

LSI THE IMAGE COMPANY

OPPORTUNITY
EVERYWHERE

OPPORTUNITY

OPPORTUNITY EVERYWHERE NOW

NOW
EVERYWHERE



2005 ANNUAL REPORT

OUR **GROWTH** WILL COME FROM
CAPITALIZING ON **OPPORTUNITIES** IN
PRESENT AND **FUTURE** **MARKETS**

IMAGE IS OUR BUSINESS

THROUGH LIGHTING, GRAPHICS AND TECHNOLOGY

GRAPHICS

LIGHTING

TECHNOLOGY

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FLEET GRAPHICS



AUTOMOTIVE



RETAIL



SUPERMARKET



COMMERCIAL



BRANDS



CONVENIENT STORE



PETROLEUM

CORPORATE PROFILE

LSI Industries is an image solutions company, combining integrated design, manufacturing, and technology to supply high quality lighting fixtures and graphics elements for applications in the retail, specialty niche, and commercial markets. The Company's Lighting Segment produces high performance products dedicated to outdoor, architectural outdoor, indoor, architectural indoor and accent/downlight applications. The Company's Graphics Segment provides a vast array of products and services, including signage, menu board systems, active digital signage, decorative fixturing, design support, and engineering and project management for custom programs for today's retail environment. LSI's major markets are the petroleum/convenience store, multi-site retail (including automobile dealerships, restaurants and national retail accounts) and the commercial/industrial lighting markets.

"Safe Harbor" Statement under the Private Securities Litigation Reform Act of 1995

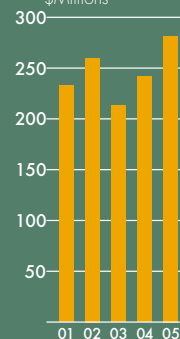
This Annual Report contains certain forward-looking statements that are subject to numerous assumptions, risks or uncertainties. The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. Forward-looking statements may be identified by words such as "estimates," "anticipates," "projects," "plans," "expects," "intends," "believes," "seeks," "may," "will," "should" or the negative versions of those words and similar expressions, and by the context in which they are used. Such statements are based upon current expectations of the Company and speak only as of the date made. Actual results could differ materially from those contained in or implied by such forward-looking statements as a result of a variety of risks and uncertainties. These risks and uncertainties include, but are not limited to, the impact of competitive products and services, product demand and market acceptance risks, reliance on key customers, financial difficulties experienced by customers, the adequacy of reserves and allowances for doubtful accounts, fluctuations in operating results or costs, unexpected difficulties in integrating acquired businesses, and the ability to retain key employees of acquired businesses. The Company has no obligation to update any forward-looking statements to reflect subsequent events or circumstances.

FINANCIAL HIGHLIGHTS

	2005	2004	2003
INCOME STATEMENT DATA			
(In thousands, except per share)			
Net sales	\$282,440	\$241,405	\$213,133
Operating income	\$ 23,026	\$ 14,034	\$ 11,366
Income before cumulative effect of accounting change	\$ 14,636	\$ 8,690	\$ 7,793
Net income (loss)	\$ 14,636	\$ 8,690	\$ (10,748)
Earnings (loss) per common share			
Basic			
Earnings per share before cumulative effect of accounting change	\$.74	\$.44	\$.40
Earnings (loss) per share	\$.74	\$.44	\$ (.55)
Diluted			
Earnings per share before cumulative effect of accounting change	\$.73	\$.43	\$.39
Earnings (loss) per share	\$.73	\$.43	\$ (.54)
BALANCE SHEET DATA			
(In thousands)			
Working capital	\$ 67,189	\$ 64,724	\$ 59,633
Total assets	\$172,637	\$174,732	\$162,776
Long-term debt, including current maturities	\$ —	\$ 11,554	\$ 14,084
Shareholders' equity	\$138,040	\$128,863	\$124,905
CASH FLOW DATA			
(In thousands)			
Capital expenditures	\$ 3,630	\$ 4,708	\$ 5,452
Depreciation and amortization	\$ 6,974	\$ 5,925	\$ 5,702
Cash flow from operating activities	\$ 27,482	\$ 12,114	\$ 13,218

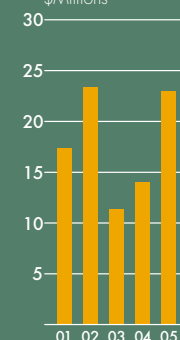
NET SALES

\$/Millions



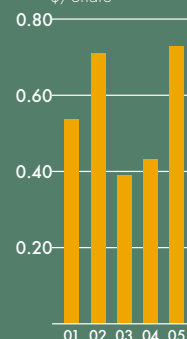
OPERATING INCOME

\$/Millions



EARNINGS PER SHARE*

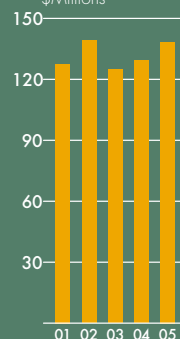
\$/Share



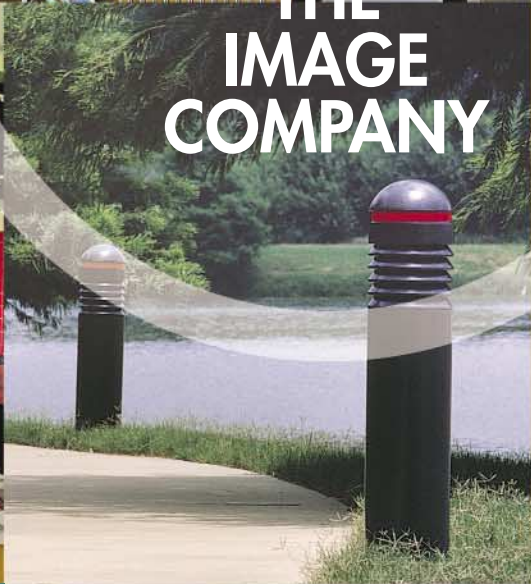
*From Continuing Operations Before Cumulative Effect of Accounting Change; Diluted

SHAREHOLDERS' EQUITY

\$/Millions



OPPORTUNITY



EVERYWHERE



LIGHTING



Photography by
MacWright Studio LLC



Over the last 12 months, we have begun to share with our customers and industry partners the outline of a new lighting group organization based on a very simple and logical strategy. Specifically, the close coordination of our various lighting companies will achieve results far beyond what these companies can achieve independently. In fiscal 2005, the LSI Lighting Solutions *Plus* team began to transition this concept into a reality.

During fiscal 2005, the lighting group recorded the highest level of lighting sales in the history of our company. Operating income continues to improve even with the short-term impact of costs associated with additional systems implementations and organizational restructuring. Our JD Edwards OneWorld system implementation along with coordinated efforts in sales, engineering, manufacturing, purchasing and service are beginning to produce visible returns in terms of our ability to adapt to a changing marketplace. We have continued to make investments to improve our manufacturing capacity and throughput in each of our lighting operations. We have made strong improvements in inventory control and use our systems' continuity between operations to enhance the movement of finished goods stock. We have maintained or

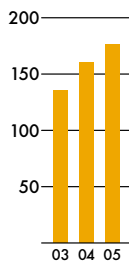
grown our market share position in our established niche markets and have made significant progress in expanding our presence in large commercial and industrial lighting markets. With a stable agent sales force and new product releases in all product categories, we are poised to maintain this momentum in fiscal 2006. While we have certainly achieved growth in this traditional sense, we have also grown immeasurably as a unified organization building upon the foundations long established over the almost 30 years of LSI's success.

We enter the new fiscal year focused on consistent day to day performance in a challenging lighting market, while at the same time using our unified companies to take advantage of larger more cyclical program business that is generated by our combined image business opportunities working with LSI Graphic Solutions *Plus*.

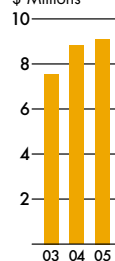
We believe our dedication to our core fundamental strategies of aggressive yet selective market penetration, constant cost control, conservative financial disciplines and the unique advantage that our Lighting, Graphics and

Technology capabilities provide us form the basis of continued strong performance for years to come. The pieces are in place, **Now** is the time for us to take advantage of the **Opportunity Everywhere!**

**NET SALES
Lighting
Segment**
\$ Millions



**OPERATING
INCOME
Lighting
Segment**
\$ Millions



Sincerely,

Scott D. Ready
President
LSI Lighting Solutions Plus

GRAPHICS

The Graphics Segment completed fiscal 2005 with record results in both sales and operating income. The plan and disciplines set forth during the last two years have proven successful and will serve us well in the years ahead.

We understand our market and watch closely for any changes that we can capitalize on or should be cautious of. Many of the markets we serve are in the process of or are due for a change. Trends, themes and marketing programs' life cycles continue to shorten constantly providing us with more demand. Mergers, acquisitions, joint ventures, new offerings and new brands are very active and again are boosting demand for our services. The biggest challenge on the graphics side of the business is to smooth the flow from quarter to quarter or year to year.

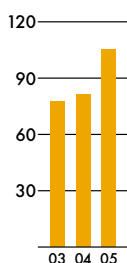
Many programs can be massive in nature and a delay in projects can cause earnings and production challenges in any particular quarter. The business flow in Fiscal 2005 was pretty smooth, certainly a model we will strive for in future years. Operational efficiencies between manufacturing plants was very good and much improved this

past year. Sales coordination, engineering, design services, and supply arrangements are areas in which we had strong teamwork and coordinated efforts.

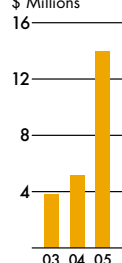
Probably the most exciting and secure feeling is taking all the learned, best practices of the past two years and applying them in the fiscal 2006 plan to a presently strong market demand. The coordinated effort between the lighting and graphics groups was good in fiscal 2005 and shows much more promise going forward. Our entry and posturing into the electronic digital side of the business and the market acceptance of this graphic medium is positive and promising. We expect this niche to play a larger role in our future.

We have built the Graphics Segment to be the recognized leader in the industry and are well known for our capabilities, thereby making us the vendor of choice for large complicated and demanding programs. The effort and plans to make LSI lighting and graphics businesses a totally integrated image company are working. It is just a matter of execution and we feel disciplined, strong and capable of more exciting years to come.

**NET SALES
Graphics
Segment**
\$ Millions



**OPERATING
INCOME
Graphics
Segment**
\$ Millions



Sincerely,

David W. McCauley

David W. McCauley
President
LSI Graphic Solutions Plus



FUTURE NOW

Dear Shareholders

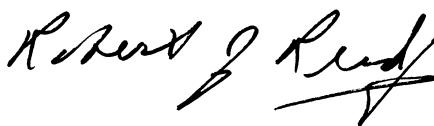
Last year at this time I wrote to you about why I believed the future was so positive for LSI Industries. Among the reasons for my strong convictions were strong customer relationships, innovative new products, a success oriented management team, and a sound balance sheet. Most importantly, however, were the strategies, plans, and directions we put in place and carefully implemented during the past several years. The positive converging results of these actions really started to come together in fiscal 2005. Net sales increased 17% over the prior fiscal year, and net income was up 68%. Careful management of working capital and the resulting strong cash flow allowed long-term debt to be eliminated further strengthening our financial condition at fiscal year end.

Numerous improvements were made in our Lighting Segment and our efforts to build brand awareness through our LSI Lighting Solutions *Plus* and LSI Graphic Solutions *Plus* groups is working well. With these groups working together we truly do see opportunity everywhere as we capitalize on our core strategy of "Lighting + Graphics + Technology = Complete Image Solutions." Comments from our two group presidents are included in their letters to shareholders.

