NATURAL GAS SYSTEMS INC/NEW
Form SB-2/A
March 03, 2006

As filed with the Securities and Exchange Commission on March 3, 2006
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U.S. SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, DC 20549

FORM SB-2

REGISTRATION STATEMENT UNDER THE SECURITIES ACT OF 1933
AMENDMENT NO. 3

NATURAL GAS SYSTEMS, INC.
(Name of Small Business Issuer in its Charter)

NEVADA	1311	41-1781991
(State of jurisdiction of incorporation or organization)	(Primary Standard Industrial Classification Code Number)	(I.R.S. Employer Identification No.)

820 GESSNER
SUITE 1340
HOUSTON, TX 77024
(713) 935-0122
(Address and telephone number of principal executive offices
and principal place of business)

COPY TO:
LAWRENCE SCHNAPP, ESQ.
TROY & GOULD PROFESSIONAL CORPORATION
1801 CENTURY PARK EAST, SUITE 1600
LOS ANGELES, CALIFORNIA 90067
(310) 789-1255
(Name, address and telephone number of agent for service)

Approximate date of proposed sale to the public:
From time to time after the date this registration statement becomes effective.

If this Form is filed to register additional securities for an offering pursuant to Rule 462(b) under the Securities Act, please check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. |_|

If this Form is a post-effective amendment filed pursuant to Rule 462(c) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. |_|

If this Form is a post-effective amendment filed pursuant to Rule 462(d) under the Securities Act, check the following box and list the Securities Act registration statement number of the earlier effective registration statement for the same offering. |_|

If delivery of the prospectus is expected to be made pursuant to Rule 434, check the following box. |_|

The registrant hereby amends this registration statement on such date or dates as may be necessary to delay its effective date until the registrant shall file

a further amendment which specifically states that this registration statement shall thereafter become effective in accordance with Section 8(a) of the Securities Act of 1933 or until the registration statement shall become effective on such date as the Commission, acting pursuant to said Section 8(a), may determine. The information in this prospectus is not complete and may be changed. The selling stockholders may not sell these securities until the registration statement filed with the Securities and Exchange Commission is effective. This prospectus is not an offer to sell these securities and it is not soliciting an offer to buy these securities in any state where the offer or sale is not permitted.

SUBJECT TO COMPLETION, DATED MARCH 3, 2006

PROSPECTUS

NATURAL GAS SYSTEMS, INC.

6,551,445 shares of our common stock

This prospectus relates to the sale of up to 5,301,445 shares of our currently outstanding shares of common stock that are owned by some of our stockholders, and 1,250,000 shares of our common stock issuable upon the exercise of outstanding common stock purchase warrants held by some of our warrant holders. For a list of the selling stockholders, please see "Selling Stockholders." We are not selling any shares of common stock in this offering and therefore will not receive any proceeds from this offering. We will, however, receive the exercise price of the warrants if and when those warrants are exercised by the selling stockholders. None of the warrants has been exercised as of the date of this prospectus. We will pay the expenses of registering these shares.

Our common stock is traded in the over-the-counter market and is quoted on the OTC Bulletin Board under the symbol NGSY. On February 21, 2006, the closing price of our common stock was $1.95 per share.

The shares included in this prospectus may be offered and sold directly by the selling stockholders in the open market at prevailing prices or in individually negotiated transactions, through agents designated from time to time or through underwriters or dealers. We will not control or determine the price at which a selling stockholder decides to sell its shares. Brokers or dealers effecting transactions in these shares should confirm that the shares are registered under applicable state law or that an exemption from registration is available.

YOU SHOULD UNDERSTAND THE RISKS ASSOCIATED WITH INVESTING IN OUR COMMON STOCK. BEFORE MAKING AN INVESTMENT, READ THE "RISK FACTORS," WHICH BEGIN ON PAGE 3 OF THIS PROSPECTUS.

NEITHER THE SECURITIES AND EXCHANGE COMMISSION NOR ANY STATE SECURITIES COMMISSION HAS APPROVED OR DISAPPROVED OF THESE SECURITIES OR PASSED UPON THE ADEQUACY OR ACCURACY OF THIS PROSPECTUS. ANY REPRESENTATION TO THE CONTRARY IS A CRIMINAL OFFENSE.

The date of this prospectus is March 3, 2006.

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YOU SHOULD RELY ONLY ON THE INFORMATION THAT IS CONTAINED IN THIS PROSPECTUS. WE HAVE NOT AUTHORIZED ANYONE TO PROVIDE YOU WITH INFORMATION DIFFERENT FROM THAT CONTAINED IN THIS PROSPECTUS. THIS PROSPECTUS MAY BE USED ONLY IN JURISDICTIONS WHERE IT IS LEGAL TO SELL THESE SECURITIES. YOU SHOULD ASSUME THAT THE INFORMATION CONTAINED IN THIS PROSPECTUS IS ACCURATE ONLY AS OF THE DATE OF THIS PROSPECTUS, REGARDLESS OF THE TIME OF DELIVERY OF THIS PROSPECTUS OR ANY SALE OF OUR COMMON STOCK. OUR BUSINESS, FINANCIAL CONDITION, RESULTS OF OPERATIONS AND PROSPECTS MAY HAVE CHANGED SINCE THE DATE OF THIS PROSPECTUS. THIS PROSPECTUS IS NOT AN OFFER TO SELL OR SOLICITATION OF AN OFFER TO BUY THESE SECURITIES IN ANY CIRCUMSTANCES UNDER WHICH THE OFFER OR SOLICITATION IS UNLAWFUL.

PROSPECTUS SUMMARY

This summary highlights information contained elsewhere in this prospectus; it does not contain all of the information you should consider before investing in our common stock. You should read the entire prospectus before making an investment decision, including the information under the headings "Risk Factors."

All information contained in this prospectus is adjusted to reflect a 40:1 reverse split of our common stock effected in May 2004.

Throughout this prospectus, the terms "we," "us," "our," "our company" and "NGS" refer to Natural Gas Systems, Inc., a Nevada corporation formerly known as Reality Interactive, Inc., and, unless the context indicates otherwise, also includes our wholly-owned subsidiaries.

COMPANY OVERVIEW

Natural Gas Systems, Inc. was formed in late 2003 to acquire established crude oil and natural gas resources and exploit them through the application of conventional and specialized technology with the objective of increasing production, ultimate recoveries, or both. We currently operate in four crude oil and natural gas fields in the State of Louisiana. Our principal executive offices are located at 820 Gessner, Suite 1340, Houston, Texas 77024. Our telephone number is (713) 935-0122 and we maintain a website at www.natgas.us. Information contained on our website does not constitute part of this prospectus.

In acquiring our crude oil and natural gas properties, we target established, shallow oil and gas fields or resources, preferably with existing road, pipeline and storage infrastructure, and reservoirs with low permeability (referred to as "tight" reservoirs in which oil or gas flow is inhibited). Such reservoirs

typically have low decline rate production and limited drainage areas per well. Our strategy is to develop incremental value by:

(i) bringing undrained or partially drained areas of the reservoirs into production, and

(ii) accelerating existing production by engaging in:

- work-overs to clean sand, water and paraffin from wells,
- re-completions into other reservoirs,
- optimization of production facilities including installation of compression facilities,
- development and exploitation drilling,
- applying lateral drilling, hydraulic fracturing and other stimulation methods to older fields that matured prior to the application of these technologies, and
- selective use of newer technologies, some of which may be unproved, to locate bypassed resources in mature fields.

The NGS team is broadly experienced in oil and gas operations, development, acquisitions and financing and follows a strategy of outsourcing most of the property, corporate administrative and accounting functions.

CORPORATE HISTORY OF REVERSE MERGER

Reality Interactive, Inc. ("Reality"), a Nevada corporation that traded on the OTC Bulletin Board under the symbol RLYI.OB, and the predecessor of Natural Gas Systems, Inc., was incorporated on May 24, 1994 for the purpose of developing technology-based knowledge solutions for the industrial marketplace. On April 30, 1999, Reality ceased business operations, sold substantially all of its assets and terminated all of its employees. Subsequent to ceasing operations, Reality explored other potential business opportunities to acquire or merge with another entity, while continuing to file reports with the SEC.

On May 26, 2004, Natural Gas Systems, Inc., a privately owned Delaware corporation formed in September 2003 ("Old NGS"), was merged into a wholly owned subsidiary of Reality. Reality was thereafter renamed Natural Gas Systems, Inc. and adopted a June 30 fiscal year end. As part of the merger, the officers and directors of Reality resigned, the officers and directors of Old NGS became the officers and directors of our company and the crude oil and natural gas business of Old NGS became that of our company.

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THE OFFERING

We are registering 6,551,445 shares of our common stock in order to enable the holders of those shares to freely re-sell those shares (on the open market or otherwise) from time to time in the future through the use of this prospectus. Of these shares, 5,301,445 shares are currently outstanding and were issued in private transactions and 1,250,000 shares may be issued to selling stockholders upon their exercise of outstanding warrants issued in private transactions. Since the foregoing shares and warrants were issued in private, unregistered transactions, none of the 6,551,445 shares can be freely transferred at this time by the selling stockholders unless the shares are included in a prospectus, such as this prospectus, or unless the shares are sold in an exempt transaction

such as a sale that complies with the terms and conditions of Rule 144 under the Securities Act of 1933.

Common stock offered by the selling stockholders	6,551,445 shares, consisting of 5,301,445 outstanding shares owned by selling stockholders and 1,250,000 shares issuable to selling stockholders upon exercise of warrants.
Common stock currently outstanding	25,210,678 shares (1)
Common stock to be outstanding after the offering, assuming no exercise of the warrants for the shares covered by this prospectus	25,210,678 shares (1)
Common stock to be outstanding after the offering, assuming the exercise of all warrants for the shares covered by this prospectus	26,460,678 shares (2)
OTC Bulletin Board Trading Symbol	NGSY
Risk	Factors An investment in our common stock involves significant risks. See "Risk Factors" beginning on page 3.

(1) Does not include (i) up to 1,819,000 shares of our common stock available for issuance under our 2004 Stock Plan, (ii) up to 2,036,000 shares of our common stock issuable upon the exercise of options granted under our 2004 Stock Plan, (iii) up to 510,000 shares of our common stock issuable upon the exercise of options granted under our 2003 Stock Option Plan, or (iv) up to 2,958,967 shares of our common stock issuable upon exercise of our outstanding warrants.

(2) Does not include (i) up to 1,819,000 shares of our common stock available for issuance under our 2004 Stock Plan, (ii) up to 2,036,000 shares of our common stock issuable upon the exercise of options granted under our 2004 Stock Plan, (iii) up to 510,000 shares of our common stock issuable upon the exercise of options granted under our 2003 Stock Option Plan, or (iv) up to 1,708,967 shares of our common stock issuable upon exercise of some of our outstanding warrants.

RISK FACTORS

An investment in our common stock involves a high degree of risk. You should carefully consider the risks described below and the other information contained in this prospectus before deciding to invest in our company. If any of the following risks actually occur, our business, financial condition or operating results and the trading price or value of our securities could be materially adversely affected.

RISKS RELATED TO OUR BUSINESS AND INDUSTRY

WE MAY BE UNABLE TO OBTAIN THE LARGE AMOUNT OF ADDITIONAL CAPITAL THAT WE NEED TO GROW OUR BUSINESS.

Based on our current estimates of production and current oil and gas prices, and absent a default causing acceleration of our debt, we currently have sufficient capital reserves to satisfy our short-term obligations through December 31, 2006. We will require more capital or success in our development activities or both to execute additional acquisitions, fund our development program beyond our 2005 Delhi Development Drilling Program we began in October 2005 (as defined in the "Properties/Delhi Field" portion of the "Business" section below), replace our existing depleting reserves or exploit any technology projects we may develop from time to time. Additionally, we may encounter unforeseen costs or lower commodity prices that could also require us to seek additional capital. While we are exploring various capital raising avenues, we cannot assure you that we will be able to obtain the capital needed to acquire additional crude oil and natural gas fields. Further, we have been operating at a loss and intend to increase our operating expenses and overhead significantly as we expand our acquisitions of crude oil and natural gas production and expand our field operations staff. The full and timely development and implementation of our business plan and growth strategy will require significant additional resources, and we may not be able to obtain the funding necessary to implement our growth strategy on acceptable terms or at all. An inability to obtain such resources would significantly impair our ability to execute our growth plan or respond to competitive pressures. Furthermore, our growth strategy may not produce material revenues even if successfully funded.

