KEITHLEY INSTRUMENTS INC
Form 10-Q
February 16, 2010

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

Form 10-Q

(Mark One)

þ **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended December 31, 2009
Commission File Number 1-9965
KEITHLEY INSTRUMENTS, INC.
(Exact name of registrant as specified in its charter)

Ohio	**34-0794417**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

28775 Aurora Road, Solon, Ohio 44139
(Address of principal executive offices) (Zip Code)
Registrant s telephone number, including area code: (440) 248-0400

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 þ NO** o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). **YES o NO** o

Indicate by check 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 and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o **Accelerated filer** o **Non-accelerated filer** þ **Smaller reporting company** o

Indicate by check whether the registrant is a shell Company (as defined in Rule 12b-2 of the Exchange Act). **YES o NO** þ

As of February 11, 2010 there were outstanding 13,617,285 Common Shares (net of shares repurchased and held in treasury), without par value; and 2,150,502 Class B Common Shares, without par value.

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Forward-Looking Statements

Statements and information included in this Quarterly Report on Form 10-Q that are not purely historical are forward-looking statements intended to be covered by the safe harbor provisions of the Private Securities Litigation Reform Act of 1995.

Forward-looking statements in this Report on Form 10-Q include statements regarding Keithley s expectations, intentions, beliefs, and strategies regarding the future, including recent trends, cyclicality, growth in the markets into which Keithley sells, conditions of the electronics industry and the economy in general, deployment of our own sales employees throughout the world, expected cost savings from cost cutting actions, investments to develop new products, the potential impact of adopting new accounting pronouncements, our future effective tax rate, liquidity position, ability to generate cash, expected growth, and obligations under our retirement benefit plans.

When used in this report, the words believes, expects, anticipates, intends, assumes, estimates, evaluate forecasts, may, could, future, forward, potential, probable, and similar expressions are intendec forward-looking statements.

These forward-looking statements involve risks and uncertainties. We may make other forward-looking statements from time to time, including in press releases and public conference calls and webcasts. All forward-looking statements made by Keithley are based on information available to us at the time the statements are made, and we assume no obligation to update any forward-looking statements. It is important to note that the forward looking statements are subject to a number of risks and uncertainties that could cause actual results to differ materially from those included in such forward-looking statements. Some of these risks and uncertainties are discussed in our Securities and Exchange Commission reports, including but not limited to, our Form 10-K for the fiscal year ended September 30, 2009.

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PART I. FINANCIAL INFORMATION

ITEM 1. Financial Statements.

KEITHLEY INSTRUMENTS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In Thousands of Dollars)
(Unaudited)

	December 31, 2009	September 30, 2009
Assets		
Current assets:		
Cash and cash equivalents	$ 33,708	$ 24,114
Restricted cash	575	569
Short-term investments	1,264	759
Refundable income taxes	140	466
Accounts receivable and other, net	12,280	11,738
Inventories:		
Raw materials	4,447	5,760
Work in process	754	613
Finished products	2,675	3,564
Total inventories	7,876	9,937
Deferred income taxes	293	303
Prepaid expenses	2,077	1,753
Total current assets	58,213	49,639
Property, plant and equipment, at cost	49,145	54,081
Less-Accumulated depreciation	40,533	42,981
Property, plant and equipment, net	8,612	11,100
Deferred income taxes	712	748
Intangible assets		910
Other assets	10,661	10,705
Total assets	$ 78,198	$ 73,102
Liabilities and Shareholders Equity		
Current liabilities:		
Accounts payable	$ 5,147	$ 4,916
Accrued payroll and related expenses	4,465	5,648
Other accrued expenses	4,625	5,424
Income taxes payable	1,614	1,122
Total current liabilities	15,851	17,110
Long-term deferred compensation	2,153	2,111

Long-term income taxes payable		3,074		2,852
Other long-term liabilities		14,473		14,419
Shareholders equity:				
Common Shares, stated value $.0125:				
Authorized 80,000,000; issued and outstanding 14,979,718 at December 31, 2009 and 14,950,093 at September 30, 2009		187		187
Class B Common Shares, stated value $.0125:				
Authorized 9,000,000; issued and outstanding 2,150,502 at December 31, 2009 and September 30, 2009		27		27
Capital in excess of stated value		39,331		39,121
Retained earnings		34,495		28,629
Accumulated other comprehensive loss		(15,874)		(15,900)
Common shares held in treasury, at cost		(15,519)		(15,454)
Total shareholders equity		42,647		36,610
Total liabilities and shareholders equity	$	78,198	$	73,102

The accompanying notes are an integral part of these condensed consolidated financial statements.