Fiscal 2005 was a good year and an extra cash dividend of \$0.10 per share was declared. Of even greater significance, the Board of Directors increased next year's regular quarterly rate from \$0.10 per share to \$0.12 per share, an increase of 20%. Over the most recent three years, the annual rate has increased from \$0.288 to \$0.40 to \$0.48 per share, a cumulative increase of 67%, plus the most recent year-end special cash dividend. Our most recent increase in the indicated annual rate is consistent with the Company's policy of setting the annual rate between 40% and 60% of expected net income for the current fiscal year. We recognize the importance of cash dividends over the long-term, and have been paying cash dividends on an uninterrupted and increasing rate since 1989.

Our efforts to broaden LSI's lighting and graphics capabilities have been successful and are, of course, on-going. At the same time, we have preserved our strong position in niche markets like the petroleum / convenience store market which has the potential to gain re-imaging momentum later this fiscal year and into fiscal 2007. We enter fiscal 2006 with confidence – Opportunity is Everywhere.

Sincerely,



Robert J. Ready
Chairman, President and CEO
LSI Industries Inc.

FINANCIAL RESULTS

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

NET SALES BY BUSINESS SEGMENT

<i>(In thousands)</i>	2005	2004	2003
Lighting Segment	\$177,021	\$159,748	\$136,076
Graphics Segment	105,419	81,657	77,057
	<u>\$282,440</u>	<u>\$241,405</u>	<u>\$213,133</u>

RESULTS OF OPERATIONS

2005 Compared To 2004

Net sales of \$282,440,000 in fiscal 2005 increased 17% from fiscal 2004 net sales of \$241,405,000. Lighting Segment net sales increased 11% to \$177,021,000 and Graphics Segment net sales increased 29% to \$105,419,000 as compared to the prior year. Sales to the petroleum/convenience store market represented 25% and 28% of fiscal 2005 and 2004 net sales, respectively. Net sales to this, the Company's largest market, are reported in both the Lighting and Graphics Segments, depending upon the product or service sold, and were up 5% from fiscal 2004 to \$70.1 million. The petroleum/convenience store market has been, and will continue to be, a very important niche market for the Company; however, if sales to other markets and customers increase more than net sales to this market, then the percentage of net sales to the petroleum/convenience store market would be expected to decline.

The \$17.3 million increase in Lighting Segment net sales is primarily the result of an aggregate increase of \$16.1 million of lighting sales to our niche markets of petroleum/convenience stores, automotive dealerships, quick service restaurants, and retail national accounts (including significantly increased sales to Wal-Mart Stores, Inc.), as well as a \$2.6 million increase in commissioned net sales to the commercial and industrial lighting market. Net sales to Wal-Mart Stores, Inc. were approximately \$30.2 million or 11% of the Company's total net sales in fiscal 2005.

The \$23.8 million increase in Graphics Segment net sales is primarily the result of the effect of increased graphics net sales to the petroleum/convenience store market (\$0.4 million), and increased net sales to retail store customers (approximately \$19.8 million, with over \$14 million of this increase related to a national drug store retailer for its re-branding program that is now complete and approximately \$7 million related to a now complete menu board enhancement program).

Image and brand programs, whether full conversions or enhancements, are important to the Company's strategic direction. Image programs include situations where our customers refurbish their retail sites around the country by replacing some or all of the lighting, graphic elements, menu board systems and possibly other items they may source from other suppliers. These image programs often take several quarters to complete and involve both our customers' corporate-owned sites as well as their franchisee-owned sites, the latter of which involve separate sales efforts by the Company with each franchisee. The Company may not always be able to replace net sales immediately when a large image conversion program has concluded. Brand programs typically occur as new products are offered or new departments are created within an existing retail store. Relative to net sales to a customer before and after an image or brand program, net sales during the program are typically significantly higher, depending upon how much of the lighting, graphics or menu board business is awarded to the Company. Sales related to a customer's image or brand program are reported in either the Lighting Segment and/or the Graphics Segment, depending upon the product and/or service provided.

The Company's Lighting Segment increased sales prices in the second half of fiscal year 2004, and again in the second and fourth quarters of fiscal 2005 on select products in some markets the Company serves. The Company experienced competitive pricing pressures in most lighting markets, thereby restricting price increases.

In some markets the Company was able to increase sales prices to recover a portion of increased raw material costs, but generally with little or no increase in gross profit. The rise in steel and aluminum prices in mainly the first eight months of fiscal 2005 caused some reduction in the Lighting Segment's gross profit margin as a percentage of net sales.

Gross profit of \$72,296,000 in fiscal 2005 increased 21% from last year, and increased as a percentage of net sales to 25.6% in fiscal 2005 as compared to 24.7% last year. The increase in amount of gross profit is due primarily to the 17% increase in net sales, product mix and efficiencies, partially offset by higher inventory adjustments related to obsolete inventory, the rising raw material costs noted above, installation, freight and distribution expenses. While the Company instituted sales price increases on select products in the second half of fiscal 2004 and again in the second and fourth quarters of fiscal 2005, increased material costs, manufacturing wages, compensation and benefits increases (\$0.6 million), competitive pricing pressures, unabsorbed manufacturing costs in the Company's New York facility, and increased manufacturing expenses (\$0.3 million of utilities, \$0.3 million of factory supplies, \$0.4 million of depreciation, and \$0.4 million of repairs, maintenance and property taxes) partially offset the favorable influences on the Company's gross profit margin.

Selling and administrative expenses in fiscal year 2005 increased \$3.6 million and decreased as a percentage of net sales to 17.4% from 18.8% last year. Fiscal 2005 had increased employee compensation and benefits expense (\$2.6 million due to increased salary »rates, staffing levels and incentive compensation), a \$0.6 million Graphics Segment expense related to alleged patent infringement, increased product warranty expense (\$0.3 million primarily in the Lighting Segment), increased sales commissions (\$0.1 million) and increased depreciation expense (\$0.7 million, primarily related to

the Company's business operating system). These increases were partially offset by a favorable \$0.4 million gain related to the Company's Graphics Segment's partial settlement of its bankruptcy claim against Kmart, reduced outside professional fees with outside consultants related to the JD Edwards OneWorld business operating system and to the documentation and testing of internal controls (08 million), and a decreased provision for bad debts (\$0.2 million).

The Company completed its annual goodwill impairment test as of July 1, 2004 as required by Statement of Financial Accounting Standards No. 142 (SFAS No. 142), "Goodwill and Other Intangible Assets," and recorded an impairment of \$186,000 in the first quarter of fiscal 2005. There was no impairment in fiscal 2004. See Note 6 to the financial statements for additional information.

The Company reported interest expense of \$217,000 in fiscal 2005 as compared to \$260,000 last year. The average interest rate on the Company's line of credit has increased in fiscal 2005 as compared to last year, but the average borrowings outstanding have decreased. The effective tax rate in fiscal 2005 was 36.0% as compared to 37.0% in fiscal 2004. The reduced effective tax rate was related to state income taxes, partially offset by a higher federal income tax rate (35% as compared to 34.1%).

Net income increased 68% in fiscal 2005 to \$14,636,000 as compared to \$8,690,000 last year. The increase is primarily the result of increased gross profit on increased net sales, partially offset by increased operating expenses, and income taxes. Diluted earnings per share was \$0.73 in fiscal 2005 as compared to \$0.43 per share in fiscal 2004, a 70% increase. The weighted average common shares outstanding for purposes of computing diluted earnings per share in fiscal 2005 was 20,087,000 shares as compared to 20,038,000 shares last year.

2004 Compared To 2003

Net sales of \$241,405,000 in fiscal 2004 increased 13% from fiscal 2003 net sales of \$213,133,000. Lighting Segment net sales increased \$23.7 million, or 17%, to \$159,748,000 and Graphics Segment net sales increased \$4.6 million, or 6%, to \$81,657,000 as compared to the prior year. Sales to the petroleum/convenience store market, the Company's largest market representing 28% and 29% of fiscal 2004 and 2003 net sales, respectively, were up 9% over fiscal 2003 to \$66.5 million. Net sales to this market are reported in both the Lighting and Graphics Segments, depending upon the product or service sold. While sales to this market have increased this year, the Company believes concerns about the Middle East and the war with Iraq have had the effect of reducing major image program spending by the major oil companies. The petroleum/convenience store market has been, and will continue to be, a very important niche market for the Company.

The \$23.7 million increase in Lighting Segment net sales is primarily the result of an approximate \$10.2 million increase in sales to the commercial/industrial lighting markets (resulting, in part, from a slight improvement in the economy, as well as good response from the Company's new independent commercial sales representatives), and an aggregate increase of \$12.4 million of lighting sales to our niche markets of petroleum/convenience store, automotive dealerships, quick service restaurants, and retail national accounts (including increased sales to a major national retailer).

The \$4.6 million increase in Graphics Segment net sales is primarily the result of the net effect of increased graphics sales to the petroleum/convenience store market (\$3.2 million), increased sales to a retail store customer (approximately \$9.5 million), and reduced menu board system sales (one quick service restaurant customer sales are down \$6.4 million as their roll out program is now considered complete in fiscal 2005).

Image and brand programs, whether full conversions or enhancements, are important to the Company's strategic direction. Image programs include situations where our customers refurbish their retail sites around the country by replacing some or all of the lighting, graphic elements, menu board systems and possibly other items they may source from other suppliers. These image

programs often take several quarters to complete and involve both our customers' corporate-owned sites as well as their franchisee-owned sites, the latter of which involve separate sales efforts by the Company with each franchisee. Brand programs typically occur as new products are offered or new departments are created within an existing retail store. Relative to net sales to a customer before and after an image or brand program, net sales during the program are typically significantly higher, depending upon how much of the lighting, graphics or menu board business is awarded to the Company. Sales related to a customer's image or brand program are reported in either the Lighting Segment and/or the Graphics Segment, depending upon the product and/or service provided.

While sales prices in some markets that the Company serves were increased in the second half of the year, inflation did not have a significant impact on sales in fiscal 2004. The Company experienced competitive pricing pressures in most markets, thereby holding price increases to a minimum. In some markets the Company was able to increase sales prices to recover increased raw material costs, but generally with little or no increase in gross profit. The rise in steel and aluminum prices caused a reduction in the gross profit margin. Additionally, during this period of transition to an improving economy, in certain situations the Company has accepted lower-than-normal sales prices and lower-than-normal margins where necessary, in part to protect and grow market share.

Gross profit of \$59,522,000 in fiscal 2004 increased 8% from last year, but decreased as a percentage of net sales to 24.7% in fiscal 2004 as compared to 25.9% last year. The increase in amount of gross profit is due primarily to the 13% increase in net sales, product mix and efficiencies, partially offset by higher installation, freight and distribution expenses. While the Company instituted sales price increases in the second half of fiscal 2004, manufacturing wages and compensation increases that were two percentage points greater than the increase in net sales, competitive pricing pressures throughout the year and increasing material costs in the second half contributed to the decreased gross profit margin percentage. Selling and administrative expenses increased \$1.7 million. Fiscal 2004 had \$0.8 million lower bad debt expense (in fiscal 2003 the

Graphics Segment had significant additional expense due primarily to customer bankruptcies and cash flow difficulties), lower legal and professional fees (\$0.2 million), and lower travel expense (\$0.2 million). Items offsetting this reduction of expense were increased employee compensation (\$1.7 million due to increased salary rates, and increased staffing levels and incentive compensation) and outside consultant expenses (\$0.7 million) related to the Company's implementation of JD Edwards OneWorld business operating system in the Cincinnati and Kentucky operations and to the documentation and testing of internal controls.

The Company reported interest expense of \$260,000 in fiscal 2004 as compared to \$378,000 last year. The change between years is reflective of both reduced interest rates and reduced average outstanding borrowings on the Company's line of credit. The effective tax rate in fiscal 2004 was 37.0%. The fiscal 2003 effective tax rate of 30.7% is the net result of a normal tax provision of about 37.5% that was reduced when the Company recorded federal and state income tax credits.

