency transaction occurs.

When the transaction occurs, the gain or loss from the derivative designated as a hedge of the transaction is reclassified from accumulated other comprehensive income (loss) to the same income statement line item in which the foreign currency gain or loss on the underlying hedged transaction is recorded. When it becomes apparent that an underlying forecasted transaction will not occur, the amount recorded in accumulated other comprehensive income (loss) related to the hedge is reclassified to the miscellaneous, net line of the income statement in the then-current period.

Because the amounts and the maturities of the derivatives approximate those of forecasted exposures, changes in the fair value of the derivatives are highly effective in offsetting changes in the cash flows of the hedged items. When it has been determined that a hedge has become ineffective, the ineffective portion of the hedge is recorded in current earnings.

At September 30, 2006, we had contracts maturing through June 2007 to sell Euros and purchase U.S. dollars of approximately \$56.1 million to hedge future foreign currency purchases. At September 30, 2006, the amount associated with these hedges that is expected to be reclassified from accumulated other comprehensive income (loss) to earnings within the next twelve months is a loss of approximately \$1.8 million. This amount also represents the fair market value of these foreign currency forward contracts at September 30, 2006. In the three months ended September 30, 2006 we recognized approximately \$0.4 million in net losses from cash flow hedges of forecasted foreign currency transactions compared to \$1.2 million in net gains in the same period last year.

As of September 30, 2006, we had contracts maturing through January 2007 to purchase and sell the equivalent of \$49.3 million of various currencies to hedge foreign currency denominated loans to foreign subsidiaries. These loans are of a long-term investment nature and are not designated in cash flow hedging relationships. Adjustments to the carrying value of the foreign currency forward contracts offset the gains and losses on the underlying remeasurement of loans. At September 30, 2006, the market value on these contracts was a net gain of \$0.1 million.

Note 9. Commitments and Contingencies

At September 30, 2006, we were involved in several legal actions. The outcome of these legal actions cannot be predicted with certainty; however, management, based upon advice from legal counsel, believes such actions are either without merit or will not have a material adverse effect on our financial position or results of operations. In fiscal 2005, we recorded a \$6 million liability for probable unasserted claims. There was no change in the status of these claims at September 30, 2006.

At September 30, 2006, our Board of Directors has authorized the repurchase of a total of up to 20 million shares of common stock. During the quarter ended September 30, 2006, we repurchased 921,100 shares of our common stock at a total cost of \$73.0 million. Through September 30, 2006, we had acquired and placed in treasury 17,611,282 shares of our common stock at a total cost of \$583.9 million. We expect future share repurchases to be funded primarily with cash generated by operations.

Note 10. Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (“FASB”) issued Statement of Financial Accounting Standards (“SFAS”) No. 157, *Fair Value Measurements*. The statement defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles in the United States of America (“GAAP”), and enhances disclosures about fair value measurements. This statement applies when other accounting pronouncements require fair value measurements; it does not require new fair value measurements. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. We do not expect SFAS No. 157 to have a material impact on our consolidated financial statements upon adoption during fiscal 2009.

In September 2006, FASB issued SFAS No.158, *Employers’ Accounting for Defined Benefit Pension and Other Postretirement Plans*. This statement requires an employer to recognize in its balance sheet the overfunded or underfunded status of a defined benefit postretirement plan measured as the difference between the fair value of plan assets and the benefit obligation. Employers must also recognize as a component of accumulated other comprehensive income, net of tax, the actuarial gains and losses and the prior service costs and credits that arise during the period. SFAS No. 158 requires companies to apply the requirement to recognize the funded status of a benefit plan and the disclosure requirements as of the end of the fiscal year ending after December 15, 2006. We are currently assessing the impact of adoption for the 2007 fiscal year end.

In September 2006, the SEC released SEC Staff Accounting Bulletin (“SAB”) No. 108, *Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements*, which addresses how uncorrected errors in previous years should be considered when quantifying errors in current-year financial statements. SAB No. 108 requires registrants to consider the effect of all carry over and reversing effects of prior-year misstatements when quantifying errors in current-year financial statements. SAB No. 108 allows registrants to record the effects of adopting the guidance as a cumulative-effect adjustment to retained earnings. This adjustment must be reported as of the beginning of the first fiscal year ending after November 15, 2006. We do not expect SAB No. 108 to have a material impact on our consolidated financial statements.