We intend to explore a number of options to secure alternative sources of capital, including the issuance of senior secured debt, volumetric production payments, subordinated debt, or additional equity, including preferred equity securities or other equity securities. We have not yet identified the sources for the additional financing we require and we do not have commitments from any third parties to provide this financing. We might not succeed, therefore, in obtaining additional and acceptable financing when we need it or at all. Our ability to obtain additional capital will also depend on market conditions, national and global economics and other factors beyond our control. We cannot assure you that we will be able to implement or capitalize on various financing alternatives or otherwise obtain required working capital, the need for which is substantial given our operating loss history. We refer you to "Management's Discussion and Analysis of Financial Condition and Results of Operations-Liquidity and Capital Resources."

OUR CURRENT CREDIT FACILITY INCLUDES STRICT FINANCIAL COVENANTS THAT WE MAY BE UNABLE TO SATISFY.

In February 2005, we entered into a credit facility with Prospect Energy Corporation. This facility is secured by substantially all of our existing and certain future assets including the common stock of certain subsidiaries. While no principal payments are required prior to maturity, we are required to meet certain ongoing financial covenants. The primary covenants include maintaining a minimum ratio of borrowing base to debt and a minimum ratio of EBITDA (earnings before interest, income tax and other non-cash charges such as depreciation, depletion and amortization) to total interest. Our borrowing base is dependent upon our proved reserves as determined by our outside engineers and the reasonable satisfaction of Prospect, future operating costs and capital expenditures and commodity prices. We cannot assure you that, in the future, commodity prices will not decline, projected reserve increases will be obtained or current proved reserves will be realized, any one of which could reduce our borrowing base, which could in turn require us to reduce our outstanding borrowings or prepay our debt due to an acceleration by our lender. At December 31, 2005, we were in compliance with our borrowing base covenant.

Under the Prospect facility, we are required to maintain an EBITDA of two times

interest payable, beginning no later than the three month period ending January 31, 2006. Our ability to comply with this requirement is dependent on achieving certain operating results, especially with respect to our 2005 Delhi Development Drilling Program that was scheduled to begin in May 2005. On October 9, 2005, this program commenced operations, following a five month delay caused by casualty repairs sustained by the drilling contractor for the account of another customer. Due to these delays and the uncertain operating results of these wells, we can not assure you that the results from this program will provide sufficient EBITDA to meet the required interest coverage ratio. If such a covenant breach occurs and is not waived by Prospect, the debt would become immediately due and payable. Since we do not have sufficient liquid assets to prepay our debt in full, we would be required to refinance all or a portion of our existing debt or obtain additional financing. If we were unable to refinance our debt or obtain additional financing, we would be required to curtail portions of our development program, sell assets, and/or reduce capital expenditures. At January 31, 2006, we were in compliance with the interest coverage ratio.

Other covenants limit additional borrowings, sales of assets and the distributions of cash or properties and prohibit the payment of dividends and the incurrence of liens. The restrictions of the credit facility may have adverse consequences on our operations and financial results, including our ability to obtain financing for working capital, capital expenditures, our development program, purchases of new technology or other purposes. We will be required to use a substantial portion of our cash flow to make debt service payments, which will reduce the funds that would otherwise be available for operations and future business opportunities. A substantial decrease in our operating cash flow or an increase in our expenses could make it difficult for us to meet our debt service requirements, thus requiring us to modify operations which could result in our becoming more vulnerable to downturns in our business or the economy generally.

Our ability to obtain and service indebtedness will depend on our future performance and performance of vendors, including our ability to manage cash flow and working capital and availability of services from vendors, which are in turn subject to a variety of factors beyond our control. We may not get timely access to vendor services to allow us to carry out our business plan. Our business may not generate cash flow at or above anticipated levels or we may not be able to borrow funds in amounts sufficient to enable us to service indebtedness, make anticipated capital expenditures or finance our development program. If we are unable to generate sufficient cash flow from operations or to borrow sufficient funds in the future to service our debt, we may be required to curtail portions of our development program, sell assets, reduce capital expenditures, refinance all or a portion of our existing debt or obtain additional financing. We may not be able to refinance our debt or obtain additional financing for many reasons, including restrictions on our ability to incur debt under our existing debt or installment purchase arrangements, and the fact that substantially all of our assets are currently pledged to secure obligations under our existing debt or installment purchase arrangements.

OUR LIMITED OPERATING HISTORY MAKES IT DIFFICULT TO PREDICT FUTURE RESULTS AND INCREASES THE RISK OF YOUR INVESTMENT.

We commenced our crude oil and natural gas operations in late 2003 and have a limited operating history. Therefore, we face all the risks common to companies in their early stages of development, including uncertainty of funding sources, high initial expenditure levels and uncertain revenue streams, an unproven business model, and difficulties in managing growth. Our prospects must be considered in light of the risks, expenses, delays and difficulties frequently

encountered in establishing a new business. Any forward-looking statements in this prospectus do not reflect any possible effect on us from the outcome of these types of uncertainty. Since inception, we have incurred significant losses. We cannot assure you that we will be successful. While members of our management have previously carried out or been involved with acquisition and production activities in the crude oil and natural gas industry while employed by other companies, we cannot assure you that our intended acquisition targets and development plans will lead to the successful development of crude oil and natural gas production or additional revenue.

WE MAY BE UNABLE TO CONTINUE LICENSING FROM THIRD PARTIES THE TECHNOLOGIES THAT WE USE IN OUR BUSINESS OPERATIONS.

As is customary in the crude oil and natural gas industry, we utilize a variety of widely available technologies in the crude oil and natural gas development and drilling process. We do not have any patents or copyrights for the technology we currently utilize. Instead, we license or purchase services from the holders of such technology, or outsource the technology integral to our business from third parties. Our commercial success will depend in part on these sources of technology and assumes that such sources will not infringe on the propriety rights of others. We cannot be certain whether any third-party patents will require us to utilize or develop alternative technology or to alter our business plan, obtain additional licenses, or cease activities that infringe on third-parties' intellectual property rights. Our inability to acquire any third-party licenses, or to integrate the related third-party products into our business plan, could result in delays in development unless and until equivalent products can be identified, licensed, and integrated. Existing or future licenses may not continue to be available to us on commercially reasonable terms or at all. Litigation, which could result in substantial cost to us, may be necessary to enforce any patents licensed to us or to determine the scope and validity of third-party obligations.

REGULATORY AND ACCOUNTING REQUIREMENTS MAY REQUIRE SUBSTANTIAL REDUCTIONS IN PROVEN RESERVES (SEE GLOSSARY) AND LIMITATIONS OF HEDGING.

We review on a periodic basis the carrying value of our crude oil and natural gas properties under the applicable rules of the various regulatory agencies, including the SEC. Under these rules, the carrying value of proved reserves of crude oil and natural gas properties may not exceed the present value of estimated future net after-tax cash flows from proved reserves, discounted at 10%. Application of this "ceiling" test generally requires pricing future revenues at the unescalated prices in effect as of the end of our fiscal year and requires a write down for accounting purposes if the ceiling is exceeded, even if prices declined for only a short period of time. We may in the future be required to write down the carrying value of our crude oil and natural gas properties when crude oil and natural gas prices are depressed or unusually volatile. Whether we will be required to take such a charge will depend on the prices for crude oil and natural gas at the end of any fiscal period and the effect of reserve additions or revisions and capital expenditures during such period. If a write down is required, it would result in a charge to our earnings but would not impact our cash flow from operating activities.

In order to reduce our exposure to short-term fluctuations in the price of crude oil and natural gas and comply with the terms of our credit facility, we have entered into commodity contracts. These arrangements apply to only a portion of our production and provide only partial price protection against declines in crude oil and natural gas prices. Our commodity contracts may expose us to risk of financial loss in certain circumstances, including instances where production is less than expected, our customers fail to purchase contracted quantities of crude oil or natural gas or a sudden, unexpected event materially impacts crude oil or natural gas prices. In addition, our commodity contracts may limit the benefit to us of increases in the price of crude oil and natural gas.

WE MAY BE UNABLE TO ACQUIRE AND DEVELOP THE ADDITIONAL OIL AND GAS RESERVES THAT ARE REQUIRED IN ORDER TO SUSTAIN OUR BUSINESS OPERATIONS.

In general, the volumes of production from crude oil and natural gas properties decline as reserves are depleted, with the rate of decline depending on reservoir characteristics. Except to the extent we acquire properties containing proved reserves or conduct successful development activities, or both, our proved reserves will decline. Our future crude oil and natural gas production is, therefore, highly dependent upon our level of success in finding or acquiring additional reserves.

WE ARE SUBJECT TO SUBSTANTIAL OPERATING RISKS THAT MAY ADVERSELY AFFECT OUR RESULTS OF OPERATIONS.

The crude oil and natural gas business involves numerous operating hazards such as well blowouts, mechanical failures, explosions, uncontrollable flows of crude oil, natural gas or well fluids, fires, formations with abnormal pressures, hurricanes, flooding, pollution, releases of toxic gas and other environmental hazards and risks. We could suffer substantial losses as a result of any of these events. While we carry general liability, control of well, and operator's extra expense coverage typical in our industry, we are not fully insured against all risks incident to our business.

We may not always be the operator of some of our wells. As a result, our operating risks for these wells and our ability to influence the operations for these wells will be less subject to our control. Operators of these wells may act in ways that are not in our best interests. If this occurs, the development of, and production of crude oil and natural gas from, some wells may not occur which would have an adverse effect on our results of operations.

THE LOSS OF KEY PERSONNEL COULD ADVERSELY AFFECT US.

We depend to a large extent on the services of certain key management personnel, including our executive officers, the loss of any of whom could have a material adverse effect on our operations. In particular, our future success is dependent upon Robert S. Herlin, our President, for capital raising, sourcing and evaluating and closing deals, and oversight of development and operations.

THE LOSS OF ANY OF OUR SKILLED TECHNICAL PERSONNEL COULD ADVERSELY AFFECT OUR BUSINESS.

We depend to a large extent on the services of skilled technical personnel to operate and maintain our crude oil and natural gas fields. We do not have the resources to perform all of these services and therefore we outsource our requirements. Additionally, as our production increases, so does our need for such services. Generally, we do not have long-term agreements with our drilling and maintenance service providers. Accordingly, there is a risk that any of our service providers could discontinue servicing our crude oil and natural gas fields for any reason. Although we believe that we could establish alternative sources for most of our operational and maintenance needs, any delay in locating, establishing relationships with, and training our sources could result in production shortages and maintenance problems, with a resulting loss of revenue to us. We also rely on third-party carriers for the transportation and distribution of our production, the loss of any of which could have a material adverse effect on our operations.

BECAUSE OUR CURRENT GAS PRODUCING FIELD HAS ONLY ONE GAS PIPELINE OUTLET, OUR BUSINESS WOULD BE ADVERSELY AFFECTED IF WE LOST ACCESS TO THAT OUTLET.

All of our natural gas sales are made via one gas pipeline connection. Our ability to sell natural gas would be adversely affected if the operators of this pipeline refused to or were unable to accept our gas. We have had infrequent sales curtailment due to gas quality issues resulting from operational problems with our gas treating facility that we believe have been rectified. Our only alternative in such event would be to permit and construct a new pipeline connection to a pipeline located several miles from the field, which could require re-locating our gas treating facility.

WE MAY HAVE DIFFICULTY MANAGING FUTURE GROWTH AND THE RELATED DEMANDS ON OUR RESOURCES AND MAY HAVE DIFFICULTY IN ACHIEVING FUTURE GROWTH.