Income before cumulative effect of an accounting change was \$8,690,000 in fiscal 2004, a 12% increase as compared to \$7,793,000 in fiscal 2003. The increase is primarily the result of increased gross profit on increased net sales and decreased interest expense, partially offset by increased operating expenses and income taxes. Diluted earnings per share, before the cumulative effect of an accounting change, was \$0.43 in fiscal 2004 as compared to \$0.39 per share in fiscal 2003. The weighted average common shares outstanding for purposes of computing diluted earnings per share in fiscal 2004 was 20,038,000 shares as compared to 19,923,000 shares last year.

The Company completed the transitional goodwill impairment test required by Statement of Financial Accounting Standards No. 142 (SFAS No. 142), "Goodwill and Other Intangible Assets," as of July 1, 2002. This test required the Company, through an independent appraisal firm, to assess the fair value, as determined on a discounted cash flow basis, of each reporting unit that had goodwill on its balance sheet, and compare that value to the carrying value of the reporting unit's net assets as of July 1, 2002. The Company determined for the fiscal 2003 transitional goodwill

impairment test that it had eight reporting units, each of which represented an acquired business that operated in the organizational structure one level below the business segment level. Based upon this analysis, there was full impairment of the recorded net goodwill of two reporting units in the Lighting Segment (totaling \$23,593,000) and one reporting unit in the Graphics Segment (totaling \$929,000). The impairment of \$24,522,000, a non-cash and non-operating charge, was booked in the amount of \$18,541,000, net of income taxes, as a change in accounting method and was recorded as of the date of adoption of SFAS No. 142, July 1, 2002. The Company has determined that it will perform its annual goodwill impairment test in accordance with SFAS No. 142 as of July 1st each year. There were no changes in accounting methods and no impairment of goodwill in fiscal 2004.

The Company recorded net income of \$8,690,000 in fiscal 2004 as compared to a net loss of \$10,748,000 in fiscal 2003. The increase in 2004 is the result of the \$18,541,000 goodwill impairment loss that was recorded as an accounting change in fiscal 2003, plus the increased fiscal 2004 income before cumulative effect of accounting change. Diluted earnings or (loss) per share was \$(0.54) in fiscal 2003 as compared to \$0.43 per share in fiscal 2004.

LIQUIDITY AND CAPITAL RESOURCES

The Company considers its level of cash on hand, its borrowing capacity, its current ratio and working capital levels to be its most important measures of short-term liquidity. For long-term liquidity indicators, the Company believes its ratio of long-term debt to equity and its historical levels of net cash flows from operating activities to be the most important measures.

At June 30, 2005 the Company had working capital of \$67.2 million, compared to \$64.7 million at June 30, 2004. The ratio of current assets to current liabilities improved to 3.13 to 1 from 3 to 1. The increase in working capital was primarily related to a significant increase in cash (\$7.0 million), increased accounts receivable (\$4.2 million), and decreased accounts payable (\$2.5 million), partially offset by decreased inventories (\$8.2 million), decreased other current assets (\$1.3 million) and increased accrued expenses (\$1.7 million). The

\$4.2 million increase in accounts receivable is due to higher fourth quarter fiscal 2005 net sales as compared to fourth quarter fiscal 2004. The DSO (days sales outstanding) was 59 days at both June 30, 2005 and June 30, 2004. With the Company's focus on inventory reduction in fiscal 2005, raw materials inventories decreased \$4.6 million, and work in process and finished goods inventories are down \$3.6 million since the end of fiscal 2004.

The Company generated \$27.5 million of cash from operating activities in fiscal 2005 as compared to a generation of cash of \$12.1 million last year. The \$15.4 million increase in net cash flows from operating activities in fiscal 2005 is primarily the net result of increased net income (\$5.9 million favorable), less of an increase in accounts receivable (unfavorable change of \$1.1 million), a decrease in refundable income taxes (unfavorable change of \$0.8 million), a decrease in inventories rather than the increase last year (favorable change of \$15.6 million), a decrease in other current assets rather than the increase last year (favorable change of \$3.2 million), an aggregate \$0.8 million decrease in accounts payable and accrued expenses in fiscal 2005 as compared to an aggregate \$8.5 million increase last year (net \$9.3 million unfavorable), more depreciation, amortization and goodwill impairment in fiscal 2005 (\$1.2 million favorable), an increase in net deferred income tax assets rather than a decrease (\$1.4 million unfavorable), and an unfavorable change of \$0.3 million related to distributions out of the Company's non-qualified deferred compensation plan.

Net accounts and notes receivables were \$46.7 million and \$42.5 million at June 30, 2005 and June 30, 2004, respectively. The 10% increase in receivables is due to the net result of increased sales of the fourth quarter of fiscal 2005 as compared to the fourth quarter of fiscal 2004 as well as the timing of customer payments. The Company believes that its receivables are ultimately collectible or recoverable, net of certain reserves, and that aggregate allowances for doubtful accounts are adequate.

Inventories at June 30, 2005 declined \$8.2 million from June 30, 2004 levels. An inventory decrease of about \$0.6 million occurred in the Graphics Segment, while Lighting Segment inventories decreased about \$7.6 million in fiscal 2005. The \$2.5 million reduction of accounts payable from June 30, 2004 to June 30, 2005 is related to the timing of both purchases of inventory and payments to suppliers.

Cash generated from operations and borrowing capacity under a line of credit agreement are the Company's primary source of liquidity. The Company has an unsecured \$50 million revolving line of credit with its bank group, all of which was available as of September 1, 2005. This line of credit consists of a \$30 million three year committed credit facility expiring in fiscal 2008 and a \$20 million credit facility with an annual renewal in the third quarter of fiscal 2006. The Company believes that the total of available lines of credit plus cash flows from operating activities is adequate for the Company's fiscal 2006 operational and capital expenditure needs. The Company is in compliance with all of its loan covenants.

Capital expenditures of \$3.6 million in fiscal 2005 compare to \$4.7 million in fiscal 2004. Fiscal 2005 spending is primarily for tooling and equipment. The Company intends to expand its graphics facility in Rhode Island, thereby increasing expected fiscal 2006 capital expenditures to the range of \$7.0 to \$8.0 million, exclusive of business acquisitions.

The Company used \$17.0 million of cash related to financing activities in fiscal 2005 as compared to a use of \$7.4 million in fiscal 2004. The \$9.6 million change between years is primarily the net result of increased net payments on the Company's line of credit (unfavorable \$9.0 million), increased dividend payments (unfavorable \$1.6 million) pursuant to the Company's increased indicated annual dividend payment amount, and increased cash flow from the exercise of stock options and issuance of common shares pursuant to compensation programs (favorable \$1.0 million). As of June 30, 2005 the Company's long term debt has been paid down to zero.

As of June 30, 2005, the Company had the following contractual obligations pursuant to long-term borrowings, leases, purchase obligations not recognized in the financial statements (i.e., open purchase orders issued to suppliers), and all other liabilities reflected in the balance sheet (in thousands):

Contractual Obligations as of
June 30, 2005

	Payments due by period				
	Total	Less than 1 year	1-3 years	3-5 years	More than 5 years
Long-Term Debt Obligations	\$ —	\$ —	\$ —	\$ —	\$ —
Capital Lease Obligations	—	—	—	—	—
Operating Lease Obligations	4,030	1,607	2,249	174	—
Purchase Obligations	8,540	8,535	5	—	—
Other Long-Term Liabilities	—	—	—	—	—
Total	<u>\$12,570</u>	<u>\$10,142</u>	<u>\$ 2,254</u>	<u>\$ 174</u>	<u>\$ —</u>

On August 24, 2005 the Board of Directors declared a regular quarterly cash dividend of \$0.10 per share (approximately \$1,987,000) as well as a special year-end cash dividend of \$0.10 per share (approximately \$1,987,000), both payable September 13, 2005 to shareholders of record on September 6, 2005. During fiscal 2005, the Company paid cash dividends of \$6,805,000, as compared to \$5,206,000 in fiscal 2004. The declaration and amount of dividends will be determined by the Company's Board of Directors, in its discretion, based upon its evaluation of earnings, cash flow, capital requirements and future business developments and opportunities, including acquisitions.

Carefully selected acquisitions have long been an important part of the Company's strategic growth plans. The Company continues to seek out, screen and evaluate potential acquisitions that could add to the lighting or graphics product lines or enhance the Company's position in selected markets. The Company believes adequate financing for any such investments or acquisitions will be available through future borrowings or through the issuance of common or preferred shares in payment for acquired businesses.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

The Company is required to make estimates and judgments in the preparation of its financial statements that affect the reported amounts of assets, liabilities, revenues and expenses, and related footnote disclosures. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. The Company continually reviews these estimates and their underlying assumptions to ensure they remain appropriate. The Company believes the items discussed below are among its most significant accounting policies because they utilize estimates about the effect of matters that are inherently uncertain and therefore are based on management's judgment. Significant changes in the estimates or assumptions related to any of the following critical accounting policies could possibly have a material impact on the financial statements.

Revenue Recognition

The Company recognizes revenue in accordance with Securities Exchange Commission Staff Accounting Bulletin No. 104, "Revenue Recognition." Revenue is recognized when title to goods and risk of loss have passed to the customer, there is persuasive evidence of a purchase arrangement, delivery has occurred or services have been rendered, and collectibility is reasonably assured. Revenue is typically recognized at time of shipment. Sales are recorded net of estimated returns, rebates and discounts. Any cash received from customers prior to the recognition of revenue is accounted for as a customer pre-payment and is included in accrued expenses.

The Company has four sources of revenue: revenue from product sales; revenue from the installation of product; service revenue generated from providing the integrated design, project and construction management, site engineering, and site permitting; and revenue from shipping and handling. *Product revenue* is recognized on product-only orders at the time of shipment. Product revenue related to orders where the customer requires the Company to install the product is generally recognized when the product is installed. In some situations, product revenue is recognized when the product is shipped, before it is installed, because by agreement the customer has taken title to and risk of ownership for the product before installation has been completed. Other than normal product warranties or the possibility of installation, the Company has no post-shipment responsibilities. *Installation revenue* is recognized when the products have been fully installed. The Company is not always responsible for installation of products it sells and has no post-installation service contracts or responsibilities. *Service revenue* from integrated design, project and construction management, site engineering and permitting is recognized at the completion of the contract with the customer. With larger customer contracts involving multiple sites, the customer may require progress billings for completion of identifiable, time-phased elements of the work, in which case revenue is recognized at the time of the progress billing, which coincides with the revenue recognition criteria. *Shipping and handling revenue* coincides with the recognition of revenue from sale of the product.

Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109 (SFAS No. 109), accordingly deferred income taxes are provided on items that are reported as either income or expense in different time periods for financial reporting purposes than they are for income tax purposes. Deferred income tax assets and liabilities are reported on the Company's balance sheet. Significant management judgment is required in developing the Company's income tax provision, including the determination of deferred tax assets and liabilities and any valuation allowances that might be required against deferred tax assets. Management has determined that no valuation allowances are required.

The Company operates in multiple taxing jurisdictions and is subject to audit in these jurisdictions. The Internal Revenue Service and other tax authorities routinely review the Company's tax returns. These audits can involve complex issues which may require an extended period of time to resolve. The impact of these examinations on the Company's liability for income taxes cannot be presently determined. In management's opinion, adequate provision has been made for potential adjustments arising from these examinations.