Note 11. Pensions and Other Postretirement Benefits

We provide defined benefit pension and other postretirement benefits to certain eligible employees. In Europe, we have business units that maintain defined benefit pension plans for certain current and former employees. Generally, plan benefits are based on age, years of service and average compensation during the final years of service. In the United States, other postretirement benefits are comprised of an unfunded Supplemental Executive Retirement Plan (SERP) that provides retirement, pre-retirement and termination benefits, as defined, to certain key executives designated by our Board of Directors.

Our pension and other postretirement benefit plans are more fully disclosed in Notes 1 and 12 to our Consolidated Financial Statements included in Item 8 of our Annual Report on Form 10-K for the year ended June 30, 2006. The following table presents the components of net periodic benefit costs for the quarters ended September 30, 2006 and 2005:

| (\$000s omitted) | Pension Benefits | | Other Postretirement Benefits | |
|-------------------------------------------------|------------------|------------|-------------------------------|--------------|
| | 2006 | 2005 | 2006 | 2005 |
| Components of net periodic benefit cost: | | | | |
| Service cost | \$ 374 | 307 | 388 | 400 |
| Interest cost | 583 | 480 | 616 | 587 |
| Expected return on plan assets | (31) | (24) | --- | --- |
| Amortization of prior service cost | --- | --- | 182 | 182 |
| Amortization of net loss | 29 | 13 | 438 | 368 |
| Net periodic benefit cost | <u>\$ 955</u> | <u>776</u> | <u>1,624</u> | <u>1,537</u> |

During the quarter ended September 30, 2006, we made an insignificant contribution to the defined benefit pension plans and expect full year contributions to be immaterial.

Note 12. Significant Customers

Presented below are the percentages of net sales to and receivables due from customers who represent 10 percent or more of our net sales or accounts receivables:

| | Net Sales | | Receivables | |
|-----------------|-------------------------------------|-------------|--------------|-------------|
| | Three months ended September 30, | | September 30 | |
| | 2006 | 2005 | 2006 | 2005 |
| DaimlerChrysler | 28% | 25% | 18% | 20% |
| BMW | 8 | 11 | 7 | 9 |
| Other Customers | 64 | 64 | 75 | 71 |
| Total | <u>100%</u> | <u>100%</u> | <u>100%</u> | <u>100%</u> |

We anticipate that DaimlerChrysler and BMW will continue to account for a significant portion of our net sales and account receivables for the foreseeable future. These automotive customers are not obligated to any long-term purchase of our products. The loss of sales to DaimlerChrysler or BMW would have a material adverse effect on our total consolidated net sales, earnings and financial position.

Note 13. Income Taxes

Income tax expense for the quarter ended September 30, 2006 was \$29.6 million, compared to \$19.8 million for the same period last year. The effective tax rate for the three months ended September 30, 2006 was 34.5 percent, compared to 26.8 percent in the prior year period. The tax rate for the prior year quarter included a \$5.3 million tax credit due to a Joint Committee on Taxation approval of an IRS settlement. We currently expect the tax rate for the full fiscal year 2007 to be approximately 34 percent.

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

General

The following discussion should be read in conjunction with the accompanying unaudited condensed consolidated financial statements and the related notes included in Item 1 of this Quarterly Report on Form 10-Q, together with Management's Discussion and Analysis of Financial Condition and Results of Operations included in our Annual Report on Form 10-K for the year ended June 30, 2006 ("2006 Form 10-K"). This discussion contains forward-looking statements which are based on our current expectations and industry experience, as well as our perception of historical trends, current market conditions, including customer acceptance of our new products, current economic data, currency exchange rates, expected future developments and other factors that we believe are appropriate under the circumstances. These statements involve risks and uncertainties that could cause actual results to differ materially from those suggested in the forward-looking statements.