We hope to experience rapid growth through acquisitions and development activity. Any future growth may place a significant strain on our financial, technical, operational and administrative resources. Our ability to grow will depend upon a number of factors, including:

- our ability to identify and acquire new development or acquisition prospects;
- our ability to develop existing properties;
- our ability to continue to retain and attract skilled personnel;
- the results of our development program and acquisition efforts;
- the success of our technologies;
- hydrocarbon prices;
- our ability to successfully integrate new properties; and
- our access to capital.

We can not assure you that we will be able to successfully grow or manage any such growth.

WE FACE STRONG COMPETITION FROM LARGER CRUDE OIL AND NATURAL GAS COMPANIES.

Our competitors include major integrated crude oil and natural gas companies and numerous independent crude oil and natural gas companies, individuals and drilling and income programs. Many of our competitors are large, well-established companies with substantially larger operating staffs and greater capital resources than we have. We may not be able to successfully conduct our operations, evaluate and select suitable properties and consummate transactions in this highly competitive environment. Specifically, many of these larger competitors are able to pay more for development projects and productive crude oil and natural gas properties and to define, evaluate, bid for and purchase a greater number of properties and prospects than our financial or human resources permit. In addition, such companies are able to expend greater resources on the existing and changing technologies that we believe are and will be increasingly important to attaining success in our industry.

THE CRUDE OIL AND NATURAL GAS RESERVES INCLUDED IN THIS PROSPECTUS ARE ONLY ESTIMATES AND MAY PROVE TO BE INACCURATE.

There are numerous uncertainties inherent in estimating crude oil and natural gas reserves and their estimated values. The reserves discussed in this

prospectus are only estimates that may prove to be inaccurate because of these uncertainties. Reservoir engineering is a subjective and inexact process of estimating underground accumulations of crude oil and natural gas that cannot be measured in an exact manner. Estimates of economically recoverable crude oil and natural gas reserves depend upon a number of variable factors, such as historical production from the area compared with production from other producing areas and assumptions concerning effects of regulations by governmental agencies, future crude oil and natural gas prices, future operating costs, severance and excise taxes, development costs and work-over and remedial costs. Some or all of these assumptions may in fact vary considerably from actual results. For these reasons, estimates of the economically recoverable quantities of crude oil and natural gas attributable to any particular group of properties, classifications of such reserves based on risk of recovery, and estimates of the future net cash flows expected therefrom prepared by different engineers or by the same engineers but at different times, may vary substantially. Accordingly, reserve estimates may be subject to downward or upward adjustment. Actual production, revenue and expenditures with respect to our reserves will likely vary from estimates, and such variances may be material. The information regarding discounted future net cash flows included in this prospectus should not be considered as the current market value of the estimated crude oil and natural gas reserves attributable to our properties. As required by the SEC, the estimated discounted future net cash flows from proved reserves are based on prices and costs as of the date of the estimate, while actual future prices and costs may be materially higher or lower. Actual future net cash flows also will be affected by factors such as the amount and timing of actual production, supply and demand for crude oil and natural gas, increases or decreases in consumption, and changes in governmental regulations or taxation. In addition, the 10% discount factor, which is required by the SEC to be used in calculating discounted future net cash flows for reporting purposes, is not necessarily the most appropriate discount factor based on interest rates in effect from time to time and risks associated with us or the crude oil and natural gas industry in general.

WE CANNOT MARKET THE CRUDE OIL AND NATURAL GAS THAT WE PRODUCE WITHOUT THE ASSISTANCE OF THIRD PARTIES.

The marketability of the crude oil and natural gas that we produce depends upon the proximity of our reserves to, and the capacity of, facilities and third-party services, including crude oil and natural gas gathering systems, pipelines, trucking or terminal facilities, and processing facilities. The unavailability or lack of capacity of such services and facilities could result in the shut-in of producing wells or the delay or discontinuance of development plans for properties. A shut-in or delay or discontinuance could adversely affect our financial condition. In addition, federal and state regulation of crude oil and natural gas production and transportation could affect our ability to produce and market our crude oil and natural gas on a profitable basis.

THE TYPES OF RESOURCES WE FOCUS ON HAVE CERTAIN RISKS.

Our business plan focuses on the acquisition and development of shallower, more complex and/or lower permeability reservoirs. Shallow reservoirs usually have lower pressure and, necessarily, less hydrocarbons in place, complex reservoirs are more difficult to analyze and exploit, and low permeability reservoirs require more wells and stimulation for development and such wells may have low profit margins.

In addition, the mature fields we currently own have well bores that were drilled as early as the 1920s. As such, they contain older down-hole equipment and casing that is more subject to failure than new equipment. The failure of such equipment or other subsurface failure can result in the complete loss of a well.

CRUDE OIL AND NATURAL GAS DEVELOPMENT, RE-COMPLETION OF WELLS FROM ONE RESERVOIR TO ANOTHER RESERVOIR, AND RESTORING WELLS TO PRODUCTION ARE SPECULATIVE ACTIVITIES AND INVOLVE NUMEROUS RISKS AND SUBSTANTIAL AND UNCERTAIN COSTS.

Our growth will be materially dependent upon the success of our future development program. Drilling for crude oil and natural gas and re-working existing wells involve numerous risks, including the risk that no commercially productive crude oil or natural gas reservoirs will be encountered. The cost of drilling, completing and operating wells is substantial and uncertain, and drilling operations may be curtailed, delayed or cancelled as a result of a variety of factors beyond our control, including:

- unexpected drilling conditions;
- pressure or irregularities in formations;
- equipment failures or accidents;
- inability to obtain leases on economic terms, where applicable;
- adverse weather conditions;
- compliance with governmental requirements; and
- shortages or delays in the availability of drilling rigs or crews and the delivery of equipment.

Drilling or re-working is a highly speculative activity. Even when fully and correctly utilized, modern well completion techniques such as hydraulic fracturing and lateral drilling do not guarantee that we will find crude oil and/or natural gas in our wells. Hydraulic fracturing involves pumping a fluid with or without particulates into a formation at high pressure, thereby creating fractures in the rock and leaving the particulates in the fractures to ensure that the fractures remain open, thereby potentially increasing the ability of the reservoir to produce oil or gas. Lateral drilling involves drilling horizontally out from an existing vertical well bore, thereby potentially increasing the area and reach of the well bore that is in contact with the reservoir. Our future drilling activities may not be successful and, if unsuccessful, such failure would have an adverse effect on our future results of operations and financial condition. We cannot assure you that our overall drilling success rate or our drilling success rate for activities within a particular geographic area will not decline. We may identify and develop prospects through a number of methods, some of which do not include lateral drilling or hydraulic fracturing, and some of which may be unproven. The drilling and results for these prospects may be particularly uncertain. Our drilling schedule may vary from our capital budget. The final determination with respect to the drilling of any scheduled or budgeted prospects will be dependent on a number of factors, including, but not limited to:

- the results of previous development efforts and the acquisition, review and analysis of data;
- the availability of sufficient capital resources to us and the other participants, if any, for the drilling of the prospects;
- the approval of the prospects by other participants, if any, after additional data has been compiled;
- economic and industry conditions at the time of drilling, including

prevailing and anticipated prices for crude oil and natural gas and the availability of drilling rigs and crews;

- our financial resources and results;
- the availability of leases and permits on reasonable terms for the prospects; and
- the success of our drilling technology.

We cannot assure you that these projects can be successfully developed or that the wells discussed will, if drilled, encounter reservoirs of commercially productive crude oil or natural gas. There are numerous uncertainties in estimating quantities of proved reserves, including many factors beyond our control.

CRUDE OIL AND NATURAL GAS PRICES ARE HIGHLY VOLATILE IN GENERAL AND LOW PRICES WILL NEGATIVELY AFFECT OUR FINANCIAL RESULTS.

Our revenues, profitability, cash flow, future growth and ability to borrow funds or obtain additional capital, as well as the carrying value of our properties, are substantially dependent upon prevailing prices of crude oil and natural gas. Lower crude oil and natural gas prices may reduce the amount of crude oil and natural gas that we can produce economically. Historically, the markets for crude oil and natural gas have been very volatile, and such markets are likely to continue to be volatile in the future. Prices for crude oil and natural gas are subject to wide fluctuation in response to relatively minor changes in the supply of and demand for crude oil and natural gas, market uncertainty and a variety of additional factors that are beyond our control, including:

- the level of consumer product demand;
- weather conditions;
- domestic and foreign governmental regulations;
- the price and availability of alternative fuels;
- political conditions;
- the foreign supply of crude oil and natural gas; and
- the price of foreign imports and overall economic conditions.

It is impossible to predict future crude oil and natural gas price movements. Declines in crude oil and natural gas prices may materially adversely affect our financial condition, liquidity, ability to finance planned capital expenditures and results of operations.

GOVERNMENT REGULATION AND LIABILITY FOR ENVIRONMENTAL MATTERS MAY ADVERSELY AFFECT OUR BUSINESS AND RESULTS OF OPERATIONS.

Crude oil and natural gas operations are subject to extensive federal, state and local government regulations, which may be changed from time to time. Matters subject to regulation include discharge permits for drilling operations, drilling bonds, reports concerning operations, the spacing of wells, unitization and pooling of properties and taxation. From time to time, regulatory agencies have imposed price controls and limitations on production by restricting the

rate of flow of crude oil and natural gas wells below actual production capacity in order to conserve supplies of crude oil and natural gas. There are federal, state and local laws and regulations primarily relating to protection of human health and the environment applicable to the development, production, handling, storage, transportation and disposal of crude oil and natural gas, by-products thereof and other substances and materials produced or used in connection with crude oil and natural gas operations. In addition, we may inherit liability for environmental damages caused by previous owners of property we purchase or lease. As a result, we may incur substantial liabilities to third parties or governmental entities. We are also subject to changing and extensive tax laws, the effects of which cannot be predicted. The implementation of new, or the modification of existing, laws or regulations could have a material adverse effect on us.

RISKS RELATED TO OUR STOCK

OUR STOCK PRICE HAS BEEN AND MAY CONTINUE TO BE VERY VOLATILE.

Our common stock is thinly traded and the market price has been, and is likely to continue to be, highly volatile. For the twelve month period ended on December 31, 2005, our stock price as traded on the OTC Bulletin Board has ranged from $1.00 to $3.47. The variance in our stock price makes it extremely difficult to forecast with any certainty the stock price at which you may be able to buy or sell shares of our common stock. The market price for our common stock could be subject to wide fluctuations as a result of factors that are out of our control, such as:

- actual or anticipated variations in our results of operations;
- naked short selling of our common stock and stock price manipulation;
- changes or fluctuations in the commodity prices of crude oil and natural gas;
- general conditions and trends in the crude oil and natural gas industry; and
- general economic, political and market conditions.

PRESENT MANAGEMENT AND DIRECTORS CURRENTLY HOLD A SIGNIFICANT PERCENTAGE OF OUR COMMON STOCK AND THEREFORE MIGHT BE ABLE TO CONTROL THE ELECTION OF OUR DIRECTORS AND OTHER MATTERS SUBMITTED TO OUR STOCKHOLDERS FOR APPROVAL.

Our executive officers and directors, in the aggregate, beneficially own approximately 38% of our outstanding common stock (including shares issuable upon the exercise of options and warrants exercisable within 60 days of March 2, 2006). Our Chairman of the Board, Mr. Laird Q. Cagan, Managing Director of Cagan McAfee Capital Partners, LLC ("CMCP") currently owns or controls, directly or indirectly, approximately 7.7 million of these shares (including shares issuable upon the exercise of warrants exercisable within 60 days of March 2, 2006), or approximately 31% of our outstanding common stock. Mr. Eric McAfee, also a Managing Director of CMCP, currently owns or controls, directly or indirectly, approximately 5.9 million shares (including shares issuable upon the exercise of warrants exercisable within 60 days of March 2, 2006), or approximately 23% of our outstanding common stock. Collectively, these two individuals currently own or control, directly or indirectly, approximately 13.6 million shares (including shares issuable upon the exercise of warrants exercisable within 60 days of March 2, 2006), or approximately 54% of our outstanding common stock. As a result, these holders of our outstanding common stock, if they were to act

together, would be able to exercise control over all matters submitted to our stockholders for approval (including the election and removal of directors and any merger, consolidation or sale of all or substantially all of our assets). This concentration of ownership may have the effect of delaying, deferring or preventing a change in control of our company, impede a merger, consolidation, takeover or other business combination involving our company or discourage a potential acquirer from making a tender offer or otherwise attempting to obtain control of our company, which in turn could have an adverse effect on the market price of our common stock.