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KEITHLEY INSTRUMENTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(In Thousands of Dollars Except for Per Share Data)
(Unaudited)

	For the Three Months Ended December 31, 2009	For the Three Months Ended December 31, 2008
Net sales	$ 28,397	$ 31,070
Cost of goods sold	10,516	13,295
Gross profit	17,881	17,775
Selling, general and administrative expenses	11,268	14,015
Product development expenses	3,130	6,053
Gain on sale of product line	(3,493)	
Adjustments to severance and related charges	(30)	(3)
Operating income (loss)	7,006	(2,290)
Investment income	25	175
Interest expense	(2)	(20)
Income (loss) before income taxes	7,029	(2,135)
Provision for income taxes	972	30,224
Net income (loss)	$ 6,057	$ (32,359)
Basic earnings (loss) per share	$ 0.39	$ (2.07)
Diluted earnings (loss) per share	$ 0.38	$ (2.07)
Cash dividends per Common Share	$ .0125	$ .0375
Cash dividends per Class B Common Share	$ .0100	$ .0300

The accompanying notes are an integral part of these condensed consolidated financial statements.

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KEITHLEY INSTRUMENTS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In Thousands of Dollars)
(Unaudited)

	For the Three Months Ended December 31, 2009	2008
Cash flows from operating activities:		
Net income (loss)	$ 6,057	$ (32,359)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Gain on sale of product line	(3,493)	
Depreciation and amortization	726	911
Non-cash stock compensation	159	(471)
Deferred income taxes	20	30,137
Other non-cash items	55	(20)
Increases in working capital	(2,640)	(1,348)
Other operating activities	611	(495)
Net cash provided by (used in) operating activities	1,495	(3,645)
Cash flows from investing activities:		
Capital expenditures	(103)	(1,076)
Increase in Restricted cash	(6)	
Proceeds from sale of product line	9,000	
Net purchases of short-term investments	(504)	
Proceeds from maturities and sales of investments		12,500
Net cash provided by investing activities	8,387	11,424
Cash flows from financing activities:		
Net borrowings of short-term debt		536
Cash dividends paid	(191)	(569)
Repurchase of Common Shares	(12)	(787)
Net cash used in financing activities	(203)	(820)
Effect of exchange rate changes on cash	(85)	128
Increase in cash and cash equivalents	9,594	7,087
Cash and cash equivalents at beginning of period	24,114	22,073
Cash and cash equivalents at end of period	$ 33,708	$ 29,160

The accompanying notes are an integral part of these condensed consolidated financial statements.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(In thousands of dollars, except for share data)

A. Nature of Operations

Keithley s business is to design, develop, manufacture and market complex electronic instruments and systems to serve the specialized needs of electronics manufacturers for high-performance production testing, process monitoring, product development and research. Our primary products are integrated systems used to source, measure, connect, control or communicate electrical direct current or optical signals. Although our products vary in capability, sophistication, use, size and price, they generally test, measure and analyze electrical, optical or physical properties. As such, we consider our business to be in a single industry segment.

B. Summary of Significant Accounting Policies

Basis of Presentation

The condensed consolidated financial statements at December 31, 2009 and 2008, and for the three-month periods then ended have not been audited by an independent registered public accounting firm, but in the opinion of our management, all adjustments necessary to fairly present the condensed consolidated balance sheets, condensed consolidated statements of operations and condensed consolidated statements of cash flows for those periods have been included. All adjustments included are of a normal recurring nature. The year-end condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America.

The Company s consolidated financial statements for the three month periods ended December 31, 2009 and 2008 included in this Form 10-Q report have been prepared in accordance with the accounting policies described in the Notes to Consolidated Financial Statements for the year ended September 30, 2009, which were included in the Company s Annual Report on Form 10-K for the fiscal year ended September 30, 2009 filed on December 14, 2009 (the 2009 Form 10-K). Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission. These financial statements should be read in conjunction with the consolidated financial statements and the notes thereto included in the 2009 Form 10-K.