We begin our discussion with an overview of our company to give you an understanding of our business and the markets we serve. This is followed with a discussion of our results of operations for the three months ended September 30, 2006 and 2005. This discussion includes an analysis of certain significant period-to-period variances in our consolidated statements of operations. We also provide specific information regarding our three reportable business segments. Our liquidity, capital resources and cash flows are discussed under the caption Financial Condition. We then provide a Business Outlook at the end of this discussion.

Overview

We design, manufacture and market high-quality, high fidelity audio products and electronic systems for the automotive, consumer and professional markets. We have developed, both internally and through a series of strategic acquisitions, a broad range of product offerings sold under renowned brand names in our principal markets. Our three reportable business segments, Automotive, Consumer and Professional, are based on the end-user markets we serve.

Automotive designs, manufactures and markets audio, electronic and infotainment systems for vehicle applications. Our systems are generally shipped directly to our automotive customers for factory installation. Infotainment systems are a combination of infotainment and entertainment components with features including or controlling GPS navigation, traffic information, cellular phone service, wireless Internet access, security, climate control, backup camera, digital audio playback and rear seat entertainment. These systems are increasingly developed using scaleable software allowing us to better serve luxury-range vehicles through the entry-level. Automotive also produces aftermarket personal navigation devices ("PNDs") that are currently sold in Europe. Our PNDs leverage many of the successful applications developed by our Automotive segment.

Consumer designs, manufactures and markets audio, video and electronic systems for home, mobile and multimedia applications. Home product applications include systems to provide high-quality audio throughout the home and to enhance home theatre performance. Our aftermarket mobile products, including in-vehicle iPod adaptors, deliver audio entertainment in the vehicle. Our multimedia products include accessories for portable electronic devices such as the iPod and other MP3 players. Our consumer systems are primarily distributed through retail outlets.

Professional designs, manufactures and markets loudspeakers and electronic systems used by audio professionals in concert halls, stadiums, airports and other public spaces. We also create products for recording, broadcast, cinema and music reproduction applications. These products are increasingly linked by our HiQnet network protocol that provides a central digital network giving audio professionals control of a complex system from a central location.

Our products are sold worldwide, with the largest markets being the United States and Germany. In the United States, our primary manufacturing facilities are located in California, Indiana, Kentucky and Utah. Outside of the United States, we have significant manufacturing facilities in Germany, Austria, the United Kingdom, Mexico, Hungary, France and Switzerland. Our businesses operate using the local currencies. Therefore, we are subject to currency fluctuations that are partially mitigated by the fact that we purchase raw materials and supplies locally when possible. We are especially affected by changes in Euro exchange rates since a significant percentage of our sales are made in Euro denominated countries.

We experience seasonal fluctuations in sales and earnings. Historically, our first quarter ending September 30 is generally the weakest due to automotive model changeovers and the summer holidays in Europe. Our sales and earnings may also vary due to customer acceptance of our products, product offerings by our competitors and general economic conditions, including fluctuations in foreign currency exchange rates.

We achieved record sales and earnings for the first quarter ended September 30, 2006 compared to the same quarter in the prior year. Both our Automotive and Professional business segments produced improved results compared to the prior year. Our Consumer business segment experienced a decline in sales due to increased competition and a decline in unit prices in the multimedia market. During the quarter, we repurchased 921,100 shares of our common stock for \$73.0 million and reduced our outstanding debt by \$24.8 million.

Critical Accounting Policies

Our critical accounting policies are described under the caption "Management's Discussion and Analysis of Financial Condition and Results of Operations" in our 2006 Form 10-K. These policies include inventory valuation, allowance for doubtful accounts, warranty liabilities, income taxes, pre-production and development costs, goodwill and stock-based compensation. Also see Note 1 "Summary of Significant Accounting Policies" to our Consolidated Financial Statements included in our 2006 Form 10-K.

Results of Operations

Sales

Our net sales for the quarter ended September 30, 2006 were \$825.5 million, a 9 percent increase compared to the prior year period. Foreign currency translation contributed approximately \$20 million to the increase in sales. The increase in net sales was primarily due to higher sales of our automotive audio and infotainment systems to automotive customers and higher automotive aftermarket sales of our personal navigation devices.