"PENNY STOCK" REGULATIONS MAY RESTRICT THE MARKETABILITY OF OUR COMMON STOCK.

The SEC's regulations generally define "penny stock" to be an OTC Bulletin Board ("OTCBB") stock that has a market price of less than $5.00 per share. Our common stock may be subject to rules that impose additional sales practice requirements on broker-dealers who sell these securities to persons other than established customers and accredited investors (generally those with assets in excess of $1,000,000, or annual incomes exceeding $200,000 or $300,000 together with their spouse). For transactions covered by these rules, the broker-dealer must make a special suitability determination for the purchase of these securities and have received the purchaser's prior written consent to the transaction.

Additionally, for any transaction, other than exempt transactions, involving a penny stock, the rules require the delivery, prior to the transaction, of a risk disclosure document mandated by the SEC relating to the penny stock market. The broker-dealer also must disclose the commissions payable to both the broker-dealer and the registered representative, current quotations for the securities and, if the broker-dealer is the sole market-maker, the broker-dealer must disclose this fact and the broker-dealer's presumed control over the market. Finally, monthly statements must be sent disclosing recent price information for the penny stock held in the account and information on the limited market in penny stocks. Consequently, the "penny stock" rules may restrict the ability of broker-dealers to sell our common stock and may affect the ability to sell our common stock in the secondary market.

THE MARKET FOR OUR COMMON STOCK IS LIMITED AND MAY NOT PROVIDE ADEQUATE LIQUIDITY.

Our common stock is currently thinly traded on the OTC Bulletin Board, a regulated quotation service that displays real-time quotes, last-sale prices, and volume information in over-the-counter equity securities. As a result, an investor may find it more difficult to dispose of, or obtain accurate quotations as to the price of, our securities than if the securities were traded on the NASDAQ Stock market, or another national exchange. There are a limited number of active market makers of our common stock. In order to trade shares of our common stock you must use one of these market makers unless you trade your shares in a private transaction. In the twelve months prior to December 31, 2005, the actual trading volume in our common stock ranged from a low of no shares of common stock traded to a high of over 319,000 shares of common stock traded, with 144 days exceeding a trading volume of 10,000 shares. On most days, this trading volume means there is limited liquidity in our shares of common stock. As of January 24, 2006, the three-month average trading volume was approximately 28,000 shares. Selling our shares is more difficult because smaller quantities of shares are bought and sold and news media coverage about us is limited. These factors result in a limited trading market for our common stock and therefore holders of our stock may be unable to sell shares purchased should they desire to do so.

IF SECURITIES OR INDUSTRY ANALYSTS DO NOT PUBLISH RESEARCH REPORTS ABOUT OUR

BUSINESS OR IF THEY DOWNGRADE OUR STOCK, THE PRICE OF OUR COMMON STOCK COULD DECLINE.

Small, relatively unknown companies can achieve visibility in the trading market through research and reports that industry or securities analysts publish. However, to our knowledge, no analysts cover our company. The lack of published reports by independent securities analysts could limit the interest in our common stock and negatively affect our stock price. We do not have any control over the research and reports these analysts publish or whether they will be published at all. If any analyst who does cover us downgrades our stock, our stock price would likely decline. If any analyst ceases coverage of our company or fails to regularly publish reports on us, we could lose visibility in the financial markets, which in turn could cause our stock price to decline.

THE ISSUANCE OF ADDITIONAL COMMON AND PREFERRED STOCK WOULD DILUTE EXISTING STOCKHOLDERS.

We are authorized to issue up to 100,000,000 shares of common stock. To the extent of such authorization, our board of directors has the ability, without seeking stockholder approval, to issue additional shares of common stock in the future for such consideration as our board may consider sufficient. The issuance of additional common stock in the future will reduce the proportionate ownership and voting power of the common stock now outstanding. We are also authorized to issue up to 5,000,000 shares of preferred stock, the rights and preferences of which may be designated in series by our board of directors. Such designation of new series of preferred stock may be made without stockholder approval, and could create additional securities which would have dividend and liquidation preferences over our common stock. Preferred stockholders could adversely affect the rights of holders of our common stock by:

- exercising voting, redemption and conversion rights to the detriment of the holders of common stock;

- receiving preferences over the holders of common stock regarding surplus funds in the event of our dissolution or liquidation;

- delaying, deferring or preventing a change in control of our company; and

- discouraging bids for our common stock.

SUBSTANTIAL SALES OF OUR COMMON STOCK COULD CAUSE OUR STOCK PRICE TO FALL.

As of March 2, 2006, we had outstanding 25,210,678 shares of common stock, of which approximately 24,162,000 shares were "restricted securities" (as that term is defined in Rule 144 promulgated under the Securities Act of 1933). Other than the shares being registered for resale by this prospectus, only approximately 1,036,000 shares are currently freely tradable shares without further registration under the Securities Act. However, as a result of the registration of the shares included in this prospectus, an additional 5,301,445 shares of our currently outstanding common stock will be able to be freely sold on the market, which number will increase to 6,551,445 shares if the warrants are exercised by the selling stockholders and the underlying 1,250,000 shares that are included in this prospectus are purchased. Because there currently are only approximately 1,036,000 freely tradable shares, the release of 5,301,445 additional freely trading shares included in this prospectus onto the market, or the perception that such shares will or could come onto the market, could have an adverse affect on the trading price of the stock.

In addition to the shares that are being registered for re-sale under this prospectus, an additional 18,000,000 shares of restricted stock became eligible for public resale under Rule 144 as of June 30, 2005. Although Rule 144 restricts the number of shares that any one holder can sell during any

three-month period under Rule 144, because more than one stockholder holds these restricted shares, a significant number of shares can now be sold under Rule 144. We cannot predict the effect, if any, that sales of the shares included in this registration statement or subject to Rule 144 sales, or the availability of such shares for sale, will have on the market prices prevailing from time to time. Nevertheless, the possibility that substantial amounts of our common stock may be sold in the public market may adversely affect prevailing market prices for our common stock and could impair our ability to raise capital through the sale of our equity securities.

WE DO NOT PLAN TO PAY ANY CASH DIVIDENDS ON OUR COMMON STOCK.

We have not paid any dividends on our common stock to date and do not anticipate that we will be paying dividends in the foreseeable future. Any payment of cash dividends on our common stock in the future will be dependent upon the amount of funds legally available, our earnings, if any, our financial condition, our anticipated capital requirements and other factors that our board of directors may think are relevant. However, we currently intend for the foreseeable future to follow a policy of retaining all of our earnings, if any, to finance the development and expansion of our business and, therefore, do not expect to pay any dividends on our common stock for the foreseeable future. Additionally, we are currently restricted from paying dividends pursuant to the terms of our credit agreement.

FORWARD-LOOKING STATEMENTS

This document contains forward-looking statements, which reflect the views of our management with respect to future events and financial performance. Certain of the statements contained in all parts of this document including, but not limited to, those relating to our acquisition and development plans, the effect of changes in strategy and business discipline, our project portfolio, future general and administrative expenses on a per unit of production basis, increases in wells operated, future growth, expansion and acquisitions, future exploration, future seismic data (including timing and results), purchase of technology licenses and their value and application, expansion of operations, generation of additional prospects, review of outside generated prospects and acquisitions, additional reserves and reserve increases, enhancement of visualization and interpretation strengths, expansion and improvement of capabilities, integration of new technology into operations, credit facilities, attraction of new members to our exploration team, future compensation programs, new focus on core areas, new prospects and drilling locations, future capital expenditures (or funding thereof), sufficiency of future working capital, borrowings and capital resources and liquidity, projected cash flows from operations, expectation or timing of reaching payout, outcome, effects or timing of any legal proceedings, drilling plans, including scheduled and budgeted wells, the number, timing or results of any wells, the plans for timing, interpretation and results of new or existing seismic surveys or seismic data, future production or reserves, future acquisition of leases, lease options or other land rights and any other statements regarding future operations, financial results, opportunities, growth, business plans and strategy and other statements that are not historical facts are forward looking.

These forward-looking statements reflect our current view of future events and financial performance. When used in this document, the words "budgeted," "anticipate," "estimate," "expect," "may," "project," "believe," "intend," "plan," "potential" and similar expressions are intended to be among the statements that identify forward looking statements. These forward-looking statements speak only as of their dates and should not be unduly relied upon. We undertake no obligation to update or review any forward-looking statement,

whether as a result of new information, future events, or otherwise. Such statements involve risks and uncertainties, including, but not limited to, the numerous risks and substantial and uncertain costs associated with drilling of new wells, the volatility of crude oil and natural gas prices and the effects of relatively low prices for our products, conducting successful exploration and development in order to maintain reserves and revenue in the future, operating risks of crude oil and natural gas operations, our dependence on key personnel, our ability to utilize changing technology and the risk of technological obsolescence, the significant capital requirements of our exploration and development and technology development programs, governmental regulation and liability for environmental matters, results of litigation, management of growth and the related demands on our resources and the ability to achieve future growth, competition from larger crude oil and natural gas companies, the potential inaccuracy of estimates of crude oil and natural gas reserve data, property acquisition risks, and other factors detailed in this prospectus. Should one or more of these risks or uncertainties materialize, or should underlying assumptions prove incorrect, actual outcomes will likely vary materially from those indicated. For a discussion of some of the factors that may cause actual results to differ materially from those suggested by the forward-looking statements, please read carefully the information under "Risk Factors" beginning on page 3.

You may rely only on the information contained in this prospectus. We have not authorized anyone to provide information different from that contained in this prospectus. Neither the delivery of this prospectus nor the sale of common stock means that information contained in this prospectus is correct after the date of this prospectus. This prospectus is not an offer to sell or solicitation of an offer to buy these securities in any circumstances under which the offer or solicitation is unlawful.

USE OF PROCEEDS

We will not receive any proceeds from the sale of our common stock by the selling stockholders pursuant to this prospectus. However, we will receive the sale price of any common stock we sell to the selling stockholders upon exercise by them of their warrants. If warrants to purchase all of the underlying 1,250,000 shares are exercised for cash, we would receive approximately $1,122,000 of total proceeds. We would expect to use these proceeds, if any, for general working capital purposes. We have agreed to pay the expenses of registration of these shares, including specified legal and accounting fees.

MARKET FOR OUR COMMON EQUITY AND RELATED STOCKHOLDER MATTERS

Our common stock is traded on the OTC Bulletin Board National Association of Securities Dealers Automated Quotation System under the symbol "NGSY" and its predecessor symbol "RLYI". Market quotations shown below were reported by Media General Financial Services and represent prices between dealers, excluding retail mark-up or commissions, and adjusted for the 40:1 stock split that occurred on February 5, 2004.

	2005		2004		2003	
Quarter Ended	High	Low	High	Low	High	Low
December 31	$1.95	$1.15	$2.30	$1.45	$1.60	$0.64
September 30	$2.05	$1.00	$3.75	$2.05	$2.60	$1.20
June 30	$3.47	$1.32	$4.75	$0.91	$1.80	$0.60
March 31	$2.30	$1.55	$3.25	$0.65	$1.80	$0.20

At August 31, 2005, we had 1,044 shareholders of record. No stock has been repurchased by us since the merger of Old NGS into us in May, 2004.

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SECURITIES AUTHORIZED FOR ISSUANCE UNDER EQUITY COMPENSATION PLANS

On August 3, 2004, shareholders approved the adoption of our 2004 Stock Plan. As of March 2, 2006, options to purchase 2,036,000 shares had been granted under the 2004 Stock Plan and 145,000 shares were issued directly under the same plan. The purpose of the 2004 Stock Plan is to grant equity compensation in the form of stock grants, options or warrants to purchase our common stock to our employees and key consultants.