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (U.S. G.A.A.P.) requires management to make estimates and assumptions. These estimates and assumptions affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the reported financial statements and the reported amounts of revenues and expenses during the reporting periods. Examples include the allowance for doubtful accounts, estimates of contingent liabilities, inventory valuation, pension plan assumptions, estimates and assumptions relating to stock-based compensation costs, the assessment of the valuation of deferred income taxes and income tax reserves. Actual results could differ from those estimates.

C. Recent Accounting Pronouncements

Recently Adopted Accounting Guidance

In September 2006, the Financial Accounting Standards Board (FASB) issued authoritative guidance which established a framework for measuring fair value in generally accepted accounting principles, and expanded disclosures about fair value measurements. The guidance is applicable to other accounting pronouncements that require or permit fair value measurements. Accordingly, the guidance did not require any new fair value measurements. However, for some entities, the application changed current practice. The guidance became effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. However, the FASB provided a one-year deferral for the implementation for nonfinancial assets and liabilities. The Company adopted the guidance effective October 1, 2008, except with respect to nonfinancial assets and liabilities, and the adoption did not have a material impact on its consolidated financial statements. The Company adopted the guidance related to nonfinancial assets and liabilities effective October 1, 2009, which resulted in expanded disclosures in its consolidated financial statements.

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Accounting Guidance Not Yet Adopted

In January 2010, the FASB issued updates to guidance that are intended to improve disclosures about fair value measurements. The updates are effective for the Company in the second quarter of fiscal 2010. Adoption is not expected to have a material impact on the Company s consolidated financial statements.

In June 2009, the FASB issued updates to guidance that address accounting for variable interest entities. These updates to Accounting Standards Codification (ASC) 810 are effective for the Company in the first quarter of fiscal 2011. The Company is currently assessing the impact that adoption will have on its consolidated financial statements.

In December 2008, the FASB issued updates to the guidance intended to enhance disclosures regarding assets in defined benefit pension or other post-retirement plans. The updates are effective for the Company in the fourth quarter of fiscal 2010. The Company does not anticipate that the adoption will have a material effect on its consolidated financial statements.

D. Earnings Per Share

Both Common Shares and Class B Common Shares are included in the calculation of earnings per share. Details of the calculation are set forth below:

	For the Three Months Ended December 31,	
	2009	2008
Net income (loss)	$ 6,057	$ (32,359)
Weighted averages shares outstanding	15,732,679	15,607,397
Dilutive effect of stock awards	61,933	
Weighted average shares used for dilutive earnings per share	15,794,672	15,607,397
Basic earnings (loss) per share	$ 0.39	$ (2.07)
Diluted earnings (loss) per share	$ 0.38	$ (2.07)

Due to the net loss for the three months ended December 30, 2008, 3,398 shares related to stock awards and the employee stock purchase plan were excluded from the dilutive calculation. Both vested and nonvested stock option awards representing approximately 3.0 million shares outstanding at December 31, 2009 and 2008, were excluded from the calculation of diluted earnings per share as their effect would have been antidilutive.

E. Comprehensive Income

Comprehensive income (loss) for the three-month periods ended December 31, 2009 and 2008 is as follows:

	2009	2008
Net income (loss)	$ 6,057	$ (32,359)
Unrealized gains (losses) on value of derivative contracts	204	(372)
Net unrealized investment gains		442
Foreign currency translation adjustments	(178)	359
Comprehensive income (loss)	$ 6,083	$ (31,930)

F. Fair Value Measurements

Authoritative guidance defines fair value as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We categorize financial instruments within the fair value hierarchy based upon the lowest level of input that is significant to the fair value measurement. Our financial instruments consist primarily of cash and cash equivalents, restricted cash, accounts receivable, short-term investments, forward contracts to purchase foreign currencies and accounts payable. Due to their short-term nature, the carrying values of accounts receivable and accounts payable approximate fair value. Level 1 assets represent those whose fair value is based upon quoted prices in active markets for identical assets, while Level 2 assets represent those whose fair value is based upon significant other observable inputs. The Company has no Level 3 assets. Financial assets measured at fair value on a recurring basis as of December 31, 2009, were as follows:

	Level 1	Level 2	Total
Assets			
Cash and cash equivalents [1]	$ 32,435	$ 1,273	$ 33,708
Restricted cash	575		575
Certificates of deposit [2]		1,264	1,264
Foreign currency forward contracts [3]		145	145
	$ 33,010	$ 2,682	$ 35,692

Financial assets measured at fair value on a recurring basis as of September 30, 2009, were as follows:

	Level 1	Level 2	Total
Assets			
Cash and cash equivalents [1]	$ 22,444	$ 1,670	$ 24,114
Restricted cash	569		569
Certificates of deposit [2]		759	759
	$ 23,013	$ 2,429	$ 25,442
Liabilities			
Foreign currency forward contracts [3]	$	$ 170	$ 170

(1) Consists of cash, money market funds and certificates of deposit having maturities of less than 90 days after September 30, 2009.

(2) Included in Short term investments in

the unaudited condensed consolidated balance sheet.

(3) Included in Prepaid expenses or Other accrued expenses in the unaudited condensed consolidated balance sheet, with related unrecognized gains and losses being recorded in Accumulated other comprehensive losses until realized, at which time they are recorded in Cost of goods sold in the condensed consolidated statement of operations.

Certain nonfinancial assets are measured at fair value on a nonrecurring basis and therefore, are not included in the tables above. These assets primarily consist of notes receivable and are included in Other assets in the condensed consolidated balance sheets. They are measured at cost and are tested for impairment when events and circumstances warrant by comparing the fair value of the underlying net assets to the carrying value of the notes receivable.

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G. Guarantor s Disclosure Requirements

Guarantee of lease

In connection with the sale of substantially all assets of the Company s radio frequency (RF) product line to Agilent Technologies, Inc. (Agilent) in November 2009, Agilent assumed the Santa Rosa lease (see Note O. for further details). The Company remains a guarantor in the event of default; however, Agilent will indemnify the Company for any amounts paid by the Company to the landlord in event of any default. The maximum amount of future payments (undiscounted) the Company would be required to make under the guarantee would be approximately $711 through April 30, 2012. The Company has not recorded any liability for this item, as it does not believe that it is probable that Agilent will default on the lease payments.

Product Warranties

Generally, the Company s products are covered under a one-year warranty; however, certain products are covered under a two or three-year warranty. It is the Company s policy to accrue for all product warranties based upon historical in-warranty repair data. In addition, the Company accrues for specifically identified product performance issues. The Company also offers extended warranties for certain of its products for which revenue is recognized over the life of the contract period. The costs associated with servicing the extended warranties are expensed as incurred. The revenue from the extended warranties, as well as the related costs, is immaterial for the three month periods ending December 31, 2009 and 2008. A reconciliation of the estimated changes in the aggregated product warranty liability for the three-month periods ending December 31, 2009 and 2008 is as follows:

	2009	2008
Balance, beginning of period	$ 466	$ 701
Accruals for warranties issued during the period	252	279
Accruals related to pre-existing warranties (including changes in estimates and expiring warranties)	(46)	(26)
Settlements made (in cash or kind) during the period	(187)	(322)
Currency translation	(2)	
Balance, end of period	$ 483	$ 632

H. Repurchase of Common Shares

In February 2007, the Company s Board of Directors approved an open market stock repurchase program (the 2007 Program). Under the terms of the 2007 Program, the Company was authorized to purchase up to 2,000,000 Common Shares, which represented approximately 12 percent of the shares outstanding at the time the 2007 Program was approved, over a two-year period ending February 28, 2009. The purpose of the 2007 Program was to offset the dilutive effect of stock option and stock purchase plans, and to provide value to shareholders. Common Shares held in treasury may be reissued in settlement of stock purchases under the stock option and employee stock purchase plans. The Company did not replace the 2007 Program upon its expiration.

Under the Company s 2002 Stock Incentive Plan, the Company repurchased 2,649 Common Shares during the first quarter of fiscal 2010 for $12 for withholding of payroll taxes relating to vested restricted share awards, representing an average cost of $4.67 each (there were no associated commissions). During the first quarter of fiscal year 2009, the Company purchased 155,000 Common Shares under the 2007 Program for $745 at an average cost of $4.80 per share, including commissions. In addition, the Company repurchased 11,733 Common Shares, at an average cost of $3.62 per share, as permitted under the Company s 2002 Stock Incentive Plan, for withholding of payroll taxes upon the issuance of Common Shares for vested performance award units in November 2008. See Note M.