Presented below is a summary of our net sales by reporting segment:

| (\$000s omitted) | Three months ended September 30, | | | |
|------------------|----------------------------------|------|---------|------|
| | 2006 | % | 2005 | % |
| Net sales: | | | | |
| Automotive | \$ 600,998 | 73% | 520,296 | 69% |
| Consumer | 93,126 | 11% | 111,368 | 15% |
| Professional | 131,419 | 16% | 122,984 | 16% |
| Total | \$ 825,543 | 100% | 754,648 | 100% |

Automotive - Net sales for the quarter ended September 30, 2006 increased \$80.7 million, or 16 percent compared to the same period last year. Foreign currency translation contributed approximately \$17 million to the increase in sales. Because a significant percentage of our automotive sales are to customers in Europe, Automotive incurs most of our foreign currency translation exposure. Increased sales of infotainment systems to European automakers and strong sales of our aftermarket navigation products contributed significantly to the increase in sales over the prior period. The primary contributors to the higher sales were strong sales of our infotainment systems to Mercedes-Benz for the S-Class, M-Class, E-Class and GL Class platforms and higher sales of infotainment systems to Audi for their new Q7 platform. Strong sales of our new aftermarket personal navigation device, Traffic Assist, also contributed to the sales growth. We had higher sales to Toyota/Lexus due to the launch of the new LS460. The increase in net sales was offset by lower sales to BMW, Chrysler and Land Rover. Sales to BMW were lower due to reduced vehicle production of the BMW 7-series and a model changeover with the BMW X5 series.

Consumer - Net sales for the quarter ended September 30, 2006 decreased \$18.2 million, or 16 percent, compared to the same period last year. Foreign currency translation contributed approximately \$2 million to the decrease in sales compared to the prior year. The decrease in net sales was primarily due to lower multimedia sales of the OnStage and OnTour products, which are accessories for the Apple iPod, as a result of increased competition within the multimedia market. We had an exceptional first quarter in the prior year when we introduced our multimedia products to the market. Sales of Infinity loudspeakers and Harman/Kardon electronics were lower due to the result of our decision to cease distribution through a major retailer.

Professional - Net sales for the quarter ended September 30, 2006 increased \$8.4 million, or 7 percent compared to the same period last year. Foreign currency translation contributed approximately \$1 million to the increase in sales compared to the prior year. The increase in sales compared to the same period last year was primarily due to higher sales at our JBL and Crown business units. Both JBL and Crown increased sales to major retailers. Also, Soundcraft/Studer and AKG products contributed to the increase in sales due to higher sales of installed sound and mixing consoles.

Gross Profit

Gross profit as a percentage of net sales decreased 0.5 percentage points to 34.8 percent for the quarter ended September 30, 2006 compared to 35.3 percent of sales in the same period last year.

Presented below is a summary of our gross profit by reporting segment:

| | Three months ended September 30, | | | |
|---------------|----------------------------------|----------------------------|---------|----------------------------|
| | 2006 | | 2005 | |
| | | Percent of net sales | | Percent of net sales |
| Gross Profit: | | | | |
| Automotive | \$ 214,740 | 35.7% | 184,279 | 35.4% |
| Consumer | 23,507 | 25.2% | 38,807 | 34.8% |
| Professional | 50,292 | 38.3% | 45,382 | 36.9% |
| Other | (1,250) | | (2,173) | |
| Total | \$ 287,289 | 34.8% | 266,295 | 35.3% |

Automotive— Gross profit as a percentage of net sales increased 0.3 percentage points for the quarter ended September 30, 2006 compared to the same period in the prior year. The gross margin improvement is primarily related to increased sales of higher margin infotainment systems and increased sales of our new personal navigation devices when compared to the prior year period. Lower warranty and fixed overhead expenses also contributed to the higher gross margins.