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights(a)	Weighted-average exercise price of outstanding options, warrants and rights(b)	Number of se remaini available fo issuance equity compe plans (exc securities r in column
Equity compensation plans approved by security holders	2,546,000(1)	$1.33	1,81
Equity compensation plans not approved by security holders	2,708,967(2)	$1.22	
Total	5,254,967	$1.27	1,81

(1) On May 26, 2004, we, as Reality Interactive, Inc., executed an Agreement and Plan of Merger with Natural Gas Systems, Inc., a Delaware corporation (the "Merger"). In connection with the Merger, we assumed the obligations of 600,000 stock options under our newly acquired subsidiary's 2003 Stock Option Plan. As of March 2, 2006, 510,000 shares remain issuable upon exercise under the 2003 Stock Option Plan and no further options will be issued thereunder. As of March 2, 2006, there were 2,036,000 shares of common stock issued or issuable upon exercise of outstanding options and 145,000 shares issued directly under the 2004 Stock Plan, leaving 1,819,000 shares of common stock available for issuance.

(2) In addition to assuming certain obligations listed in footnote (1) above, there are outstanding compensatory warrants to issue 1,200,000 shares of our common stock in connection with loans entered into with Prospect Energy Corporation; 471,467 shares of our common stock in connection with merger, capital raising and advisory services (including warrants to our Chairman and placement agent Laird Q. Cagan); a warrant to purchase 287,500 shares of common stock and a warrant to purchase 400,000 shares of common stock in connection with Mr. Herlin's employment agreement with the Company; a warrant to purchase 150,000 shares of common stock in connection with Mr. McDonald's employment with the Company; and a warrant to purchase 200,000 shares in connection with Daryl Mazzanti's (our Vice President of Operations) employment agreement with the Company.

DIVIDENDS

We have not paid any dividends on our common stock to date and do not anticipate that we will be paying dividends in the foreseeable future. Any payment of cash dividends on our common stock in the future will be dependent upon the amount of funds legally available, our earnings, if any, our financial condition, our anticipated capital requirements and other factors that our board of directors may think are relevant. However, we currently intend for the foreseeable future to follow a policy of retaining all of our earnings, if any, to finance the development and expansion of our business and, therefore, do not expect to pay any dividends on our common stock for the foreseeable future. Additionally, we are currently restricted from paying dividends pursuant to the terms of our credit agreement.

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

RESULTS OF OPERATIONS

Summary

We have continued our growth in critical metrics of production and revenues while limiting our cash overhead costs. In the three and six month periods ended December 31, 2005, our sales volumes have increased by 93% or more, and our revenues have increased by 127% or more over the comparable periods of 2004. Key considerations in this growth are:

- The Tullos Area properties we purchased from Atkins as of September 1, 2004 only contributed production and revenues for four of the six months ended December 31, 2004, as compared to a six month contribution during the six months ended December 31, 2005;

- The Tullos Area properties we purchased from Chadco as of February 1, 2005 contributed no production or revenues during the six months ended December 31, 2004, as compared to a six month contribution during the six months ended December 31, 2005; and

- Only one of our five 2005 Delhi Development Drilling Program wells, the Delhi 92-2, was completed soon enough to make a meaningful revenue contribution in the three months ended December 31, 2005, and then for only the last half of the period.

Our most significant development activity to date has been the implementation of our 2005 Delhi Development Drilling Program that was originally scheduled to begin in May 2005 and was delayed until the second week of October, 2005 by the drilling contractor. During the period ended December 31, 2005, only one of the five wells we drilled and completed was producing -- primarily due to poor drilling practices by the drilling contractor, delays in drilling due to breakdowns in rig equipment, contractor crew turnover and resulting oil-water emulsions and paraffin blockages created in the reservoir. The oil-water emulsions and paraffin blockages have been alleviated, in part, through chemical treatments, and additional work is anticipated to further increase production. As of February 28, 2006, three of the wells were producing, one completed well was shut in pending further work to clean out blockage and the fifth well was still undergoing completion activities. We also anticipate additional work in March to enhance production from two of the producing wells.

Of particular significance, the fourth well drilled and completed, the Delhi 225-2, was an unproved location that we elected to drill ahead of other proved locations. The results of that well will add to our proved producing reserves and we believe should lead to one or more proved undeveloped locations in the

same reservoir that could hold substantial reserves.

The sixth and seventh wells previously anticipated to be drilled in our 2005 Delhi Development Drilling Program have been rescheduled for later in 2006 due to unfavorable ground conditions resulting from heavy rains in early January in the area and the significant financial costs of putting the drilling rig on standby. Consequently, the drilling rig was released in early January 2006 as a cost saving measure. We are in negotiations with another contractor for a drilling rig to initiate our 2006 Delhi Development Drilling Program. The sixth and seventh wells from the 2005 program are expected to be included in our 2006 drilling program.

Going forward, our objectives for calendar year 2006 are to:

- Continue increasing our net property values (net present value in excess of our costs) through re-investments in infrastructure, work-overs, recompletions, water disposal capacity and new development drilling, at the potential cost of reduced near term cash flows and earnings; and
- Ultimately increase our margins, net cash flows and earnings by:
- Increasing production and revenues
- Controlling cash G&A expense to a growth rate slower than our revenue growth
- Maintaining or reducing field operating expense per BOE
- Seek additional oil & gas property acquisitions.

Three months ended December 31, 2005 compared to the three months ended December 31, 2004

The following table sets forth certain financial information with respect to our oil and gas operations.

	Three Months Ended December 31			
Net to NGS	2005	2004	Variance	% change
Sales Volumes:				
Oil (Bbl)	11,827	5,263	6,564	125%
Gas (Mcf)	24,109	15,860	8,249	52%
Oil and Gas (Boe)	15,845	7,906	7,940	100%
Revenue data (a):				
Oil revenue	$ 551,981	$ 250,931	$ 301,050	120%
Gas revenue	278,955	114,837	164,118	143%
Total oil and gas revenues	$ 830,936	$ 365,768	$ 465,168	127%
Average prices (a):				
Oil (per Bbl)	$ 46.67	$ 47.68	$ (1.01)	-2%
Gas (per Mcf)	11.57	7.24	4.33	60%

Oil and Gas (per Boe)	52.44	46.26	6.18	13%
Expenses (per BOE)				
Lease operating expenses and production taxes	$ 26.52	$ 26.05	$ 0.47	2%
DD&A expense on oil and gas properties	7.16	6.88	0.28	4%

(a) Includes the cash settlement of hedging contracts

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Net loss. For the three months ended December 31, 2005, we reported a net loss of $541,884 or $0.02 loss per share on total revenues of $830,936, as compared with a net loss of $473,207 or $0.02 loss per share on total revenues of $365,768 for the three months ended December 31, 2004. The increase in losses is attributable to increases in lease operating and general and administrative expenses, high workover costs in October 2005 and losses on lender required price hedges, partially offset by increases in revenues due to higher sales volumes and sales prices. Excluding non-cash stock compensation expense of $156,277 and non-cash penalty expense of $114,239 for not obtaining an effective registration statement, our net loss for the three months ended December 31, 2005 was $271,368, or $0.01 loss per share. By comparison, after excluding non-cash stock compensation expense of $64,828 for the three months ended December 31, 2004, our net loss was $408,379, or $0.017 loss per share.

Sales Volumes. Oil sales volumes, net to our interest, for the three months ended December 31, 2005 increased 125% to 11,827 Bbls, compared to 5,263 Bbls for the three months ended December 31, 2004. The increase in sales volumes is primarily due to oil sales from the Chadco acquisition in the Tullos Field Area and the result of workovers and recompletions in our portfolio. The five wells we drilled and completed did not contribute materially to oil sales during the three months ended December 31, 2005.

Net natural gas volumes sold for the three months ended December 31, 2005 were 24,109 Mcfs, an increase of 52% from the three months ended December 31, 2004. Gas volumes increased primarily due to the Delhi 92-2 well which was drilled and completed in early November.

Production. Oil production varies from oil sales volumes by changes in crude oil inventories, which are not carried on the balance sheet. Net oil production for the three months ended December 31, 2005 increased 115% to 11,860 Bbls, compared to 5,524 Bbls for the three months ended December 31, 2004. This is primarily due to the acquisition of wells in the Tullos Field Area and general field development opportunities. The five wells we drilled and completed did not contribute materially to oil production during the three months ended December 31, 2005. Net natural gas production for the three months ended December 31, 2005 increased 38% to 29,203 Mcfs, compared to 21,161 Mcfs for the three months ended December 31, 2004. This increase was due to a new well drilled in November 2005, the Delhi 92-2.

Oil and Gas Revenues. Revenues presented in the table above and discussed herein represent revenue from sales of our oil and natural gas production volumes, net to our interest. Production sold under fixed price delivery contracts, which have been designated for the normal purchase and sale exemption under SFAS 133, are also included in these amounts. Realized prices may differ from market prices in effect during the periods, depending on when the fixed delivery contract was executed.

Oil and gas revenues increased 127% for the three month period ended December 31, 2005, compared to the same period in 2004, as a result of the 100% increase in sales volumes due to the Chadco acquisition of producing leases in the Tullos Field Area and additional natural gas sales from the 92-2 well which was completed and began production in November 2005. Another component of the increase was a 13% increase in the sales prices we received per BOE during the three months ended December 31, 2005 as compared to the three months ended December 31, 2004.

Lease Operating Expenses. Lease operating expenses for the three months ended December 31, 2005 increased $205,217 from the comparable 2004 period to $398,686. The increase in operating expenses in 2005 is primarily attributable to (1) an increase in the number of active wells due to the acquisition of properties in the Tullos Field Area, (2) substantial increases in overall industry service costs, and (3) high workover costs associated with our Delhi 87-2 and 197-2 wells, repairs to our salt water disposal system and repairs to two separate gas gathering line leaks.

General and Administrative Expenses. General and administrative expenses (exclusive of non-cash stock compensation expense of $156,277 and penalty expense of $114,239) was $391,590 for the three months ended December 31, 2005, a decrease of $84,151 from $475,741 (exclusive of non-cash stock compensation expense of $64,828), for the three months ended December 2004. Overall general and administrative expenses were higher in the prior year due to significant start up expenses associated with a being a public registrant, including expenses for audited financial statements, SEC counsel, outside engineering estimates, D&O insurance, outside director fees and other related costs.

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Depletion and Amortization Expense. Depletion and amortization expense increased $59,457 for the three months ended December 31, 2005 to $113,443 from $53,986 for the same period in 2004. The increase is primarily due to a 100% increase in sales volumes and a 4% increase in the average depletion rate, period over period.

Interest Expense. Interest expense for the three months ended December 31, 2005 increased $149,914 to $191,016 (of which $141,151 was cash expense) compared to $41,102 (of which $6,370 was cash expense) for the three months ended December 31, 2004. The increase in interest expense was primarily due to interest expense associated with the Prospect Facility, which was not outstanding in the 2004. The non-cash portion of interest expense is associated with amortization of the discount we assigned to the Prospect note, based on the fair value we attributed to the granting of the warrants to Prospect.

Six months ended December 31, 2005, compared to the six months ended December 31, 2004.

The following table sets forth certain financial information with respect to our oil and gas operations.