At December 31, 2009 and 2008, 1,380,297 and 1,377,648 Common Shares remained in treasury at an average cost, including commissions, of $9.93 and $9.94, respectively.

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Also, included in Common shares held in treasury, at cost are shares purchased to settle non-employee Directors fees deferred pursuant to the Keithley Instruments, Inc. 1996 Outside Directors Deferred Stock Plan. Shares held in treasury pursuant to this plan totaled 233,364 and 208,569 at December 31, 2009 and 2008, respectively.

I. Investments

The Company classifies its investments in certificates of deposits and money market fund investments as trading , which requires they be recorded at fair market value in the Company s consolidated balance sheet with the changes in fair value and resulting gains and losses included in the Company s condensed consolidated statements of operations. There were no realized gains or losses on sales of marketable securities during the first quarter of fiscal years 2010 or 2009. U.S. G.A.A.P. defines fair value as the price that would be received upon sale of an asset or paid upon transfer of a liability in an orderly transaction between market participants at the measurement date and in the principal or most advantageous market for that asset or liability. We determined the fair market value of the trading investments at December 31 and September 30, 2009, using quoted prices for similar assets, which is a Level 2 hierarchy fair value measurement. The balance of trading investments was $1,264 and $759 at December 31, and September 30, 2009, respectively, and there were no unrealized gains or losses.

At December 31 and September 30, 2009, the investments have maturity dates of less than one year.

J. Financing Arrangements

Effective March 31, 2009, the Company amended its $10,000 credit agreement. The revised agreement consists of a $5,000 facility ($0 of short-term debt and $575 of standby letters of credit outstanding at December 31, 2009) that provides unsecured, multi-currency revolving credit at various interest rates based on Prime or LIBOR. LIBOR was 0.25% and the Prime rate was 3.25% as of December 31, 2009. The agreement does not contain debt covenants, but requires cash to be pledged against outstanding borrowings and standby letters of credit. The Company is required to pay a facility fee of 0.25% per annum on the total amount of the commitment. The agreement s expiration date is March 31, 2011, and may be extended annually. Additionally, per the terms of the agreement, the Company may borrow up to $5,000 from other lenders. The Company has a number of other such credit facilities in various currencies and for standby letters of credit aggregating $1,540 ($0 outstanding at December 31, 2009). At December 31, 2009, the Company had total unused lines of credit with domestic and foreign banks aggregating $5,965.

K. Derivatives and Hedging Activities

In the normal course of business, the Company uses derivative financial instruments to manage foreign currency exchange rate risk. The Company does not enter into derivative transactions for trading purposes. The objective of the Company s hedging strategy is to hedge the foreign currency risk associated with the anticipated sale of inventory and the settlement of the related intercompany accounts receivable. The forward contracts are designated as cash flow hedges that encompass the variability of U.S. dollar cash flows attributable to the settlement of intercompany foreign currency denominated receivables resulting from the sale of inventory manufactured in the U.S. to our wholly-owned foreign subsidiaries. The foreign exchange forward contracts generally have maturities of three months or less. Changes in the fair value of these derivatives are recorded in the financial statement line item Accumulated other comprehensive loss on the condensed consolidated balance sheets and reclassified into the financial statement line item Cost of goods sold on the condensed consolidated statements of operations in the same period during which the hedged transaction affects earnings. Cash flows resulting from hedging transactions are classified in the condensed consolidated statements of cash flows in the same category as the cash flows from the item being hedged; i.e., in operating activities. In accordance with U.S. G.A.A.P., all of the Company s derivative instruments are recognized on the balance sheet at their fair value. At December 31, 2009, the Company had obligations under foreign exchange forward contracts to sell 1,825,000 Euros, 225,000 British pounds and 150,000,000 Yen at various dates through February 2010.

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The fair values of the derivative instruments are recorded on the consolidated balance sheets as follows:

	December 31, 2009	September 30, 2009
Assets:		
Contract value	$ 4,616	$ 371
Fair value	4,469	360
Total asset	147	11
Liabilities:		
Contract value	119	4,350
Fair value	121	4,531
Total liability	(2)	(181)
Net asset (liability)	$ 145	$ (170)

The net asset or net liability balances are included in the line items Prepaid expenses or Other accrued expenses , respectively, on the Company s condensed consolidated balance sheets. Forward foreign exchange contracts are entered into with substantial and creditworthy multinational banks. The fair market value was determined by utilizing a valuation received from the foreign currency trader, which we independently verified, and as such, is considered to be derived from Level 2 inputs as defined by U.S. G.A.A.P.