Consumer— Gross profit as a percentage of net sales decreased 9.6 percentage points for the quarter ended September 30, 2006 compared to the same period in the prior year. Gross margins were lower due to increased competition in the multimedia market and a discontinuance of sales of relatively high margin Infinity and Harman/Kardon products to a major retailer. Gross margins were also negatively impacted by increased inventory reserve requirements for discontinued products.

Professional— Gross profit as a percentage of net sales increased 1.4 percentage points for the quarter ended September 30, 2006 compared to the same period in the prior year. The gross margins improved as a percentage of sales primarily due to lower fixed factory overhead costs as a percent of sales. Gross margins also improved because AKG had significant inventory write-downs in the same period last year.

Selling, General and Administrative Expenses

Selling, general and administrative expenses (“SG&A”), as a percentage of sales, decreased 0.6 percentage points for the quarter ended September 30, 2006 compared to the same period in the prior year. The decrease primarily relates to the impact of higher sales offset by higher research and development costs associated with new infotainment system programs. Research and development costs were \$82.8 million, or 10.0 percent of sales, for the quarter ended September 30, 2006 compared to \$68.4 million, or 9.1 percent of sales, in the same period last year.

During the fourth quarter of fiscal 2006, we initiated a restructuring program designed to increase efficiencies in our manufacturing facilities and to realign our engineering organization. SG&A expenses associated with this program were \$0.7 million for the three months ended September 30, 2006. We also made cash payments of \$0.9 million during the first quarter ended September 30, 2006, primarily for severance. Since the inception of the restructuring program, we have incurred costs of \$10.2 million. We presently expect to record an additional \$5.8 million, for total restructuring costs of \$16.0 million, in future periods to complete the program.

Presented below is a summary of SG&A expenses by reporting segment:

| | Three months ended September 30, | | | |
|----------------|----------------------------------|----------------------------|----------------|----------------------------|
| | 2006 | Percent of net sales | 2005 | Percent of net sales |
| SG&A Expenses: | | | | |
| Automotive | \$ 124,572 | 20.7% | 110,342 | 21.2% |
| Consumer | 27,956 | 30.0% | 28,229 | 25.3% |
| Professional | 33,217 | 25.3% | 32,515 | 26.4% |
| Other | 14,626 | --- | 17,016 | --- |
| Total | <u>\$ 200,371</u> | 24.3% | <u>188,102</u> | 24.9% |

Automotive— SG&A expenses as a percentage of sales decreased 0.5 percentage points for the quarter ended September 30, 2006 compared to the same period last year. The decrease is primarily due to the impact of higher sales. Research and development expenses were \$65.4 million, or 10.9 percent of sales, for the quarter ended September 30, 2006 compared to \$51.6 million, or 9.9 percent of sales, in the prior year. Research and development expenses increased primarily due to higher spending to support new automotive infotainment systems for programs launching in fiscal 2008 and 2009.

Consumer — SG&A expenses as a percentage of sales increased 4.7 percentage points for the quarter ended September 30, 2006 compared to the same period last year. The increase is primarily due to the impact of lower sales. Research and development expenses were \$8.9 million, or 9.5 percent of sales, for the quarter ended September 30, 2006 compared to \$8.5 million, or 7.7 percent of sales, in the same period last year.

Professional — SG&A expenses as a percentage of sales decreased 1.1 percentage points for the quarter ended September 30, 2006 compared to the same period last year. The decrease is related to leveraging the fixed portion of SG&A expenses over a higher sales base. Also, AKG reported substantial costs in the first quarter of last year to discontinue lower margin products. Research and development expenses were \$8.5 million for the quarter ended September 30, 2006 compared to \$8.2 million in the same period last year.

Other — Corporate SG&A expenses for the three months ended September 30, 2006 decreased \$2.4 million compared to the same period last year. Lower advertising expenses primarily contributed to the lower corporate general and administrative expenses.

Operating Income

Operating income for the quarter ended September 30, 2006 was \$86.9 million, or 10.5 percent of sales compared to \$78.2 million, or 10.4 percent of sales in the same period last year. The improvement in operating margin for the quarter was primarily the result of improvements in our Automotive and Professional segments as well as lower corporate expenses, partially offset by lower Consumer operating margins.