	Six Months Ended December 31			
Net to NGS	2005	2004	Variance	% change
Sales Volumes:				
Oil (Bbl)	20,781	9,202	11,579	126%
Gas (Mcf)	33,959	27,117	6,842	25%

Oil and Gas (Boe)	26,441	13,722	12,720	93%
Revenue data (a):				
Oil revenue	$1,036,932	415,454	$ 621,478	150%
Gas revenue	336,888	181,481	155,407	86%
Total oil and gas revenues	$1,373,820	$ 596,935	$ 776,885	130%
Average prices (a):				
Oil (per Bbl)	$ 49.90	$ 45.15	$ 4.75	11%
Gas (per Mcf)	9.92	6.69	3.23	48%
Oil and Gas (per Boe)	51.96	43.50	8.45	19%
Expenses (per Boe)				
Lease operating expenses and production taxes	$ 34.00	$ 26.22	$ 7.78	30%
DD&A expense on oil and gas properties	7.16	6.88	0.28	4%

(a) Includes the cash settlement of hedging contracts

Net Loss. For the six months ended December 31, 2005, we reported a net loss of $1,341,943 or $0.05 loss per share on total revenues of $1,373,820, as compared with a net loss of $775,843 or $0.03 loss per share on total revenues of $596,935 for the six months ended December 31, 2004. The increase in losses are attributable to overall increases in lease operating and general and administrative expenses, partially offset by increases in revenues due to higher sales volumes and sales prices. Excluding non-cash stock compensation expense of $269,351 and non-cash penalty expense of $114,239 for not having obtained an effective registration statement, our net loss for the six months ended December 31, 2005 was $958,353, or $0.04 loss per share. By comparison, excluding non-cash stock compensation expense of $111,121 for the six months ended December 31, 2004, our net loss was $664,722, or $0.03 loss per share.

Sales Volumes. Oil sales volumes, net to our interest, for the six months ended December 31, 2005 increased 126% to 20,781 Bbls, compared to 9,202 Bbls for the six months ended December 31, 2004. The increase in sales volumes is primarily due to oil sales from the Chadco acquisition in the Tullos Field Area and the result of workovers and recompletions in our portfolio.

Net natural gas volumes sold for the six months ended December 31, 2005 were 33,959 Mcfs, an increase of 25% from the six months ended December 31, 2004. Gas volumes increased primarily due to the Delhi 92-2 well which was drilled in October and completed in early November.

Production. Oil production varies from oil sales volumes by changes in crude oil inventories, which are not carried on the balance sheet. Net oil production for the six months ended December 31, 2005 increased 140% to 22,500 Bbls, compared to 9,375 Bbls for the six months ended December 31, 2004. This is primarily due to the acquisition of wells in the Tullos Field Area and general field development opportunities.

Our net oil stock ending inventory increased approximately 80% at December 31, 2005 to approximately 4,300 Bbls, as compared to approximately 2,400 Bbls at December 31, 2004. Increases in oil inventory were attributable to additional producing wells (and tank batteries) acquired in the Chadco acquisition and approximately 1,600 barrels of oil that were not picked up by our crude oil purchaser for sale by December 31, 2005. Since many of these leases do not make a full truckload within one month (one truckload equals ~ 160 Bbls), the Tullos Field Area tends to maintain higher levels of inventory compared to production, and can cause erratic oil runs due to the preference of our oil purchaser to gather a full truckload from a single tank battery.

Net natural gas production for the six months ended December 31, 2005 increased 16% to 43,570 Mcfs, compared to 37,521 Mcfs for the six months ended December 31, 2004. This increase was due to a new well drilled in November 2005, the Delhi 92-2, offset by well downtime caused by mechanical problems on the Delhi 184-2 well, shut-in of our gas gathering line to repair line leaks and normal production declines.

Oil and Gas Revenues. Revenues presented in the table above and discussed herein represent revenue from sales of our oil and natural gas production volumes, net to our interest. Production sold under fixed price delivery contracts, which have been designated for the normal purchase and sale exemption under SFAS 133, are also included in these amounts. Realized prices may differ from market prices in effect during the periods, depending on when the fixed delivery contract was executed.

Oil and gas revenues increased 130% for the six month period ended December 31, 2005, compared to the same period in 2004, as a result of a 93% increase in production volumes due to the Chadco and Atkins acquisitions of producing leases in the Tullos Field Area and increases in production from our Delhi Field, including the gas production from our recently drilled Delhi 92-2 well. Another component of the increase was a 19% increase in the average sales prices we received per BOE during the six months ended December 31, 2005 as compared to the six months ended December 31, 2004.

Lease Operating Expenses. Lease operating expenses for the six months ended December 31, 2005 increased $531,659 from the comparable 2004 period to $862,876. The increase in operating expenses in 2005 is primarily attributable to (1) an increase in the number of active wells due to the acquisition of properties in the Tullos Field Area, (2) substantial increases in overall industry service costs, and (3) high workover costs associated with our Delhi 87-2 and 197-2 wells, repairs to our salt water disposal system and repairs to two separate gas gathering line leaks.

On a BOE basis, lease operating expense and production taxes totaling $34.00 per BOE did not meet our expectations for the six months ended December 31, 2005, as compared to 2004's comparable period of $26.22. The unfavorable variance in the current period was predominately due to the previously mentioned workover costs associated with an unusually large number of our Delhi wells, combined with the loss of production from well downtime while working over the wells. Over half of this unfavorable variance was attributable to workover expenses incurred to maintain production on our Delhi 87-2 well, which currently accounts for the majority of our production from our Delhi Field. As previously reported, our Delhi 87-2 well is over 65 years old. Following its recompletion last year into a new reservoir with an initial flowing production rate of 90 bopd, it suffered a casing collapse, causing us to engage in numerous expensive workovers that eventually enabled us to produce the well at a constrained rate of 30 to 35 bopd.

General and Administrative Expenses. General and administrative expenses (exclusive of non-cash stock compensation expense of $269,351 and penalty

expense of $114,239) was $862,794 for the six months ended December 31, 2005, an increase of $122,211 as compared to $740,583 (exclusive of non-cash stock compensation expense of $111,121) for the comparable 2004 period. The increase is primarily due to an increase in employees from two to five and implementation of an outsourced property accounting service with Petroleum Financial Incorporated. Overall general and administrative expenses are high due to expenses associated with a being a public registrant, including expenses for audited financial statements, SEC counsel, outside engineering estimates, D&O insurance, outside director fees and other related costs.

Depletion and Amortization Expense. Depletion and amortization expense increased $88,256 for the six months ended December 31, 2005 to $189,348 from $101,092 for the same period in 2004. The increase is primarily due to a 93% increase in sales volumes and a 4% increase in the average depletion rate, period over period.

Interest Expense. Interest expense for the six months ended December 31, 2005 increased $346,326 to $412,694 (of which $282,516 was cash expense) compared to $66,368 (of which $18,452 was cash expense) for the six months ended December 31, 2004. The increase in interest expense was primarily due to interest expense associated with the Prospect Facility, which was not outstanding in the comparable period in 2004. In addition, $32,509 was recorded as a non-recurring charge to interest expense, representing the fair value of 200,000 revocable warrants issued in consideration to amend the Prospect Facility on September 22, 2005.

Hurricane Update. On August 29, 2005, Hurricane Katrina, came onshore just east of New Orleans, LA. None of our oil and gas properties suffered casualty losses from this storm. On September 24, 2005, Hurricane Rita came onshore near the Texas/Louisiana border and headed north near our oil and gas operations in Northern Louisiana. None of our oil and gas properties suffered casualty losses from this storm, except we experienced approximately two days of deferred production at our Tullos Field, due to sporadic electricity outages.

For fiscal years ended June 30, 2005, June 30, 2004 and December 31, 2003:

As used herein, the term "three months ended December 31, 2003" refers to our inception date, September 23, 2003, through December 31, 2003.

We did not commence our crude oil and natural gas operations until October 2003. Accordingly, our comparative results are limited.

During the twelve months ended June 30, 2005, we generated revenues of $1,635,187, as compared to $118,158 for the six months ended June 30, 2004 and $24,229 for the three months ended December 31, 2003, producing net losses of $2,164,571, $1,027,682 and $336,905 for the same respective periods. Excluding non-cash compensatory stock expense, our net losses were $1,457,454, $919,068 and $286,505 for the twelve month, six month and three month periods of 2005, 2004 and 2003, respectively. On an annualized basis, our net loss for the year ended June 30, 2005 decreased 21% from the year ended June 30, 2004, excluding non-cash compensatory stock expense.

Our results of operations were positively impacted by the following events during the fiscal year 2005:

- o Began our first natural gas sales from our Delhi Field in July 2004.
- o Closed two acquisitions of producing properties in the Tullos Field Area in September 2004 and February 2005.

- Re-completed the Delhi Ut. #184-2 as a gas well with initial production rate of almost 400 MCFD.

- Re-completed the Delhi Ut. #87-2 as a flowing oil well at an initial rate of 90 BOPD and 35 MCFD and original reservoir pressure, which is being produced at a lower rate as described below.

- Completed the first phase of mapping of the Delhi Field and identified 15 locations to be drilled.

Our revenues have continued to increase substantially each quarter, albeit at a slower rate of change than anticipated. Specifically, our operating results for the year ended June 30, 2005 were adversely impacted by the following events:

- The re-completion of the Delhi Ut. #87-2 did not begin production until April 2005 and encountered mechanical problems in the (65 year old) well bore that severely reduced production in May and June 2005. Following a series of workovers to repair the damage, we elected to defer further work and produce the well at a lower rate of 30-35 BOPD, compared to the initial rate of 90 BOPD, in order to lower the possibility of further damage. Correspondingly, we anticipate drilling a replacement well as part of our current development program that is expected to be higher in structure than the 87-2 and, therefore, should recover attic reserves that are otherwise not producible from the 87-2 well.

- Our second most significant oil well, the Delhi Ut. #197-2, continued to experience constrained production and numerous non-production days due to sand production. The current production level of about 10-15 BOPD appears to minimize sand influx and substantially reduce workover costs and downtime.

- Our most significant gas well, the Delhi Ut. #184-2, suffered plugging by ash material produced by the formation. Consequently, the well is producing at a curtailed rate until we initiate a cleanup and treatment.

- Heavy rains prevented regular lease maintenance and repairs from January through early April 2005, particularly in our Tullos Field Area. As the wells in the Tullos Field Area require a high level of maintenance and repairs, our production was significantly reduced in those months.

- Extensive rains also prevented most development work in all fields. Roads could not be built for new locations and existing roads could not be maintained to allow crude oil trucks to pick up product.

- The high industry demand for workover service rigs resulted in our losing access to vendor equipment during March and April 2005 due to the weather and the vendors' moving of inactive equipment to other parts of the region not so adversely impacted by the weather.

- The properties purchased in the Tullos Field Area were transferred without the normally available well plats, geological maps and well histories. Consequently, our development plan for Tullos Field has been delayed while we reproduce or locate much of this information necessary to more efficiently produce the wells, collect and dispose of water and identify precise disposal needs and workover opportunities.

- Our general and administrative costs have been affected by our legal costs associated with Rule 144 stock sales, recruitment costs, including sign on bonuses, in a tight market for skilled energy staff, and the relatively high cost of being a public company in our early stages of growth.

The following remedial actions have been or are planned to be taken:

- We are producing the 87-2 well at a reduced rate to limit the potential of further mechanical problems while scheduling a replacement well to be drilled up structure to recover additional reserves as well.

- We are evaluating alternative lift mechanisms for the Delhi Ut. #197-2 well that may be more resistant to sand production.

- We are planning to stimulate the 184-2 well following completion of the first few wells in our drilling program.

- We have nearly completed the reconstruction of the Tullos Field Area's records and maps.

- We are developing a program of improving the roads and lease batteries in key areas of the Tullos Field Area and are evaluating the movement of certain tank batteries to locations more resistant to rain.

- We are replacing certain high maintenance beam pumps with submersible pumps in the Tullos Field Area, potentially reducing maintenance expense and production downtime.

- We have arranged for a local well service company to activate and dedicate a service rig to our priority use in the Tullos Field Area.