Asset Impairment

Carrying values of goodwill and other intangible assets with indefinite lives are reviewed at least annually for possible impairment in accordance with Statement of Financial Accounting Standards No. 142 (SFAS No. 142), "Goodwill and Other Intangible Assets," which was adopted on July 1, 2002. The Company's impairment review involves the estimation of the fair value of goodwill and indefinite-lived intangible assets using a discounted cash flow approach, at the reporting unit level, that requires significant management judgment with respect to revenue and expense growth rates, changes in working capital and the selection and use of an appropriate discount rate. The estimates of fair value of reporting units are based on the best information available as of the date of the assessment. The use of different assumptions would

increase or decrease estimated discounted future operating cash flows and could increase or decrease an impairment charge. Company management uses its judgment in assessing whether assets may have become impaired between annual impairment tests. Indicators such as adverse business conditions, economic factors and technological change or competitive activities may signal that an asset has become impaired. An impairment charge of \$24.5 million, or \$18.5 million net of tax, related to goodwill was recorded in fiscal 2003 as the cumulative effect of an accounting change and charged against income. A goodwill impairment charge of \$186,000 was recorded in fiscal 2005 resulting from the Company's fiscal 2005 SFAS No. 142 annual review. See Note 6 to the financial statements for further discussion.

Carrying values for long-lived tangible assets and definite-lived intangible assets, excluding goodwill, are reviewed for possible impairment as circumstances warrant in connection with Statement of Financial Accounting Standards No. 144 (SFAS No. 144), "Accounting for the Impairment or Disposal of Long-Lived Assets," which was adopted on July 1, 2002. Impairment reviews are conducted at the judgment of Company management when it believes that a change in circumstances in the business or external factors warrants a review. Circumstances such as the discontinuation of a product or product line, a sudden or consistent decline in the forecast for a product, changes in technology or in the way an asset is being used, a history of negative operating cash flow, or an adverse change in legal factors or in the business climate, among others, may trigger an impairment review. The Company's initial impairment review to determine if a potential impairment charge is required is based on an undiscounted cash flow analysis at the lowest level for which identifiable cash flows exist. The analysis requires judgment with respect to changes in technology, the continued success of product lines and future volume, revenue and expense growth rates, and discount rates. There were no impairment charges related to long-lived tangible assets or definite-lived intangible assets recorded by the Company during 2005, 2004 or 2003.

Credit and Collections

The Company maintains allowances for doubtful accounts receivable for estimated losses resulting from either customer disputes or the inability of its customers to make required payments. If the financial condition of the Company's customers were to deteriorate, resulting in their inability to make the required payments, the Company may be required to record additional allowances or charges against income. The Company determines its allowance for doubtful accounts by first considering all known collectibility problems of customers' accounts, and then applying certain percentages against the various aging categories of the remaining receivables. The resulting allowance for doubtful accounts receivable is an estimate based upon the Company's knowledge of its business and customer base, and historical trends. The Company also establishes allowances, at the time revenue is recognized, for returns and allowances, discounts, pricing and other possible customer deductions. These allowances are based upon historical trends.

NEW ACCOUNTING PRONOUNCEMENTS

In November 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 151, "Inventory Costs." This statement amends Accounting Research Board (ARB) No. 43, "Inventory Pricing," to clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials should be recognized as current-period charges. In addition, this statement requires that allocation of fixed production overheads to the cost of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005, or the Company's 2006 fiscal year beginning July 1, 2005. The Company is currently evaluating the impact of this statement, but does not expect any significant impact on its financial condition or results of operations when it is implemented.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 123(R) (revised 2004), "Share-Based Payment." This statement establishes standards for the accounting of transactions in which an entity exchanges its equity instruments for goods or services, primarily when it obtains employee services in share-based payment transactions. SFAS No. 123(R) (revised 2004) supersedes the Accounting Principles Board Opinion No. 25, Accounting for Stock issued to Employees. This Statement requires public entities to measure the cost of employee services received in exchange for an award of equity instruments based upon the grant date fair value of the award, with this cost being recognized over the period during which an employee is required to provide the services. This statement is effective for the first fiscal year beginning after June 15, 2005, or the Company's first quarter of fiscal 2006 which begins July 1, 2005. The Company is currently evaluating the impact of this statement, but expects the impact to be consistent with the pro forma information presented in Note 1.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 153, "Exchanges of Nonmonetary Assets." This statement addresses the measurement of exchanges of nonmonetary assets and is effective for fiscal periods beginning after June 15, 2005. The Company is currently evaluating the impact of this statement, but does not expect any significant impact on its financial condition or results of operations when it is implemented.

In May 2005, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 154, "Accounting Changes and Error Corrections." This statement replaces Accounting Principles Board (APB) Opinion No. 20, "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirement for the accounting for and reporting of a direct effect of a voluntary change in accounting principle. It also applies to changes required by an accounting pronouncement in the instance that the pronouncement does not include specific transition provisions. SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This statement also requires that a change in depreciation, amortization, or depletion method for long-lived, non-financial assets be accounted for as a change in accounting estimate affected by a change in accounting principle. This statement is effective for accounting changes and error corrections made in fiscal years beginning after December 15, 2005, or the Company's first quarter of fiscal year 2007 which begins July 1, 2006. The Company will comply with the provisions of this statement for any accounting changes or error corrections that occur after June 30, 2006.

CONSOLIDATED INCOME STATEMENTS

LSI INDUSTRIES INC.

For the years ended June 30, 2005, 2004, and 2003
(In thousands, except per share)

	2005	2004	2003
Net sales	\$282,440	\$241,405	\$213,133
Cost of products and services sold	210,144	181,883	157,966
Gross profit	72,296	59,522	55,167
Selling and administrative expenses	49,084	45,488	43,801
Goodwill impairment	186	—	—
Operating income	23,026	14,034	11,366
Interest (income)	(64)	(23)	(259)
Interest expense	217	260	378
Income before income taxes	22,873	13,797	11,247
Income tax expense	8,237	5,107	3,454
Income before cumulative effect of accounting change	14,636	8,690	7,793
Cumulative effect of accounting change, net of tax	—	—	18,541
Net income (loss)	\$ 14,636	\$ 8,690	\$ (10,748)
Earnings (loss) per common share			
Basic			
Earnings per share before cumulative effect of accounting change	\$ 0.74	\$ 0.44	\$ 0.40
Earnings (loss) per share	\$ 0.74	\$ 0.44	\$ (0.55)
Diluted			
Earnings per share before cumulative effect of accounting change	\$ 0.73	\$ 0.43	\$ 0.39
Earnings (loss) per share	\$ 0.73	\$ 0.43	\$ (0.54)

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

CONSOLIDATED BALANCE SHEETS

LSI INDUSTRIES INC.

June 30, 2005 and 2004
(In thousands, except shares)

	2005	2004
ASSETS		
Current Assets		
Cash and cash equivalents	\$ 7,210	\$ 205
Accounts and notes receivable, less allowance for doubtful accounts of \$1,116 and \$1,264, respectively	46,726	42,545
Inventories	39,452	47,672
Refundable income taxes	—	516
Other current assets	5,416	6,185
Total current assets	98,804	97,123
Property, Plant and Equipment, at cost		
Land	6,651	6,698
Buildings	32,361	32,120
Machinery and equipment	56,790	55,692
Construction in progress	400	209
	96,202	94,719
Less accumulated depreciation	(45,118)	(40,567)
Net property, plant and equipment	51,084	54,152
Goodwill, net	17,117	17,303
Other Intangible Assets, net	4,230	4,710
Other Assets, net	1,402	1,444
	<u>\$172,637</u>	<u>\$174,732</u>

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

	2005	2004
LIABILITIES & SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	\$ 15,807	\$ 18,289
Accrued expenses	15,808	14,110
Total current liabilities	<u>31,615</u>	<u>32,399</u>
Long-Term Debt	—	11,554
Deferred Income Taxes	1,693	1,333
Other Long-Term Liabilities	1,289	583
Shareholders' Equity		
Preferred shares, without par value; Authorized 1,000,000 shares, none issued	—	—
Common shares, without par value; Authorized 30,000,000 shares; Outstanding 19,869,513 and 19,733,804 shares, respectively	54,405	53,059
Retained earnings	83,635	75,804
Total shareholders' equity	<u>138,040</u>	<u>128,863</u>
	<u>\$172,637</u>	<u>\$174,732</u>

CONSOLIDATED STATEMENTS OF SHAREHOLDERS' EQUITY

LSI INDUSTRIES INC.

For the years ended June 30, 2005, 2004, and 2003

(In thousands, except per share)

	Common Shares		Retained Earnings	Total
	Number of Shares	Amount		
Balance at June 30, 2002	19,721	\$52,497	\$86,852	\$139,349
Net (loss)	—	—	(10,748)	(10,748)
Purchase of treasury shares	(30)	(243)	—	(243)
Deferred stock compensation	—	240	—	240
Stock options exercised, net	11	91	—	91
Dividends - \$0.192 per share	—	—	(3,784)	(3,784)
Balance at June 30, 2003	19,702	52,585	72,320	124,905
Net income	—	—	8,690	8,690
Purchase of treasury shares	(19)	(211)	—	(211)
Deferred stock compensation	—	185	—	185
Stock options exercised, net	51	500	—	500
Dividends - \$0.264 per share	—	—	(5,206)	(5,206)
Balance at June 30, 2004	19,734	53,059	75,804	128,863
Net income	—	—	14,636	14,636
Stock compensation awards	4	55	—	55
Sale of treasury shares, net	19	208	—	208
Deferred stock compensation	—	(71)	—	(71)
Stock options exercised, net	113	1,154	—	1,154
Dividends - \$0.372 per share	—	—	(6,805)	(6,805)
Balance at June 30, 2005	<u>19,870</u>	<u>\$54,405</u>	<u>\$83,635</u>	<u>\$138,040</u>

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

CONSOLIDATED STATEMENTS OF CASH FLOWS

LSI INDUSTRIES INC.

For the years ended June 30, 2005, 2004, and 2003

(In thousands)

	2005	2004	2003
Cash Flows From Operating Activities			
Net income (loss)	\$14,636	\$ 8,690	\$(10,748)
Non-cash items included in income			
Cumulative effect of accounting change, before taxes	—	—	24,522
Depreciation and amortization	6,974	5,925	5,702
Deferred income taxes	(178)	1,179	(4,365)
Deferred compensation plan	(71)	185	240
Issuance of common shares as compensation	55	—	—
(Gain) loss on disposition of fixed assets	54	116	31
Goodwill Impairment	186	—	—
Change (excluding effects of acquisitions) in			
Accounts and notes receivable	(4,181)	(5,231)	4,959
Inventories	8,220	(7,346)	(1,480)
Refundable income taxes	516	1,307	166
Accounts payable	(2,482)	4,686	(1,307)
Accrued expenses and other	3,753	2,603	(4,502)
Net cash flows from operating activities	<u>27,482</u>	<u>12,114</u>	<u>13,218</u>
Cash Flows From Investing Activities			
Purchase of property, plant, and equipment	(3,630)	(4,708)	(5,452)
Proceeds from sale of fixed assets	150	7	21
Net cash flows from investing activities	<u>(3,480)</u>	<u>(4,701)</u>	<u>(5,431)</u>
Cash Flows From Financing Activities			
Proceeds from issuance of long-term debt	3,460	1,725	3,746
Payment of long-term debt	(15,014)	(4,255)	(7,715)
Cash dividends paid	(6,805)	(5,206)	(3,784)
Exercise of stock options	1,154	500	91
Sale (purchase) of treasury shares	208	(211)	(243)
Net cash flows from financing activities	<u>(16,997)</u>	<u>(7,447)</u>	<u>(7,905)</u>
Increase (decrease) in cash and cash equivalents	7,005	(34)	(118)
Cash and cash equivalents at beginning of year	205	239	357
Cash and cash equivalents at end of year	<u>\$ 7,210</u>	<u>\$ 205</u>	<u>\$ 239</u>

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

NOTE 1 - SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Consolidation:

The consolidated financial statements include the accounts of LSI Industries Inc. (an Ohio corporation) and its subsidiaries, all of which are wholly owned. All significant intercompany transactions and balances have been eliminated.

Revenue recognition:

The Company has four sources of revenue: revenue from product sales; revenue from the installation of product; service revenue generated from providing the integrated design, project and construction management, site engineering, and site permitting; and revenue from shipping and handling.