Interest Expense, Net

Interest expense is reported net of interest income in our consolidated statements of operations. Net interest expense was \$0.1 million for the quarter ended September 30, 2006 compared to \$3.8 million in the same quarter last year. Our first quarter fiscal 2007 interest expense, net, included \$2.3 million of gross interest expense and \$2.2 million of interest income. For the same period in the prior year, gross interest expense was \$5.4 million and interest income was \$1.6 million. Weighted average borrowings outstanding were \$172.7 million for the quarter ended September 30, 2006 compared to \$356.2 million for the same period in the prior year. In the prior year period, the weighted average borrowings exclude the average fair value of the interest rate swaps of \$3.8 million. There were no interest rate swaps at September 30, 2006.

The weighted average interest rate on borrowings was 5.4 percent for the quarter ended September 30, 2006 compared to 6.1 percent in the same quarter last year. The weighted average interest rate decreased due to lower rates on current outstanding debt and the repayment of fixed rate debt at higher interest rates.

Miscellaneous Expenses

Miscellaneous, net expenses were \$0.9 million for the quarter ended September 30, 2006 compared to \$0.6 million in the same period last year. For the quarter ended September 30, 2006, miscellaneous expenses included \$0.1 million for debt repurchase premiums in connection with the repurchase of \$13.2 million of our outstanding senior notes during the quarter.

Income Taxes

Income tax expense for the quarter ended September 30, 2006 was \$29.6 million, compared to \$19.8 million for the same period last year. The effective tax rate for the quarter ended September 30, 2006 was 34.5 percent, compared to 26.8 percent in the prior year period. The tax rate for the prior year quarter included a \$5.3 million tax credit due to a Joint Committee on Taxation approval of an IRS settlement. We currently expect the tax rate for the full fiscal year 2007 to be approximately 34 percent.

Financial Condition

Liquidity and Capital Resources

We primarily finance our working capital requirements through cash generated by operations, trade credit and borrowings under our revolving credit facility. Cash and cash equivalents were \$135.0 million at September 30, 2006 compared to \$291.8 million at June 30, 2006. During the three-month period, cash was primarily used to repurchase shares of our common stock and reduce our outstanding debt. Cash was also used to meet the working capital needs of our business segments.

We will continue to have cash requirements to support seasonal working capital needs, capital expenditures, interest, principal and dividend payments and stock and debt repurchases. We intend to use cash on hand, cash generated by operations and borrowings under our revolving credit facility to meet these requirements. We believe that cash from operations and our borrowing capacity will be adequate to meet our cash requirements over the next twelve months. Following is a more detailed discussion of our cash flow activities during the quarter ended September 30, 2006.

Operating Activities

For the three months ended September 30, 2006, our cash flows used for operations were \$44.6 million compared to cash flows from operations of \$31.2 million in the same period last year. The decrease in operating cash flows is primarily due to increased working capital requirements. At September 30, 2006, working capital, excluding cash and short-term debt, was \$246.0 million, compared with \$106.7 million at June 30, 2006. The \$139.3 million increase was primarily due to higher inventory levels at all of our business segments for seasonal needs and a decrease in accounts payable due to timing of vendor payments.

Investing Activities

Capital expenditures for the three months ended September 30, 2006 were \$12.4 million compared to \$21.4 million for the same period last year. The decrease in spending is due to the timing of several capital projects being delayed until later in the current fiscal year. We anticipate capital expenditures in fiscal 2007 to be approximately \$150 million, primarily to make significant investments in facilities, manufacturing equipment and tooling to support the continued growth in our automotive infotainment systems business.

Financing Activities

In the first quarter of fiscal 2007, we paid \$73.0 million to repurchase 921,100 shares of our common stock. At September 30, 2006, we had the authority to purchase up to 2.4 million additional shares of our common stock under our current share repurchase program. We presently intend to continue our share repurchase program for the remainder of the fiscal year, evaluating the buy levels on a quarter-to-quarter basis.