Following is a summary of the progress we have made in both sales volumes and revenues, net to our interest:

				Three months ended		
	units	12/31/2003	3/31/2004	6/30/2004	9/30/2004	12/31
Oil & Gas revenues	$	$24,229	$48,572	$69,586	$231,167	$36
Oil volumes sold	BO	857	1,498	1,934	3,955	
Gas volumes sold	MMBTU	--	--	110	11,252	1
Barrels of oil equivalent sold	BOE	857	1,498	1,952	5,830	
Oil price (excludes price risk management activities)	$BBL	$28.29	$32.43	$35.64	$42.66	$
Gas price (excludes price risk management activities)	$/MMBTU	--	--	$5.90	$5.55	
Operating cost	BOE	$92.54	$43.20	$43.17	$26.38	$

Depreciation, depletion & amortization ("DD&A")	BOE	$16.29	$9.06	$14.33	$6.88

Highlights of our performance since beginning our oil and gas operations, as shown in the table above:

- We have increased revenues for each quarter.
- We have increased sales volumes for each quarter, with average daily sales increasing from 9 BOEPD during the three months ended December 31, 2003 to 103 BOEPD, net to our interest.
- We have reduced operating costs per BOE.
- We have consistently reduced DD&A, due to lower acquisition costs per BOE on recent field purchases.

General and administrative expenses increased for the year ended June 30, 2005 to $2,220,780, as compared to $912,761 for the six months ended June 30, 2004 and $239,093 for the three months ended December 31, 2003. Of the amount incurred in fiscal 2005, $707,117 was due to non-cash charges for stock compensation expense (largely attributable to the Tatum contract re-negotiation) as compared to $108,614 of similar non-cash charges for the six months ended June 30, 2004 and $50,400 for the three months ended December 31, 2003.

Also included in general and administrative expenses for the twelve month period ended June 30, 2005 and the six months ended June 30, 2004, are significant costs of being a public company. Such costs include additional audit, tax, legal, printing, stock transfer, annual proxy statement preparation, merger expenses and similar costs incurred by public companies. Merger fees and expenses related to the merger of Old NGS into a subsidiary of Reality amounted to $370,000 for the six month period ended June 30, 2004. Old NGS was not a public company until its merger with us in May 2004.

PRODUCT PRICES AND PRODUCTION

Refer to "Markets and Customers", for a discussion of oil and gas prices and marketing.

Although product prices are key to our ability to operate profitably and to budget capital expenditures, they are beyond our control and are difficult to predict. Gas sales are completed on a BTU basis and the gas pipeline measures the BTU content at the delivery point. The gas produced at our Delhi Field is high BTU, with over 1100 BTU per cubic foot of gas from the dry gas wells, and over 1300 BTU in gas associated with the oil wells. We utilize a J-T gas processing unit that strips out most of the heavier liquids, in accordance with the sales pipeline criteria, leaving the residual, or sales, gas at a heat content of 1157 BTU per cubic foot, which is higher than the standard unit measure of 1000 BTU per cubic foot.

Increases in oil and natural gas volumes for the twelve months ended June 30, 2005, the six months ended June 30, 2004 and the three months ended December 31, 2003 were a result of more months in the period, the successful workovers and restoration to production of several wells and the acquisitions of additional producing properties.

Refer to "Significant Properties, Estimated Proved Crude Oil and Natural Gas Reserves and Future Net Revenues" and "Production, Average Sales Prices and Average Production Costs" for disclosures regarding reserve values and for a summary on production, average sales prices and average production costs.

LIQUIDITY AND CAPITAL RESOURCES

At December 31, 2005, we had $433,465 of unrestricted cash and positive working capital of $619,025, as compared to $2,548,688 of unrestricted cash and positive working capital of $2,599,232 at June 30, 2005, and $91,563 of unrestricted cash and negative working capital of $1,349,315 at December 31, 2004. In 2005, our working capital was positively impacted by the $3,000,000 of gross proceeds we received from the sale of our common stock in May of 2005, and the re-financing of our short-term debt with long-term debt and equity under the Prospect Facility in February 2005.

Effective September 22, 2005, we entered into an amendment to the Prospect Facility, thereby obtaining covenant relief with respect to our obligation to maintain an EBITDA to interest payable coverage ratio of 2.0:1. The amendment changes our compliance date to begin not later than the three months ended January 31, 2006, as compared to October 31, 2005 under the original terms of the agreement. In consideration for the amendment, we have issued to Prospect revocable warrants to purchase 200,000 shares of our common stock, exercisable at $1.36 per share over five years. As a result, a non-recurring charge of $32,509 was recorded to interest expense during the three months ended September 30, 2005. The warrants will be automatically revoked in the event we achieve $200,000 in EBITDA, as defined, for any one month period through April 30, 2006. We also agreed to limit our acquisitions of additional oil and gas properties to a maximum of $100,000 plus any new funds raised, until we achieve a trailing three month EBITDA to interest coverage ratio of 2.0:1. Since we exceeded the 2:1 EBITDA to interest coverage ratio for the three months ended January 31, 2006, the acquisition limitation is no longer in effect.

The amendment to the Prospect Facility was effected in order to allow us to proceed with the delayed drilling program of proved undeveloped reserve locations in our Delhi Field, the results of which we are relying on to achieve the EBITDA coverage ratio required of us by Prospect. The timely drilling and production of our proved undeveloped reserves, based on the reserve report prepared by W.D. Von Gonten & Co dated July 1, 2005, will be necessary to provide sufficient additions to earnings to comply with Prospect's EBITDA coverage ratio, and to provide sufficient cash to maintain our operations for at least the next twelve months. Although the 2005 Delhi Development Drilling Program has been substantially completed, we can give no assurance that the assumptions in the reserve report will be achieved or that the wells will be completed and placed onto production in the timely manner necessary to comply with Prospect's EBITDA covenant coverage. If such a covenant breach occurs and is not waived by Prospect, the debt would become immediately due and payable. Since we do not have sufficient liquid assets to prepay our debt in full, we would be required to refinance all or a portion of our existing debt or obtain additional financing. If we were unable to refinance our debt or obtain additional financing, we would be required to curtail portions of our development program, sell assets, and/or reduce capital expenditures. At January 31, 2006, we were in compliance with our 2:1 EBITDA to interest coverage ratio.

We have historically financed our development activities through proceeds from debt and equity proceeds. In the short term we intend to finance our current development drilling program through our existing working capital resources. As operator of all of our projects in development, we have the ability to significantly control the timing of most of our capital expenditures. We believe the cash flows from operating activities, combined with our ability to control the timing of substantially all of our future development and acquisition requirements, will provide us with the flexibility and liquidity to meet our future planned capital requirements through the next twelve months.

Cash used in operating activities for the six months ended December 31, 2005 was $804,698 and cash used in operations for the comparative period in 2004 was $68,455. In 2005, the increase in cash used in operating activities was primarily due to higher operating expenses, partially offset by higher revenues.

Cash flow used by our operating activities was $1,077,535 for the twelve months ended June 30, 2005, as compared to $854,350 used during the six months ended June 30, 2004 and $247,003 used during the three months ended December 31, 2003. On an annualized basis, cash flow used by operating activities improved 37% in fiscal 2005, as compared to the six months ended June 30, 2004. The improvement was mostly attributable to $735,573 of cash flow provided from field operations in the twelve months ended June 30, 2005, as compared to $24,405 used in field operations for the six months ended June 30, 2004.

Cash used in investing activities in the six months ended December 31, 2005 and 2004 was $1,303,771 and $938,915, respectively. In 2005, the majority of the development capital expenditures were spent on the 2005 Delhi Development Drilling Program. For the six months ended December 2004, we expended approximately $725,000 in capital acquisition costs for the purchase of producing properties in our Tullos Field Area, and approximately $215,000 was used for development capital in our existing portfolio.

Cash flow used by investing activities was $2,778,623 for the twelve months ended June 30, 2005. Of the major investing activities, approximately $1,504,000 was used to acquire oil and gas properties in the Tullos Urania Field Area, $553,543 was used to develop our oil and gas properties and $560,000 was used to comply with the debt service reserve account under the Prospect Facility. This compares to $4,194 used by investing activities during the six months ended June 30, 2004, and $1,805,485 for the three months ended December 31, 2003. Of the major investing activities in the three months ended December 31, 2003, $1,290,560 was invested in oil and gas properties, mostly to acquire our Delhi Field, and $301,835 was used to fund a Site Specific Trust Fund with the state of Louisiana for future plugging and abandonment related to the acquisition of our Delhi Field.

Cash used in financing activities for the six months ended December 31, 2005 was $6,754, which was used to pay off the remaining note for property insurance. Comparatively, $731,102 was provided in the 2004 period which consisted of $977,875 in net proceeds from loans and $529,199 of gross cash proceeds from the private sale of 369,200 shares of our common stock, before commissions, less $775,972 used for loan repayments.

During the twelve months ended June 30, 2005, we increased our debt, net of repayments, by $2,081,511 and replaced short-term debt with long-term debt under the Prospect Facility. We also raised gross proceeds from equity sales totaling $4,729,091, of which $3,580,083 was received from the sale of 1,594,200 shares of our common stock and the issuance of 235,000 shares of our common stock upon the exercise of options and direct stock awards granted under our 2004 Stock Plan. The remaining $1,149,008 was raised through the sale of warrants to Prospect Energy as described under "Common Stock, Options and Warrants" in Note 8 to our consolidated financial statements.

Budgeted Capital Expenditures. Our 2005 Delhi Development Drilling Program began in early October, 2005. As of February 28, 2006, three of the wells were producing, one completed well was shut in pending further work to clean out blockage and the fifth well was still undergoing completion activities. We also anticipate additional work in March to enhance production from two of the producing wells. We estimate that total capital expenditures approximating $1.3

million, provided from our working capital, will be expended for the five wells. The two option wells we originally planned for the 2005 program (wells six and seven) were postponed due to heavy rains at Delhi during January 2006. We anticipate that these wells will be combined with other locations to comprise our 2006 Delhi Development Drilling Program, to commence later in calendar year 2006. Budgeting for our 2006 plan is in progress.

INCREASE IN OPERATING CASH FLOWS

We continue to work on increasing cash flow from operations through our Delhi, Tullos Urania, Colgrade and Crossroads Fields, thereby spreading our overhead, including significant expenses of being a public company, over a larger revenue base. We also expect to continue evaluating additional acquisition candidates that would increase our cash flows from operations.

OFF BALANCE SHEET ARRANGEMENTS

We had no off balance sheet arrangements as of December 31, 2005.

SIGNIFICANT PROPERTIES, ESTIMATED PROVED CRUDE OIL AND NATURAL GAS RESERVES, AND FUTURE NET REVENUES

We engaged W. D. Von Gonten & Co. ("Von Gonten") to prepare independent reports of our proved reserves as of July 1, 2005, July 1, 2004 and January 1, 2004.

Estimates of reserve quantities and values must be viewed as being subject to significant change as more data about the properties becomes available. All of our existing wells are generally mature wells, some of which were originally drilled as many as 79 years ago. As such, they contain older down-hole equipment that is more subject to failure than new equipment. The failure of such equipment or other subsurface failure can result in the complete loss of a well.

The following table sets forth information regarding our proved reserves based on the assumptions set forth in note 10 to our consolidated financial statements for the twelve months ended June 30, 2005, where additional reserve information is provided. The average NYMEX prices used were adjusted for transportation, market differentials and BTU content of natural gas produced. Amounts do not include estimates of future Federal and State income taxes.

PROVED RESERVES

					ESTIMATED FUTURE	
		GAS &				
	CRUDE	NGL(1)	$ PER (2)			
AS OF DATE	OIL (BBLS)	(MCF)	BBL	MMBTU	NET REVENUES	NET REVENUES DISCOUNTED AT 10%
July 1, 2005	771,883	732,123	$56.50	$6.98	$24,892,850	$17,479,484
July 1, 2004	238,904	508,800	37.05	6.16	8,121,711	6,320,754
January 1, 2004	240,362	778,700	32.52	6.19	10,065,493	8,119,670

(1) NGL reserves of 5,000 bbls and 7,300 bbls at July 1, 2004 and July 1, 2005,

respectively, are included in the above natural gas volumes, at a 6:1 ratio.

(2) NYMEX prices used for calculating reserves and net revenues in the reports prepared by W.D. Von Gonten & Co., before adjustments for market, quality and contract differentials.