Product revenue is recognized on product-only orders at the time of shipment. Product revenue related to orders where the customer requires the Company to install the product is generally recognized when the product is installed. In some situations, product revenue is recognized when the product is shipped, before it is installed, because by agreement the customer has taken title to and risk of ownership for the product before installation has been completed. Other than normal product warranties or the possibility of installation, the Company has no post-shipment responsibilities.

Installation revenue is recognized when the products have been fully installed. The Company is not always responsible for installation of products it sells and has no post-installation service contracts or responsibilities.

Service revenue from integrated design, project and construction management, site engineering and permitting is recognized at the completion of the contract with the customer. With larger customer contracts involving multiple sites, the customer may require progress billings for completion of identifiable, time-phased elements of the work, in which case revenue is recognized at the time of the progress billing, which coincides with the revenue recognition criteria.

Shipping and handling revenue coincides with the recognition of revenue from sale of the product.

Amounts received from customers prior to the recognition of revenue are accounted for as customer pre-payments and are included in accrued expenses.

Credit and Collections:

The Company maintains allowances for doubtful accounts receivable for estimated losses resulting from either customer disputes or the inability of its customers to make required payments. If the financial condition of the Company's customers were to deteriorate, resulting in their inability to make the required payments, the Company may be required to record additional allowances or charges against income. The Company determines its allowance for doubtful accounts by first considering all known collectibility problems of customers' accounts, and then applying certain percentages against the various aging categories of the remaining receivables. The resulting allowance for doubtful accounts receivable is an estimate based upon the Company's knowledge of its business and customer base, and historical trends. The Company also establishes allowances, at the time revenue is recognized, for returns and allowances, discounts, pricing and other possible customer deductions. These allowances are based upon historical trends.

Cash and cash equivalents:

The cash balance includes cash and cash equivalents which have original maturities of less than three months. At June 30, 2005 and 2004 the bank balances included \$8,881,000 and \$916,000, respectively, in excess of FDIC insurance limits.

Inventories:

Inventories are stated at the lower of cost or market. Cost is determined on the first-in, first-out basis.

Property, plant and equipment and related depreciation:

Property, plant and equipment are stated at cost. Major additions and betterments are capitalized while maintenance and repairs are expensed. For financial reporting purposes, depreciation is computed on the straight-line method over the estimated useful lives of the assets as follows:

Buildings	31 – 40 years
Machinery and equipment	3 – 10 years
Computer software	3 – 8 years

Costs related to the purchase, internal development, and implementation of the Company's business operating software system are either capitalized or expensed in accordance with the American Institute of Certified Public Accountants' Statement of Position 98-1, "Accounting for the Costs of Computer Software Developed or Obtained for Internal Use." The current business operating software was first implemented in January 2000. All costs capitalized for the business operating software are being depreciated over an eight year life from the date placed in service. Other purchased computer software is being depreciated over periods ranging from three to five years. Leasehold improvements are depreciated over the shorter of fifteen years or the remaining term of the lease. The Company recorded \$6,494,000 and \$5,442,000 of depreciation expense in the years ended June 30, 2005 and June 30, 2004, respectively.

Intangible assets:

Intangible assets consisting of customer lists, trade names, patents and trademarks are recorded on the Company's balance sheet and are being amortized to expense over periods ranging between twelve and forty years. The excess of cost over fair value of assets acquired ("goodwill") was amortized to expense over periods ranging between fifteen and forty years through fiscal 2002. Beginning in fiscal 2003, goodwill is no longer amortized, but is subject to review for impairment. See additional information about goodwill and intangibles in Note 6. The Company periodically evaluates intangible assets, goodwill and other long-lived assets for permanent impairment. Impairments have been recorded only with respect to goodwill (see Note 6).

Fair value of financial instruments:

The Company has financial instruments consisting primarily of cash and cash equivalents, revolving lines of credit, and long-term debt. The fair value of these financial instruments approximates carrying value because of their short-term maturity and/or variable, market-driven interest rates. The Company has no financial instruments with off-balance sheet risk.

Contingencies:

The Company is party to various negotiations, customer bankruptcies, and legal proceedings arising in the normal course of business. In the opinion of management, the ultimate disposition of these matters will not have a material adverse effect on the Company's financial position, results of operations, cash flows or liquidity. See also Note 12.

Employee benefit plans:

The Company has a defined contribution retirement plan and a discretionary profit sharing plan covering substantially all of its employees, a second discretionary profit sharing plan covering employees of one subsidiary, and a non-qualified deferred compensation plan covering certain employees. The costs of employee benefit plans are charged to expense and funded annually. Total costs were \$1,864,000 in 2005, \$1,755,000 in 2004, and \$1,500,000 in 2003. Additionally a \$775,000 non-cash expense was recorded in fiscal 2005 in accordance with variable accounting procedures related to the deferred compensation plan.

Advertising expense:

The Company recorded \$631,000, \$360,000 and \$345,000 of advertising expense in 2005, 2004 and 2003, respectively. Advertising costs are expensed the first time the advertising occurs. Expense related to printed product or capabilities literature, brochures, etc. is recorded on a ratable basis over the useful life of that printed media.

Income taxes:

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards No. 109 (SFAS No. 109), accordingly deferred income taxes are provided on items that are reported as either income or expense in different time periods for financial reporting purposes than they are for income tax purposes. Deferred income tax assets and liabilities are reported on the Company's balance sheet. See also Note 10.

Earnings per common share:

The computation of basic earnings per common share is based on the weighted average common shares outstanding for the period. The computation of diluted earnings per share is based on the weighted average common shares outstanding for the period and includes common share equivalents. Common share equivalents include the dilutive effect of stock options, contingently issuable shares (for which issuance has been determined to be probable), and common shares to be issued under a deferred compensation plan, all of which totaled 305,000 shares in 2005, 321,000 shares in 2004, and 215,000 shares in 2003. See also Note 4.

Stock options:

The company applies the provisions of Accounting Principles Board Opinion No. 25, "Accounting for Stock Issued to Employees." Accordingly, no compensation expense has been reflected in the financial statements as the exercise price of options granted to employees and non-employee directors is equal to the fair market value of the Company's common shares on the date of grant. The Company has adopted the disclosure-only provisions of Statement of Financial Accounting Standards No. 123 (SFAS No. 123), "Accounting for Stock Based Compensation."

If the Company had adopted the expense recognition provisions of SFAS No. 123, net income and earnings per share for the years ended June 30, 2005, 2004, and 2003 would have been as follows:

<i>(In thousands except earnings per share)</i>	2005	2004	2003
Net income (loss)			
As reported	\$14,636	\$ 8,690	\$(10,748)
Add: Stock-based compensation expense included in reported net income, net of related tax effects	35	—	—
Deduct: Total stock-based compensation determined under the fair value based method for all awards, net of tax effects	452	354	409
Pro forma	<u>\$14,219</u>	<u>\$ 8,336</u>	<u>\$(11,157)</u>

	2005	2004	2003
Earnings (loss) per common share			
Basic			
As reported	\$ 0.74	\$ 0.44	\$(0.55)
Pro forma	\$ 0.72	\$ 0.42	\$(0.57)
Diluted			
As reported	\$ 0.73	\$ 0.43	\$(0.54)
Pro forma	\$ 0.71	\$ 0.42	\$(0.56)

Since SFAS No. 123 has not been applied to options granted prior to December 15, 1994, the resulting compensation cost shown above may not be representative of that expected in future years.

Recent pronouncements:

In November 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 151, "Inventory Costs." This statement amends Accounting Research Board (ARB) No. 43, "Inventory Pricing," to clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials should be recognized as current-period charges. In addition, this statement requires that allocation of fixed production overheads to the cost of conversion be based on the normal capacity of the production facilities. SFAS No. 151 is effective for fiscal years beginning after June 15, 2005, or the Company's 2006 fiscal year beginning July 1, 2005. The Company is currently evaluating the impact of this statement, but does not expect any significant impact on its financial condition or results of operations when it is implemented.

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 123(R) (revised 2004), "Share-Based Payment." This statement establishes standards for the accounting of transactions in which an entity exchanges its equity instruments for goods or services, primarily when it obtains employee services in share-based payment transactions. SFAS No. 123(R) (revised 2004) supersedes the Accounting Principles Board Opinion No. 25, Accounting for Stock issued to Employees. This Statement requires public entities to measure the cost of employee services received in

exchange for an award of equity instruments based upon the grant date fair value of the award, with this cost being recognized over the period during which an employee is required to provide the services. This statement is effective for the first fiscal year beginning after June 15, 2005, or the Company's first quarter of fiscal 2006 which begins July 1, 2005. The Company is currently evaluating the impact of this statement, but expects the impact to be consistent with the pro forma information presented in this Note 1 under "Stock options."

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 153, "Exchanges of Nonmonetary Assets." This statement addresses the measurement of exchanges of nonmonetary assets and is effective for fiscal periods beginning after June 15, 2005. The Company is currently evaluating the impact of this statement, but does not expect any significant impact on its financial condition or results of operations when it is implemented.

In May 2005, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards (SFAS) No. 154, "Accounting Changes and Error Corrections." This statement replaces Accounting Principles Board (APB) Opinion No. 20, "Accounting Changes" and SFAS No. 3, "Reporting Accounting Changes in Interim Financial Statements," and changes the requirement for the accounting for and reporting of a direct effect of a voluntary change in accounting principle. It also applies to changes required by an accounting pronouncement in the instance that the pronouncement does not include specific transition provisions. SFAS No. 154 requires retrospective application to prior periods' financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change. This statement also requires that a change in depreciation, amortization, or depletion method for long-lived, non-financial assets be accounted for as a change in accounting estimate affected by a change in accounting principle. This statement is effective for accounting changes and error corrections made in fiscal years beginning after December 15, 2005, or the

Company's first quarter of fiscal year 2007 which begins July 1, 2006. The Company will comply with the provisions of this statement for any accounting changes or error corrections that occur after June 30, 2006.

Comprehensive income:

The Company does not have any comprehensive income items other than net income.

Reclassification:

Certain reclassifications have been made to prior year amounts in order to be consistent with the presentation for the current year.

Use of estimates:

The preparation of the financial statements in conformity with accounting principles generally accepted in the United States of America requires the Company to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

NOTE 2 - BUSINESS SEGMENT INFORMATION

Effective July 1, 2003, the Company re-aligned its business segments and now operates in the following two business segments: the Lighting Segment and the Graphics Segment. The Company is organized such that the chief operating decision maker (the President and Chief Executive Officer) now receives financial and operating information relative to these two business segments, and organizationally, has a President of LSI Lighting Solutions *Plus* and a President of LSI Graphics Solutions *Plus* reporting directly to him. In the seven years prior to fiscal 2004, the Company reported business segments as the Image Segment and the Commercial/Industrial Lighting Segment. All prior period information has been revised to reflect the Company's new segments. The Company's most significant market is the petroleum/convenience store market with approximately 25%, 28%, and 29% of total net sales concentrated in this market in fiscal 2005, 2004, and 2003, respectively.

The Company considers its geographic areas to be: 1) the United States, and 2) foreign. The foreign content of business is represented by 3%, or less, of total net sales in fiscal years 2003 through 2005. All capital expenditures, depreciation and amortization, and identifiable assets are in the United States. The following information is provided for the following periods:

<i>(In thousands)</i>	2005	2004	2003
Net sales:			
Lighting Segment	\$177,021	\$159,748	\$136,076
Graphics Segment	105,419	81,657	77,057
	<u>\$282,440</u>	<u>\$241,405</u>	<u>\$213,133</u>
Operating income:			
Image Segment	\$ 9,088	\$ 8,848	\$ 7,558
Graphics Segment	13,938	5,186	3,808
	<u>\$ 23,026</u>	<u>\$ 14,034</u>	<u>\$ 11,366</u>
Identifiable assets:			
Lighting Segment	\$102,831	\$110,616	\$ 96,582
Graphics Segment	61,883	63,002	63,437
	164,714	173,618	160,019
Corporate	7,923	1,114	2,757
	<u>\$172,637</u>	<u>\$174,732</u>	<u>\$162,776</u>
Capital expenditures:			
Lighting Segment	\$ 3,048	\$ 3,160	\$ 4,647
Graphics Segment	582	1,548	805
	<u>\$ 3,630</u>	<u>\$ 4,708</u>	<u>\$ 5,452</u>
Depreciation and amortization:			
Lighting Segment	\$ 5,095	\$ 4,252	\$ 3,836
Graphics Segment	1,879	1,673	1,866
	<u>\$ 6,974</u>	<u>\$ 5,925</u>	<u>\$ 5,702</u>

Operating income of the business segments includes net sales less all operating expenses, including allocations of corporate expense. Sales between business segments are immaterial.