Our total debt at September 30, 2006 was \$172.8 million, primarily comprised of \$150.1 million of borrowings under our revolving credit facility. Also included in total debt was \$16.5 million principal amount of 7.32 percent senior notes due July 1, 2007 and capital leases and other short-term borrowings of \$6.2 million.

We have a \$300 million committed multi-currency revolving credit facility that expires in June 2010. At June 30, 2006, we had outstanding borrowings on our revolving credit facility of \$159.9 million. During the quarter ending September 30, 2006, we reduced the balance by \$9.8 million to \$150.1 million. At September 30, 2006 we had borrowings of \$150.1 million and outstanding letters of credit of \$6.6 million under this facility. Unused availability under the revolving credit facility was \$143.3million atSeptember 30, 2006. Interest on the revolving credit facility is based on LIBOR rates plus a credit spread.

Our long-term debt agreements contain financial and other covenants that, among other things, limit our ability to incur additional indebtedness, restrict subsidiary dividends and distributions, limit our ability to encumber certain assets and restrict our ability to issue capital stock of our subsidiaries. Our long-term debt agreements permit us to pay dividends or repurchase our capital stock without any dollar limitation provided that we would be in compliance with the financial covenants in our revolving credit facility after giving effect to such dividend or repurchase. At September 30, 2006, we were in compliance with the terms of our long-term debt agreements.

Equity

Total shareholders' equity at September 30, 2006 was \$1.211 billion compared with \$1.228 billion at June 30, 2006. The slight decrease is primarily due to share repurchases of \$73.0 million partially offset by net income of \$56.6 million. We repurchased 921,100 shares of our common stock during the three months ended September 30, 2006.

Business Outlook

We had a very strong first quarter ended September 30, 2006. Our Automotive and Professional business segments reported strong results when compared to the prior year period, while our Consumer segment experienced increased competition in the multimedia market. We continue to believe we will see growth in all three of our core business segments in fiscal 2007. For the full fiscal year ending June 30, 2007, we currently believe our net sales will be approximately \$3.5 billion and earnings per share will be approximately \$4.35 per share, representing a 16 percent increase over our \$3.75 earnings per share in fiscal 2006. Our current expectations for fiscal 2007 could be affected by the potential impact of changes in currency exchange rates, softness in automobile sales and increases in research and development costs to support new infotainment business, as well as the other factors described below under "Risk Factors."

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are required to include information about potential effects of changes in interest rates and currency exchange rates in our periodic reports filed with the Securities and Exchange Commission. Since June 30, 2006, there have been no material changes in the quantitative or qualitative aspects of our market risk profile.

Interest Rate Sensitivity/Risk

At September 30, 2006, interest on approximately 9.5 percent of our borrowings was determined on a fixed rate basis. The interest rates on the balance of our debt are subject to changes in U.S. and European short-term interest rates. To assess exposure to interest rate changes, we have performed a sensitivity analysis assuming a hypothetical 100 basis point increase or decrease in interest rates across all outstanding debt and investments. Our analysis indicates that, based on our September 30, 2006 positions, the impact of such changes in interest rates was approximately \$0.1 million to net income for the three months ended September 30, 2006.

Foreign Currency Risk

We maintain significant operations in Germany, the United Kingdom, France, Austria, Hungary, Mexico and Switzerland. As a result, we are subject to market risks arising from changes in foreign currency exchange rates, principally the change in the value of the Euro compared to the U.S. dollar. Our subsidiaries purchase products and raw materials in various currencies. As a result, we may be exposed to the cost changes relative to local currencies in the markets to which we sell our products. To mitigate these transactional risks, we enter into forward foreign exchange contracts. Also, foreign currency positions are partially offsetting and are netted against one another to reduce exposure.

The effect of changes in currency exchange rates, principally the change in the value of the Euro compared to the U.S. dollar, has an impact on our reported results when the financial statements of foreign subsidiaries are translated into U.S. dollars. Over half of our sales are now denominated in Euros. Currency translation for the Euro versus the U.S. dollar had a significant impact on earnings for the first quarter of fiscal 2007 compared to

the prior year first quarter due to the strengthening of the Euro relative to the U.S. dollar. The first-quarter average exchange rate for the Euro versus the U.S. dollar increased 4.49 percent from the prior year's first quarter average exchange rate.