As of December 31, 2009, we have recorded unrealized gains on derivatives of $204 in Accumulated other comprehensive loss, which we expect to reclassify into earnings in the next three months. During the first quarter of fiscal 2010, losses of $91 were reclassified into earnings from Accumulated other comprehensive loss.

L. Pension Benefits

The Company has a noncontributory defined benefit pension plan covering all of its eligible employees in the United States and a contributory defined plan covering eligible employees at its German subsidiary. Pension benefits are based upon the employee s length of service and a percentage of compensation. The Company also has government mandated defined benefit retirement plans for its eligible employees in Japan and Korea; however, these plans are not material to the Company s consolidated financial statements.

A summary of the components of net periodic pension cost for the U.S. plan and the German plan is shown below:

	United States Plan For the Three Months Ended December 31,		German Plan For the Three Months Ended December 31,	
	2009	2008	2009	2008
Service costs-benefits earned during the period	$ 368	$ 389	$ 34	$ 44
Interest cost on projected benefit obligation	653	629	121	106
Expected return on plan assets	(925)	(961)	(21)	(17)
Amortization of net loss (gain)	99		(4)	
Amortization of prior service cost	8	24	1	1
Net periodic benefit cost	$ 203	$ 81	$ 131	$ 134

The Company expects to contribute approximately $1,000 to $2,000 to its pension plans in fiscal year 2010.

M. Stock-based Compensation

In December 2008, the Company s Board of Directors approved the Keithley Instruments, Inc. 2009 Stock Incentive Plan (the 2009 Plan) which was approved by the Company s shareholders at its annual meeting held on February 7, 2009. No awards have been granted from the 2009 Plan since its inception through December 31, 2009. The Company has three other equity-based compensation plans under which options are currently outstanding. Of the four plans, stock-based compensation awards can be granted to employees and Directors from two of the plans, while no new awards may be granted from the other two plans as they have been terminated or have expired. The Company also has an employee stock purchase plan (ESPP) that provides employees with the opportunity to purchase Common Shares at 95 percent of the fair market value at the end of the one-year subscription period. The provisions of the ESPP are such that measurement of compensation expense is not required by U.S. G.A.A.P. Additionally, no shares were issued pursuant to the ESPP during the first quarter of fiscal years 2010 or 2009.

Compensation costs recorded

Our stock-based compensation expense is attributable to the granting of stock options, performance share units, restricted share units and restricted share awards. The Company records the expense using the single approach method on a straight-line basis over the requisite service period of the respective grants. The amount recorded in the quarter ended December 31, 2009, represents net compensation expense. The amount recorded in the period ended December 31, 2008, represents net compensation income, and includes a favorable adjustment of approximately $700 for performance award units granted in fiscal years 2007 and 2008. Those awards were expected, as of December 31, 2008, to settle at zero percent and 50 percent of target, respectively. The table below summarizes the allocation of stock-based compensation expense (income) recorded for the three months ended December 31, 2009 and 2008:

	2009	2008
Cost of goods sold	$ (1)	$ (75)
Selling, general and administrative expenses	176	(248)
Product development expenses	(16)	(148)
Stock-based compensation included in operating expenses	159	(471)
Estimated tax effect of stock-based compensation		
Stock-based compensation expense (income)	$ 159	$ (471)

Due to the net operating loss position in the United States, there was no tax impact on stock-based compensation in the first quarter of fiscal years 2010 or 2009, nor were there any excess tax benefits recognized during the first quarter of fiscal years 2010 and 2009. Likewise, we expect to record no tax effects of stock based compensation for fiscal 2010.

As of December 31, 2009, there was $839 of total pretax unrecognized compensation cost related to nonvested awards. That cost is expected to be recognized over a weighted-average period of 3.0 years.

Stock option activity

During the first quarter of fiscal 2010, we granted 174,800 non-qualified stock options shares to officers and other key employees. These awards have a term of ten years, vest fifty percent after two years, and an additional twenty five percent each after years three and four. The options have an exercise price equal to the closing market price