Identifiable assets are those assets used by each segment in its operations, including allocations of shared assets. Corporate assets consist primarily of cash and cash equivalents, and refundable income taxes.

NOTE 3 - MAJOR CUSTOMER CONCENTRATIONS

The Company's net sales to a major customer in the Lighting Segment, Wal-Mart Stores, Inc., represented approximately \$30,197,000 or 11% of consolidated net sales in fiscal 2005. The Company had a concentration of receivables with the receivable from Wal-Mart being approximately \$7.9 million, or about 17% of total net accounts receivable as of June 30, 2005, and approximately \$5.1 million, or about 12% of total net accounts receivable as of June 30, 2004.

NOTE 4 - EARNINGS PER COMMON SHARE

The following table presents the amounts used to compute earnings per common share and the effect of dilutive potential common shares on net income and weighted average shares outstanding:

<i>(In thousands, except per share)</i>	2005	2004	2003
BASIC EARNINGS PER SHARE			
Income before			
cumulative effect of			
accounting change	\$ 14,636	\$ 8,690	\$ 7,793
Cumulative effect of			
accounting change	<u>—</u>	<u>—</u>	18,541
Net income (loss)	<u>\$ 14,636</u>	<u>\$ 8,690</u>	<u>\$(10,748)</u>
Weighted average			
shares outstanding			
during the period,			
net of treasury shares	<u>19,782</u>	<u>19,717</u>	<u>19,708</u>
Basic earnings per share			
before cumulative effect			
of accounting change	\$ 0.74	\$ 0.44	\$ 0.40
Cumulative effect of			
accounting change	<u>—</u>	<u>—</u>	(0.95)
Basic earnings (loss)			
per share	<u>\$ 0.74</u>	<u>\$ 0.44</u>	<u>\$ (0.55)</u>

(In thousands, except per share) **2005** 2004 2003

DILUTED EARNINGS PER SHARE

Income before			
cumulative effect of			
accounting change	\$14,636	\$ 8,690	\$ 7,793
Cumulative effect of			
accounting change	<u>—</u>	<u>—</u>	<u>18,541</u>
Net income (loss)	<u>\$14,636</u>	<u>\$ 8,690</u>	<u>\$(10,748)</u>
Weighted average			
shares outstanding			
during the period, net			
of treasury shares	19,782	19,717	19,708
Effect of dilutive			
securities (A):			
Impact of common			
shares to be issued			
under stock option			
plans, a deferred			
compensation plan,			
and contingently			
issuable shares	<u>305</u>	<u>321</u>	<u>215</u>
Weighted average			
shares outstanding (B)	<u>20,087</u>	<u>20,038</u>	<u>19,923</u>
Diluted earnings			
per share before			
cumulative effect of			
accounting change	\$ 0.73	\$ 0.43	\$ 0.39
Cumulative effect of			
accounting change	<u>—</u>	<u>—</u>	<u>(0.93)</u>
Diluted earnings			
(loss) per share	<u>\$ 0.73</u>	<u>\$ 0.43</u>	<u>\$ (0.54)</u>

(A) Calculated using the "Treasury Stock" method as if dilutive securities were exercised and the funds were used to purchase common shares at the average market price during the period.

(B) Options to purchase 227,851 common shares, 248,160 common shares, and 368,618 common shares at June 30, 2005, 2004, and 2003, respectively, were not included in the computation of diluted earnings per share because the exercise price was greater than the average fair market value of the common shares.

NOTE 5 - BALANCE SHEET DATA

The following information is provided as of June 30:

(In thousands)	2005	2004
Inventories:		
Raw materials	\$21,143	\$25,352
Work-in-process	4,178	5,007
Finished goods	14,131	17,313
	<u>\$39,452</u>	<u>\$47,672</u>
Accrued Expenses:		
Compensation and benefits	\$ 8,594	\$ 8,042
Customer prepayments	1,409	2,141
Accrued sales commissions	1,143	1,100
Other accrued expenses	4,662	2,827
	<u>\$15,808</u>	<u>\$14,110</u>

NOTE 6 - GOODWILL AND OTHER INTANGIBLE ASSETS

The Company completed its transitional goodwill impairment test in fiscal 2003 as of July 1, 2002, its date of adoption of SFAS No. 142. The Company determined for the transitional goodwill impairment test that it had eight reporting units, each of which represented an acquired business that operated in the organizational structure one level below the business segment level. Based upon this analysis, there was full impairment of the recorded net goodwill of two reporting units in the Lighting Segment (totaling \$23,593,000) and one reporting unit in the Graphics Segment (totaling \$929,000). The impairment of \$24,522,000, a non-cash and non-operating charge, was booked in the amount of \$18,541,000, net of income taxes, as a change in accounting method and was recorded as of the date of adoption of SFAS No. 142, July 1, 2002. The fiscal 2004 SFAS No. 142 testing was completed in the first quarter of fiscal 2004. The Company determined that it had three reporting units, two of which represented acquired businesses and one of which was an aggregation of acquired businesses at the business segment level. Test results indicated there was no impairment of goodwill. The Company completed its annual goodwill impairment test in fiscal 2005 as of July 1, 2004. The Company determined

that it had three reporting units. Based upon this analysis, there was full impairment of the recorded net goodwill of one reporting unit in the Lighting Segment. The impairment of \$186,000, a non-cash charge, was recorded as an operating expense in the first quarter of fiscal 2005.

The following tables present information about the Company's goodwill and other intangible assets on the dates or for the periods indicated:

<i>(In thousands)</i>	As of June 30, 2005		
	Carrying Amount	Accumulated Amortization	Net
Goodwill	<u>\$ 19,502</u>	<u>\$ 2,385</u>	<u>\$ 17,117</u>
Other Intangible Assets	<u>\$ 6,430</u>	<u>\$ 2,200</u>	<u>\$ 4,230</u>

<i>(In thousands)</i>	As of June 30, 2004		
	Carrying Amount	Accumulated Amortization	Net
Goodwill	<u>\$19,712</u>	<u>\$ 2,409</u>	<u>\$17,303</u>
Other Intangible Assets	<u>\$ 6,430</u>	<u>\$ 1,720</u>	<u>\$ 4,710</u>

Fiscal Year	Amortization Expense	
	Other Intangible Assets	
2005	<u>\$</u>	<u>480</u>
2004	<u>\$</u>	<u>483</u>
2003	<u>\$</u>	<u>486</u>

Changes in the carrying amount of goodwill for the years ended June 30, 2004 and 2005, by operating segment, are as follows:

<i>(In thousands)</i>	Lighting Segment	Graphics Segment	Total
Balance June 30, 2003	\$ 321	\$16,982	\$17,303
Impairment losses	—	—	—
Balance June 30, 2004	321	16,982	17,303
Impairment losses	(186)	—	(186)
Balance June 30, 2005	<u>\$ 135</u>	<u>\$16,982</u>	<u>\$17,117</u>

The gross carrying amount and accumulated amortization by major other intangible asset class is as follows:

<i>(In thousands)</i>	June 30, 2005	
	Gross Carrying Amount	Accumulated Amortization
Amortized Intangible Assets		
Customer list	<u>\$ 5,400</u>	<u>\$ 2,063</u>
Trademarks	<u>920</u>	<u>105</u>
Patents	<u>110</u>	<u>32</u>
	<u>\$ 6,430</u>	<u>\$ 2,200</u>

<i>(In thousands)</i>	June 30, 2004	
	Gross Carrying Amount	Accumulated Amortization
Amortized Intangible Assets		
Customer list	\$5,400	\$1,613
Trademarks	920	82
Patents	110	25
	<u>\$6,430</u>	<u>\$1,720</u>

Aggregate amortization expense for other intangible assets was \$480,000 in fiscal 2005, \$483,000 in fiscal 2004 and \$486,000 in fiscal 2003.

The Company expects to record amortization expense of \$480,000 related to other intangible assets in each of the next five years following 2005.

NOTE 7 - REVOLVING LINES OF CREDIT AND LONG-TERM DEBT

The Company has an unsecured \$50 million revolving line of credit with its bank group, all of which was available as of June 30, 2005. A portion of this credit facility is a \$20 million line of credit that expires in the third quarter of fiscal 2006. The remainder of the credit facility is a \$30 million three year committed line of credit that expires in fiscal 2008. Annually in the third quarter, the credit facility is renewable with respect to adding an additional year of commitment to replace the year just ended. Interest on the revolving lines of credit is charged based upon an increment over the LIBOR rate as

periodically determined, an increment over the Federal Funds Rate as periodically determined, or at the bank's base lending rate, at the Company's option. The increment over the LIBOR borrowing rate, as periodically determined, fluctuates between 50 and 75 basis points depending upon the ratio of indebtedness to earnings before interest, taxes, depreciation and amortization (EBITDA). The increment over the Federal Funds borrowing rate, as periodically determined, fluctuates between 150 and 200 basis points, and the commitment fee on the unused balance of the \$30 million committed portion of the line of credit fluctuates between 15 and 25 basis points based upon the same leverage ratio. Under terms of these agreements, the Company has agreed to a negative pledge of assets, to maintain minimum levels of profitability and net worth, and is subject to certain maximum levels of leverage. The Company's borrowings under its bank credit facilities during fiscal year 2005 averaged approximately \$7.8 million at an approximate average borrowing rate of 2.43%.

<i>(In thousands)</i>	2005	2004
Long-term debt:		
Revolving Line of Credit (3 year committed line)	\$ —	\$11,554
Less current maturities of long-term debt	—	—
Long-term debt	<u>\$ —</u>	<u>\$11,554</u>

NOTE 8 - SHAREHOLDERS' EQUITY

The Company has an equity compensation plan that covers all of its full-time employees and non-employee directors. This equity compensation plan replaced two stock option plans that still have outstanding options that may be exercised in the future. The options granted pursuant to this plan are granted at fair market value at date of grant. Options granted to non-employee directors are immediately exercisable and options granted to employees generally become exercisable 25% per year (cumulative) beginning one year after the date of grant. The number of shares reserved for issuance is 2,910,188,

of which 1,862,463 shares were available for future grant as of June 30, 2005. The plan allows for the grant of incentive stock options, non-qualified stock options, stock appreciation rights, restricted and unrestricted stock awards, performance stock awards, and other stock awards. The Company awarded a total of 3,700 common shares in fiscal 2005, valued at their approximate \$55,000 fair market value on the date of issuance pursuant to the compensation programs for non-employee Directors who receive a portion of their compensation as an award of Company stock and employees who receive a stock award following their twentieth employment anniversary.

Statement of Financial Accounting Standards No. 123(R) (SFAS No. 123) requires, at a minimum, pro forma disclosures of expense for stock-based awards based on their fair values. The fair value of each option on the date of grant has been estimated using the Black-Scholes option pricing model. The following weighted average assumptions were used for grants in fiscal 2005, 2004, and 2003.

	2005	2004	2003
Dividend yield	3.29%	2.16%	1.89%
Expected volatility	38%	47%	48%
Risk-free interest rate	3.3%	3.26%	2.93%
Expected life	8 yrs.	4-9 yrs.	8 yrs.