To assess exposure to changes in currency exchange rates, we prepared an analysis assuming a hypothetical 10 percent change in currency exchange rates across all currencies used by our subsidiaries. This analysis indicated that a 10 percent increase or decrease in exchange rates would have increased or decreased income before income taxes by approximately \$8.7 million for the three months ended September 30, 2006.

Competitive conditions in the markets in which we operate may limit our ability to increase prices in the event of adverse changes in currency exchange rates. For example, certain products made in the U.S. are sold outside of the U.S. Sales of these products are affected by the value of the U.S. dollar relative to other currencies. Any long-term strengthening of the U.S. dollar could depress the demand for these U.S. manufactured products and reduce sales. However, due to the multiple currencies involved in our business and the netting effect of various simultaneous transactions, our foreign currency positions are partially offsetting.

Actual gains and losses in the future may differ materially from the hypothetical gains and losses discussed above based on changes in the timing and amount of interest rate foreign currency exchange rate movements and our actual exposure and hedging transactions.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures - Under the supervision and with the participation of our management, including our Executive Chairman, Chief Executive Officer and Chief Financial Officer, we have evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) promulgated by the Securities and Exchange Commission under the Securities Exchange Act of 1934) as of the end of the period covered by this Quarterly Report on Form 10 Q. Based on that evaluation, our Executive Chairman, Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures are effective to provide reasonable assurance that information required to be disclosed in the reports that we file or submit under the Securities Exchange Act of 1934 is recorded, processed, summarized, and reported within the time periods specified in Securities and Exchange Commission rules and forms. We note that the design of any system of controls is based in part upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving our stated goals under all potential future conditions.

Change in Internal Control Over Financial Reporting - There has not been any change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) as promulgated by the Securities and Exchange Commission under the Securities Act of 1934) during our most recently completed fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Part II. OTHER INFORMATION**Item 2. Unregistered Sales of Equity Securities and Use of Proceeds**

The following table sets forth our repurchases of common stock for each month in the first quarter of fiscal 2007:

Issuer Purchases of Equity Securities

| | Total number of Shares purchased | Average price paid per share | Total number of shares purchased as part of publicly announced plans or programs | Maximum number of shares that may yet be purchased under the plans or programs |
|----------------------------------------------|-------------------------------------------|---------------------------------------|-------------------------------------------------------------------------------------------------------|-----------------------------------------------------------------------------------------------------|
| July 1, 2006 through July 31, 2006 | 110,600 | \$83.39 | 110,600 | 3,199,218 |
| August 1, 2006 through August 31, 2006 | 810,500 | 78.67 | 810,500 | 2,388,718 |
| September 1, 2006 through September 30, 2006 | --- | --- | --- | 2,388,718 |
| | <u>921,100</u> | 79.24 | <u>921,100</u> | 2,388,718 (1) |

(1) Our share repurchase program was first publicly announced on June 16, 1998. In August 2005, the Board authorized the purchase of up to an additional four million shares, bringing the total authorized to 20 million shares. The total number of shares repurchased through September 30, 2006 was 17,611,282.

Item 6. Exhibits

Exhibits required by Item 601 of Regulation S-K

- | | |
|------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 10.1 | Employment Agreement, dated November 6, 2006, between the Company and Dr. Erich A. Geiger. |
| 31.1 | Certification of Sidney Harman pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Bernard A. Girod pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.3 | Certification of Kevin L. Brown pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Sidney Harman, Bernard A. Girod and Kevin L. Brown, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, Harman International Industries, Incorporated has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

Harman International Industries, Incorporated

(Registrant)

Date: November 9, 2006

By: /s/ Kevin L. Brown

Kevin L. Brown
Executive Vice President and Chief Financial Officer
(Principal Financial Officer)

Date: November 9, 2006

By: /s/ Sandra B. Robinson

Sandra B. Robinson
Vice President – Financial Operations and Chief Accounting Officer
(Principal Accounting Officer)