The 377,000 options granted during fiscal 2005 to employees and non-employee directors had, at June 30, 2005, exercise prices ranging from \$8.55 to \$10.71, fair values ranging from \$3.50 to \$4.26 per option, and remaining contractual lives of about nine years. The 7,550 options granted during fiscal 2004 to employees and non-employee directors had, at June 30, 2004, exercise prices ranging from \$9.60 to \$12.99, fair values ranging from \$3.33 to \$5.40 per option, and remaining contractual lives of four to nine years. At June 30, 2003, the 5,625 options granted during fiscal 2003 to non-employee directors had, at June 30, 2003, exercise prices of \$8.59, fair values of \$4.01 and remaining contractual lives of about nine years.

Information involving the stock option plans for the years ended June 30, 2005, 2004, and 2003 is shown in the table below:

<i>(Shares in thousands)</i>	2005	
	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	667	\$ 9.73
Granted	377	\$ 9.97
Terminated	(8)	\$11.57
Exercised	(113)	\$ 9.16
Outstanding at end of year	923	\$ 9.88
Exercisable at end of year	520	\$ 9.63

<i>(Shares in thousands)</i>	2004	
	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	734	\$ 9.74
Granted	7	\$11.73
Terminated	(23)	\$11.68
Exercised	(51)	\$ 9.35
Outstanding at end of year	667	\$ 9.73
Exercisable at end of year	487	\$ 9.44

<i>(Shares in thousands)</i>	2003	
	Shares	Weighted Average Exercise Price
Outstanding at beginning of year	805	\$ 9.78
Granted	5	\$ 8.76
Terminated	(65)	\$10.46
Exercised	(11)	\$ 8.13
Outstanding at end of year	734	\$ 9.74
Exercisable at end of year	401	\$ 9.27

The Company has a non-qualified deferred compensation plan providing for both Company contributions and participant deferrals of compensation. All Plan investments are in common shares of the Company. As of June 30, 2005 there were 36 participants with either partially or fully vested account balances. A total of 185,535 common shares with a cost of \$1,846,000, and 204,492 common shares with a cost of \$2,054,000 were held in the Plan as of June 30, 2005 and 2004, respectively, and, accordingly, have been recorded as treasury shares. The change in the number of shares held by this plan is the net result of share purchases from compensation deferred into the Plan and the sales of shares for distributions to terminated employees. As a result of the Company changing the distribution method for this deferred compensation plan in April 2004 from one of issuing shares of Company stock to terminated participants to one of issuing cash, it was determined that this plan is now subject to variable accounting. Therefore, the shares in this plan were "marked-to-market" and a \$775,000 non-cash expense and long-term liability were recorded to reflect the \$13.94 per share market price of the Company's common shares at June 30, 2005.

On August 24, 2005, the Board of Directors declared a regular quarterly cash dividend of \$0.10 per share as well as a special year end cash dividend of \$0.10 per share, both payable September 13, 2005 to shareholders of record on September 6, 2005. Annual cash dividend payments made during fiscal years 2005, 2004, and 2003 were \$0.372, \$0.264, and \$0.192 per share, respectively.

NOTE 9 - LEASES AND PURCHASE COMMITMENTS

The Company leases certain of its facilities and equipment under operating lease arrangements. Rental expense was \$2,342,000 in 2005, \$1,920,000 in 2004, and \$1,906,000 in 2003. Minimum annual rental commitments under non-cancelable operating leases are: \$1,607,000 in 2006, \$1,282,000 in 2007, \$967,000 in 2008, and \$172,000 in 2009, and \$2,000 in 2010. There are no commitments beyond 2010. Purchase commitments of the Company totaled \$8,540,000 as of June 30, 2005.

NOTE 10 - INCOME TAXES

The following information is provided for the years ended June 30:

<i>(In thousands)</i>	2005	2004	2003
Provision (benefit) for income taxes:			
Current federal	\$6,851	\$3,383	\$1,585
Current state and local	778	643	253
Deferred	608	1,081	1,616
	<u>\$8,237</u>	<u>\$5,107</u>	<u>\$3,454</u>

Reconciliation to federal statutory rate:			
Federal statutory tax rate	35.0%	34.1%	34.0%
State and local taxes, net of federal benefit	2.3	3.3	1.6
Federal and state tax credits	(.3)	(.8)	(5.1)
Goodwill and other	(1.0)	.4	.2
Effective tax rate	<u>36.0%</u>	<u>37.0%</u>	<u>30.7%</u>

The components of deferred income tax assets and (liabilities) at June 30, 2005 and 2004 are as follows:

<i>(In thousands)</i>	2005	2004
Reserves against current assets	\$ 1,007	\$ 805
Accrued expenses	1,130	794
Depreciation	(5,269)	(5,615)
Goodwill, acquisition costs and intangible assets	1,765	3,051
State net operating loss carryover	769	471
Deferred compensation	1,042	760
Income tax credits	1,194	917
Valuation reserve	(1,194)	(917)
Net deferred income tax asset	<u>\$ 444</u>	<u>\$ 266</u>

Reconciliation to the balance sheets as of June 30, 2005 and 2004:

<i>(In thousands)</i>	2005	2004
Deferred income tax asset (liability) included in:		
Other current assets	\$2,137	\$1,599
Long-term deferred income tax liability	(1,693)	(1,333)
Net deferred income tax asset	<u>\$ 444</u>	<u>\$ 266</u>

As of June 30, 2004, the Company had recorded refundable income taxes as a current asset in the amount of \$516,000. The majority of the refundable income taxes related to excess quarterly estimated federal income tax payments made during the year. Such refundable income taxes were applied in fiscal year 2005 to the Company's quarterly estimated federal income tax payments. As of June 30, 2005 the Company has recorded a current income tax liability of \$279,000 that is included in accrued expenses.

As of June 30, 2005 the Company has recorded a deferred New York state income tax asset in the amount of \$769,000 related to the approximate \$16 million state net operating loss carryover generated by the Company's LSI Lightron subsidiary. Additionally, as of June 30, 2005 the Company has recorded a deferred New York state income tax asset in the amount of \$566,000 related to LSI Lightron's impaired goodwill that was written off in fiscal 2003. The Company has determined that a valuation reserve is not required as of June 30, 2005 because the Company has determined in accordance with Statement of Financial Accounting Standards No. 109 (SFAS No. 109) that the net operating loss tax benefit will, more likely than not, be realized. The Company will continue to monitor the operations of this subsidiary to evaluate any potential need for a valuation reserve.

NOTE 11 - SUPPLEMENTAL CASH FLOW INFORMATION

<i>(In thousands)</i>	2005	2004	2003
Cash payments:			
Interest	\$ 257	\$ 248	\$ 367
Income taxes	\$7,704	\$2,360	\$2,232

NOTE 12 - LOSS CONTINGENCY RESERVE

The Company is party to various negotiations and legal proceedings arising in the normal course of business, most of which are dismissed or resolved with minimal expense plus the Company's legal fees. As of June 30, 2005 the Company is the defendant in a complex lawsuit alleging patent infringement with respect to some of the Company's menu board systems sold over the past nine years. The Company intends to defend this case vigorously. In the progress of this case, the Company made a reasonable settlement offer and, accordingly, has recorded a loss contingency reserve in the amount of \$590,000 (approximately \$.02 per share, diluted) in the third quarter of fiscal 2005. This settlement offer was not accepted by the plaintiff and the Company received a counter offer of \$4.1 million to settle the majority of the alleged patent infringement. A non-binding mediation will be held in the second quarter of fiscal 2006 to determine if the parties can reach a settlement before the lawsuit proceeds to court. There is the possibility that final resolution of this matter could result in an additional loss in excess of the presently established loss reserve. Management is not able to estimate the likelihood or amount of such additional loss, or a range of additional loss. However, management believes that while the ultimate disposition of this matter and such potential additional loss could have a material adverse effect on the Company's results from operations and cash flows in the period in which it is recorded or paid, no such charge would have a material adverse effect on the Company's financial position or liquidity. Should this patent infringement case be resolved against the Company, it would be likely that the Company would be responsible to make royalty payments to the plaintiff at a currently unknown percentage of future menu board system sales.

NOTE 13 - RELATED PARTY TRANSACTIONS

The Company has recorded expense for the following related party transactions in the fiscal years indicated (amounts in thousands):

<i>(In thousands)</i>	2005	2004	2003
Net sales:			
Keating Muething & Klekamp PLL	\$215	\$166	\$155
American Engineering and Metal Working	\$519	\$ 20	\$ 4
McRye Development	\$ 5	\$ 76	\$ 71

As of the balance sheet date indicated, the Company had the following liabilities recorded with respect to related party transactions (amounts in thousands):

	June 30, 2005	June 30, 2004
Keating Muething & Klekamp PLL	\$ 9	\$29
American Engineering and Metal Working	\$50	\$ —

The law firm of Keating Muething & Klekamp PLL, of which one of the Company's independent outside directors is a senior partner, is the Company's primary outside law firm providing legal services in most all areas required. The manufacturing firm of American Engineering and Metal Working, which is owned and operated by the son of the president of the Company's Graphics Segment, provides metal fabricated components. McRye Development, which is owned and operated by the brother of the president of the Graphics Segment, provides installation subcontracting services. All related parties provide the Company either products or services at market-based arms-length prices.

NOTE 14 - SUMMARY OF QUARTERLY RESULTS (UNAUDITED)

(In thousands except per share data)	Quarter Ended				Fiscal Year
	Sept. 30	Dec. 31	March 31	June 30	
2005					
Net sales	\$68,335	\$74,299	\$67,814	\$71,992	\$282,440
Gross profit	17,805	20,006	15,379	19,106	72,296
Net Income	3,316	4,792	2,422	4,106(a)	14,636
Earnings per share					
Basic	\$ 0.17	\$ 0.24	\$ 0.12	\$ 0.21	\$ 0.74
Diluted	\$ 0.17	\$ 0.24	\$ 0.12	\$ 0.20	\$ 0.73
Range of share prices					
High	\$ 11.62	\$ 11.50	\$ 12.09	\$ 14.36	\$ 14.36
Low	\$ 8.40	\$ 9.48	\$ 9.84	\$ 10.85	\$ 8.40
2004					
Net sales	\$59,099	\$64,116	\$51,500	\$66,690	\$241,405
Gross profit	15,223	18,231	11,810	14,258(c)	59,522
Net income	2,601	4,006	920	1,163	8,690
Earnings per share					
Basic	\$ 0.13	\$ 0.20	\$ 0.05	\$ 0.06	\$ 0.44
Diluted	\$ 0.13	\$ 0.20	\$ 0.05	\$ 0.06	\$ 0.43(b)
Range of share prices					
High	\$ 11.95	\$ 13.63	\$ 14.79	\$ 13.03	\$ 14.79
Low	\$ 8.40	\$ 10.19	\$ 11.15	\$ 9.00	\$ 8.40
2003					
Net sales	\$56,045	\$57,275	\$44,228	\$55,585	\$213,133
Gross profit	15,054	15,020	10,562	14,531	55,167
Income before					
cumulative effect of					
accounting change	2,215	2,687	468	2,423	7,793
Net income (loss)	(16,326)(d)	2,687	468	2,423	(10,748)(d)
Earnings per share before cumulative					
effect of accounting change					
Basic	\$ 0.11	\$ 0.14	\$ 0.02	\$ 0.12	\$ 0.40
Diluted	\$ 0.11	\$ 0.14	\$ 0.02	\$ 0.12	\$ 0.39
Earnings (loss) per share					
Basic	\$ (0.83)	\$ 0.14	\$ 0.02	\$ 0.12	\$ (0.55)
Diluted	\$ (0.82)	\$ 0.14	\$ 0.02	\$ 0.12	\$ (0.54)
Range of share prices					
High	\$ 14.83	\$ 11.60	\$ 11.29	\$ 10.91	\$ 14.83
Low	\$ 7.12	\$ 7.15	\$ 6.59	\$ 6.88	\$ 6.59

(a) The fourth quarter of fiscal 2005 includes a \$775,000 non-cash expense (\$469,000 net of taxes) associated with "marking-to-market" the Company's common shares held in its non-qualified deferred compensation plan in accordance with variable accounting procedures.

(b) The total of the earnings per share for each of the four quarters does not equal the total earnings per share for the full year because the calculations are based on the average shares outstanding during each of the individual periods.

(c) The fourth quarter of fiscal 2004 includes \$1,086,000 of net unfavorable inventory adjustments in the Lighting Segment.

(d) See Note 6 for discussion of an accounting change related to goodwill impairment.

At August 18, 2005, there were 385 shareholders of record. The Company believes this represents approximately 3,000 beneficial shareholders.

MANAGEMENT'S REPORT ON INTERNAL CONTROL OVER FINANCIAL REPORTING

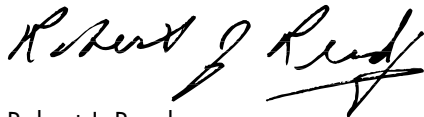
The Management of LSI Industries Inc. is responsible for the preparation and accuracy of the financial statements and other information included in this report. LSI's Management is also responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Securities Exchange Act Rules 13a-15(f). Under the supervision and with the participation of Management, including LSI's principal executive officer and principal financial officer, the Company conducted an evaluation of the effectiveness of internal control over financial reporting as of June 30, 2005, based on the criteria set forth in "Internal Control – Integrated Framework" issued by the Committee of Sponsoring Organizations of the Treadway Commission.

There are inherent limitations on the effectiveness of any system of internal controls and procedures, including the possibility of human error and the circumvention or overriding of the controls and procedures. Accordingly, even effective internal controls and procedures can only provide reasonable assurance of achieving their control objectives.

In meeting its responsibility for the reliability of the financial statements, the Company depends upon its system of internal accounting controls. The system is designed to provide reasonable assurance that assets are safeguarded and that transactions are properly authorized and recorded. The system is supported by policies and guidelines, and by careful selection and training of financial management personnel. The Company also has a Disclosure Controls Committee, whose responsibility is to help ensure appropriate disclosures and presentation of the financial statements and notes thereto. Additionally, the Company has an Internal Audit Department to assist in monitoring compliance with financial policies and procedures.

The Board of Directors meets its responsibility for overview of the Company's financial statements through its Audit Committee which is composed entirely of independent Directors who are not employees of the Company. The Audit Committee meets periodically with Management and Internal Audit to review and assess the activities of each in meeting their respective responsibilities. Grant Thornton has full access to the Audit Committee to discuss the results of their audit work, the adequacy of internal accounting controls, and the quality of financial reporting.

Based on LSI's evaluation, Management concluded that internal control over financial reporting was effective as of June 30, 2005. Management's assessment of the effectiveness of internal control over financial reporting as of June 30, 2005 has been audited by Grant Thornton LLP, an independent registered public accounting firm, as stated in their report which is presented in these financial statements.



Robert J. Ready
President and Chief Executive Officer



Ronald S. Stowell
Vice President, Chief Financial Officer, and Treasurer

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and
Shareholders of LSI Industries Inc.

We have audited the accompanying consolidated balance sheets of LSI Industries Inc. (an Ohio Corporation) and subsidiaries as of June 30, 2005 and 2004, and the related consolidated statements of income, stockholders' equity, and cash flows for each of the three years in the period ended June 30, 2005. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of LSI Industries Inc. and subsidiaries as of June 30, 2005 and 2004, and the results of their operations and their cash flows for each of the three years in the period ended June 30, 2005 in conformity with accounting principles generally accepted in the United States of America.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of LSI Industries Inc.'s internal control over financial reporting as of June 30, 2005, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated August 19, 2005 expressed an unqualified opinion therein.

A handwritten signature in cursive script that reads "Grant Thornton LLP".

Cincinnati, Ohio
August 19, 2005

REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

Board of Directors and
Shareholders of LSI Industries Inc.

We have audited management's assessment, included in the accompanying Report of Management on Internal Control over Financial Reporting, that LSI Industries Inc. (an Ohio Corporation) maintained effective internal control over financial reporting as of June 30, 2005, based on criteria established in Internal Control-Integrated Framework issued by the Committee of Sponsoring Organizations of the Treadway Commission (the COSO criteria). LSI Industries Inc.'s management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit included obtaining an understanding of internal control over financial reporting, evaluating management's assessment, testing and evaluating the design and operating effectiveness of internal control, and performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

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

In our opinion, management's assessment that LSI Industries Inc. maintained effective internal control over financial reporting as of June 30, 2005, is fairly stated, in all material respects, based on the COSO criteria. Also, in our opinion, LSI Industries Inc. maintained, in all material respects, effective internal control over financial reporting as of June 30, 2005, based on the COSO criteria.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated balance sheets of LSI Industries Inc. and subsidiaries as of June 30, 2005 and 2004, and the related consolidated statements of income, shareholders' equity and cash flows for each of the three years in the period ended June 30, 2005 and our report dated August 19, 2005 expressed an unqualified opinion on those financial statements.



Cincinnati, Ohio
August 19, 2005

SELECTED FINANCIAL DATA

LSI INDUSTRIES INC.

The following data has been selected from the Consolidated Financial Statements of the Company for the periods and dates indicated:

Income Statement Data:

(In thousands except per share)

	2005	2004	2003	2002	2001
Net sales	\$282,440	\$241,405	\$213,133	\$259,261	\$233,940
Cost of products sold	210,144	181,883	157,966	186,838	168,471
Operating expenses	49,084	45,488	43,801	49,039	48,175
Goodwill impairment	186	—	—	—	—
Operating income	23,026	14,034	11,366	23,384	17,294
Interest (income)	(64)	(23)	(259)	(51)	(630)
Interest expense	217	260	378	575	607
Income from continuing operations before income taxes	22,873	13,797	11,247	22,860	17,317
Income taxes	8,237	5,107	3,454	8,674	6,716
Income from continuing operations before cumulative effect of accounting change and discontinued operations	14,636	8,690	7,793	14,186	10,601
Cumulative effect of accounting change, net of tax (a)	—	—	18,541	—	—
Discontinued operations	—	—	—	—	723
Net income (loss)	\$ 14,636	\$ 8,690	\$ (10,748)	\$ 14,186	\$ 9,878
Earnings per common share from continuing operations before cumulative effect of accounting change and discontinued operations					
Basic	\$ 0.74	\$ 0.44	\$ 0.40	\$ 0.72	\$ 0.55
Diluted	\$ 0.73	\$ 0.43	\$ 0.39	\$ 0.71	\$ 0.54
Earnings (loss) per common share					
Basic	\$ 0.74	\$ 0.44	\$ (0.55)	\$.72	\$ 0.51
Diluted	\$ 0.73	\$ 0.43	\$ (0.54)	\$.71	\$ 0.50
Cash dividends paid per share	\$ 0.37	\$ 0.26	\$ 0.19	\$.19	\$ 0.21
Weighted average common shares					
Basic	19,782	19,717	19,708	19,644	19,421
Diluted	20,087	20,038	19,923	20,059	19,731

Balance Sheet Data:

(At June 30; in thousands)

	2005	2004	2003	2002	2001
Working capital	\$ 67,189	\$ 64,724	\$ 59,633	\$ 55,793	\$ 62,119
Total assets	172,637	174,732	162,776	189,842	181,759
Long-term debt, including current maturities	—	11,554	14,084	18,053	23,990
Shareholders' equity	138,040	128,863	124,905	139,349	127,193

(a) See Footnote No. 6 to the financial statements.

CORPORATE INFORMATION

Independent Registered Public Accounting Firm

Grant Thornton LLP
Cincinnati, Ohio

Legal Counsel

Keating Muething Klekamp PLL
Cincinnati, Ohio

Transfer Agent and Registrar

Computershare Investor Services, LLC
2 North LaSalle Street
Chicago, Illinois 60602

Dividend Reinvestment Plan

The LSI Industries Automatic Dividend Reinvestment and Stock Purchase Plan offers registered shareholders and employees an opportunity to purchase additional shares through automatic dividend reinvestment and/or optional cash investments. For additional information, contact:

Computershare Trust Co., Inc.
2 North LaSalle Street
Chicago, Illinois 60602
(866) 770-0656
E-mail: web.queries@computershare.com
Internet: www.computershare.com

Annual Meeting

The LSI Industries Inc. annual shareholders' meeting will be held Thursday, November 15, 2005 at 10:00 a.m. at the Company's corporate offices located at 10000 Alliance Road, Cincinnati, Ohio.

Form 10-K

Shareholders may obtain the 2005 Annual Report on Form 10-K as filed with the Securities and Exchange Commission without charge by writing to:

Investor Relations Manager
LSI Industries Inc.
10000 Alliance Road
Cincinnati, Ohio 45242

Market for the Company's Common Shares

LSI Industries Inc. Common Shares are traded on The Nasdaq Stock Market under the symbol LYTS.

Internet Site

The LSI Industries site on the Internet, www.lsi-industries.com, contains the Company's 10-K and 10-Q filings, proxy statements, other SEC filings, annual reports, news releases, stock prices, and a variety of other information about LSI Industries and its products and services.

OPERATING FACILITIES

Location		Telephone Number	Operations/Products & Services
Lighting Segment			
Ohio	Cincinnati	513-793-3200	Lighting
California	Fontana	909-357-0725	Distribution Center
Kansas	Kansas City	913-281-1100	Lighting
Kentucky	Independence	859-342-9944	Metal Fabrication
New York	New Windsor	845-220-3200	Lighting
Tennessee	Manchester	931-723-4442	Electrical Wire Harnesses
Texas	Dallas	972-466-1133	Lighting
Graphics Segment			
Ohio	North Canton	330-494-9444	Graphics; Engineering Services
	Cincinnati	513-793-3200	Menu Boards
Kentucky	Independence	859-342-9944	Menu Boards
North Carolina	Charlotte	704-588-3850	Engineering Services
Oregon	Portland	503-892-2346	Engineering Services
Rhode Island	Woonsocket	401-766-7446	Graphics
Texas	Houston	713-744-4100	Graphics
Washington	Seattle	206-654-7045	Engineering Services

BOARD OF DIRECTORS

Robert J. Ready

*President, Chief Executive Officer &
Chairman of the Board
Chairman of Executive Committee*

James P. Sferra

*Secretary - LSI Industries Inc.
Executive Vice President - Manufacturing
Member of Executive Committee*

Gary P. Kreider

*Senior Partner of Keating Muething Klekamp PLL
Cincinnati, Ohio
Member of Compensation Committee
Chairman of Nominating and Corporate Governance
Committee*

Dennis B. Meyer

*Director of Midmark Corporation, Versailles, Ohio
Member of Audit Committee
Chairman of Compensation Committee
Member of Nominating and Corporate Governance
Committee*

Wilfred T. O'Gara

*Chief Executive Officer – The O'Gara Group, Inc.
Cincinnati, Ohio
Chairman of Audit Committee
Member of Compensation Committee
Member of Nominating and Corporate Governance
Committee*

Mark A. Serrianne

*Chief Executive Officer - Northlich, Inc.
Member of Audit Committee
Member of Compensation Committee
Member of Nominating and Corporate Governance
Committee*

CORPORATE OFFICERS AND EXECUTIVE MANAGEMENT

Robert J. Ready

President and Chief Executive Officer

James P. Sferra

Secretary; Executive Vice President - Manufacturing

Ronald S. Stowell

Vice President, Chief Financial Officer, and Treasurer

David W. McCauley

President LSI Graphic Solutions Plus

Scott D. Ready

President LSI Lighting Solutions Plus



LSI Industries Inc.

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Cincinnati, Ohio 45242

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