PRODUCTION, AVERAGE SALES PRICES AND AVERAGE PRODUCTION COSTS

Our net production quantities and average price realizations per unit, excluding hedging activities for the fiscal periods are set forth below:

	12 months ended June 30, 2005		6 months ended June 30, 2004		3 months ended December 31, 2003	
Product	Volume*	Price	Volume*	Price	Volume	Price
Gas (Mcf)	54,137	$6.70	110	$5.90	--	--
Oil (Bbls)	27,230	$50.66	3,180	$36.95	857	$28.27

* Natural gas volumes are on an "as-sold" basis, which excludes gas used in operations of 18,029 MCF's and 13 MCF's, respectively for the twelve month period ended June 30, 2005 and the six months ended June 30, 2004.

Our net production quantities and average price realizations per unit for the fiscal periods are set forth below, including hedging losses totaling $102,632 for oil and $4,280 for natural gas, are included in the prices in the table below:

	12 months ended June 30, 2005		6 months ended June 30, 2004		3 months ended December 31, 2003	
Product	Volume*	Price	Volume*	Price	Volume	Price
Gas (Mcf)	54,137	$6.62	110	$5.90	--	--
Oil (Bbls)	27,230	$46.89	3,180	$36.95	857	$28.27

* Natural gas volumes are on an "as-sold" basis, which excludes gas used in operations of 18,029 MCF's and 13 MCF's, respectively for the twelve month period ended June 30, 2005 and the six months ended June 30, 2004.

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PRODUCTIVE WELLS AND DEVELOPED ACREAGE

Developed acreage at June 30, 2005 totaled 14,155.36 net and gross acres, held by a unitization agreement or by production. Unitization occurs when more than one owner of working interests in a given field and reservoir agree to combine their interests into a single block, each owning a pro rata percentage of the overall project. Unitization is used to simplify, or enable, comprehensive and efficient development activity that is common to numerous leases.

GROSS AND NET DEVELOPED ACREAGE

PROPERTY	GROSS ACRES	NET ACRES
Delhi Field	13,636.55	13,636.55
Tullos Field - Sept 2004 Acq	386.04	386.04
Tullos Field - Feb 2005 Acq	132.77	132.77
Total	14,155.36	14,155.36

We own total working interests in 306 net and gross wells consisting of 253

crude oil wells, 3 natural gas wells, 18 water disposal wells and 32 shut-in wells with uncertain future utility. Following is a table of productive wells (defined as producing or capable of production) and producing wells as of June 30, 2005:

Productive Gross and Net Wells

	OIL		GAS	
State	Gross	Net	Gross	Net
Louisiana	253	253	3	3
Total	253	253	3	3
	Producing			
Louisiana	139	139	3	3

UNDEVELOPED ACREAGE

All working interest acreage owned by us as of June 30, 2005 was held by production or through an active lease or through the Delhi unitization agreement described above.

DRILLING

During the fiscal years ended December 31, 2003, June 30, 2004 and June 30, 2005, we drilled no new wells.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Accounting for Oil and Gas Property Costs. As more fully discussed in Note 3 to the consolidated financial statements, we (i) follow the full cost method of accounting for the costs of our oil and gas properties, (ii) amortize such costs using the units of production method, and (iii) apply a quarterly full cost ceiling test. Adverse changes in conditions (primarily oil or gas price declines) could result in permanent write-downs in the carrying value of oil and gas properties as well as non-cash charges to operations, but would not affect cash flows.

Estimates of Proved Oil and Gas Reserves. An independent petroleum engineer annually estimates 100% of our proved reserves. Reserve engineering is a subjective process that is dependent upon the quality of available data and the interpretation thereof. In addition, subsequent physical and economic factors such as the results of drilling, testing, production and product prices may justify revision of such estimates. Therefore, actual quantities, production timing, and the value of reserves may differ substantially from estimates. A reduction in proved reserves would result in an increase in depreciation, depletion and amortization ("DD&A") expense.

Estimates of Asset Retirement Obligations. In accordance with SFAS No 143, we make estimates of future costs and the timing thereof in connection with recording our future obligations to plug and abandon wells. Estimated abandonment dates will be revised in the future based on changes to related economic lives, which vary with product prices and production costs. Estimated plugging costs may also be adjusted to reflect changing industry experience. Increases in operating costs and decreases in product prices would increase the estimated amount of the obligation and increase DD&A expense. Cash flows would not be affected until costs to plug and abandon were actually incurred.

New Accounting Pronouncements.

In December 2004, the FASB issued Statement of Financial Accounting Standards No. 123R "Shared Based Payment" ("SFAS 123R"). This statement is a revision of SFAS Statement No. 123 "Accounting for Stock-Based Compensation" and supersedes APB Opinion No. 25, "Accounting for Stock Issued to Employees," and its related implementation guidance. SFAS 123R addresses all forms of shared based compensation ("SBP") awards, including shares issued under employee stock purchase plans, stock options, restricted stock and stock appreciation rights. Under SFAS 123R, SBP awards result in a cost that will be measured at fair value on the awards' grant date, based on the estimated number of awards that are expected to vest and will be reflected as compensation cost in the historical financial statements. This statement became effective for public entities that file as small business issuers as of the beginning of the first annual reporting period that began after December 15, 2005. We are is in the process of evaluating whether SFAS No. 123R will have a significant impact on our overall results of operations or financial position.

This prospectus includes certain statements that may be deemed to be "forward-looking statements". All statements included in this prospectus, other than statements of historical facts, address matters that we reasonably expect, believe or anticipate will or may occur in the future. Such statements are subject to various assumptions, risks and uncertainties, many of which are beyond our control. You are cautioned that any such statements are not guarantees of future performance and actual results or developments may differ materially from those described in the forward-looking statements. We base our forward-looking statements on information currently available and undertake no obligation to update them.

BUSINESS

COMPANY OVERVIEW

Old NGS was privately formed in late 2003 to acquire established crude oil and natural gas properties and exploit them through the application of conventional and specialized technology, with the objective of increasing production, ultimate recoveries, or both. We currently operate in four crude oil and natural gas producing fields in the State of Louisiana, all of which are referred to as our Delhi Field or our Tullos Field (Area), with five full time employees and a small number of independent contractors and service providers operating from our headquarters in Houston, Texas.

The NGS team is broadly experienced in oil and gas operations, development, acquisitions and financing, and we follow a strategy of outsourcing most of our property, corporate administrative and accounting functions. Our principal executive offices are located at 820 Gessner, Suite 1340, Houston, TX 77024 and our telephone number at that address is (713) 935-0122. We maintain a website at www.natgas.us. Information contained on our website does not constitute part of this prospectus.

Our stock is quoted on the OTC Bulletin Board under the symbol of NGSY.OB.

CORPORATE HISTORY

Reality Interactive, Inc. ("Reality"), a Nevada corporation, was incorporated on May 24, 1994 for the purpose of developing technology-based knowledge solutions for the industrial marketplace. On April 30, 1999, this company ceased business operations, sold substantially all of its assets and terminated all of its employees. Subsequent to ceasing operations, Reality explored potential business

opportunities to acquire or merge with an entity with existing operations, while continuing to file reports with the SEC.

On May 26, 2004, Natural Gas Systems, Inc., a privately owned Delaware corporation formed in September 2003 ("Old NGS"), was merged into a wholly owned subsidiary of Reality and Reality acquired all the outstanding shares of Old NGS in exchange for 21,750,001 shares of our common stock and warrants and options to purchase approximately 903,932 shares of our common stock upon cancellation of outstanding warrants and options to purchase shares of Old NGS. Reality thereafter changed its name to Natural Gas Systems, Inc. and adopted a June 30 fiscal year end. As part of the merger, the officers and directors of Reality resigned and the officers and directors of Old NGS became the officers and directors of Natural Gas Systems, Inc., and we moved our offices to Houston, Texas. Immediately prior to the merger, Reality did not conduct any operations and had minimal assets and liabilities.

BUSINESS ACTIVITIES

We seek to acquire majority working interests of oil and gas resources in established fields and redevelop those fields through the application of capital and technology to convert the oil and gas resources into producing reserves. In acquiring our crude oil and natural gas properties, we target established, shallow oil and gas fields or resources, preferably with existing road, pipeline and storage infrastructure, and reservoirs with low permeability (referred to as "tight" reservoirs in which oil or gas flow is inhibited). Such reservoirs typically have low decline rate production and limited drainage areas per well. Our strategy is to develop incremental value by:

- Focusing on established fields with long-lived production from relatively shallow reservoirs and reservoirs with low permeability, providing us the following potential advantages:
  - Reduced exposure to the risk of whether resources are present.
  - Reduced capital expenditures for infrastructure, such as roads, water handling facilities and pipelines.
  - Long-lived properties generally reduce risks from short-term oil and gas price volatility and spread the cost of acquisitions over more reserves.
  - Reduced technical and operational risks and costs associated with lower pressures and lower temperatures typically found at shallow depths.
  - The ability to obtain majority working interests, and thus maintain full control of operations and development often available when acquiring established fields.
- Accelerating existing production by:
  - Bringing shut-in, non-producing wells, back to production.
  - Performing workovers to clean sand, water and paraffin from wells.
  - Optimizing production facilities, including installation of compression facilities.
  - Bringing un-drained or partially drained areas of the reservoirs

into production by:

- Re-completing into other reservoirs.
- Performing development and exploitation drilling.
- Applying lateral drilling, hydraulic fracturing and other stimulation methods to older fields that matured prior to the application of these technologies.
- Selective use of newer technologies, some of which may be unproved, to locate bypassed resources in mature fields.

Old NGS purchased its first property in September 2003 through the acquisition of a 100% working interest and an approximate 80% average net revenue interest, in property and wells located in northeastern Louisiana which we refer to as the "Delhi Field." Please see "--Properties." This acquisition included the purchase of six producing wells, one salt water disposal well and 37 shut-in wells with aggregate average production of approximately 18 barrels of crude oil per day ("BOPD") and no natural gas sales. The Delhi Field encompasses approximately 13,636 acres. We own all working interest rights from the surface to the top of the Massive Anhydride Formation, which lies below the Tuscaloosa formation in which our currently producing wells are completed and that are targeted in our development plan, less and except the Mengel Reservoir, which is being produced by another operator in a small number of wells.

In September 2004, we completed the acquisition of a 100% working interest and an approximate 78% average net revenue interest, in producing crude oil wells, equipment and improvements located in the Tullos Urania, Colgrade and Crossroads Fields in LaSalle and Winn Parishes, Louisiana, which we refer to collectively as the "Tullos Field (Area)". The purchased assets included approximately 124 oil wells, nine water disposal wells, and all associated infrastructure, including water disposal facilities, crude oil and water tanks, flow lines and pumping units. The purchase included 15 wells without leases, for which we are attempting to secure new leases.

In early February 2005, we completed the acquisition of a 100% working interest and an approximate 79% average net revenue interest in similar properties in the Tullos Field Area. The purchased assets included approximately 121 oil wells, 8 salt water disposal wells and associated infrastructure and equipment.

In January, 2006, we completed the acquisition of an additional net revenue interest in one of the fields we already own, at a purchase price of $1 million.

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MARKETS AND CUSTOMERS

Marketing of crude oil and natural gas production is influenced by many factors that are beyond our control, the exact effect of which is difficult to predict. These factors include changes in supply and demand, market prices, government regulation and actions of major foreign producers.

Over the past 20 years, crude oil price fluctuations have been extremely volatile, with crude oil prices varying from $8.50, to in excess of $70 per barrel. Worldwide factors such as geopolitical, macroeconomic, supply and demand, refining capacity, petrochemical production and derivatives trading, among others, influence prices for crude oil. Local factors also influence prices for crude oil and include regulation and transportation issues unique to certain producing regions.

Over the past 20 years, domestic natural gas prices have also been volatile, ranging from $1 to in excess of $15 per MMBTU. The spot market for natural gas, changes in supply and demand, derivatives trading, pipeline availability, BTU content of the natural gas and weather patterns, among others, cause natural gas prices to be subject to significant fluctuations. Due to the practical difficulties in transporting natural gas, price influences tend to be more localized for natural gas than for crude oil.

In the U.S. market where we operate, crude oil and gas liquids are readily transportable and marketable. We sell all of our crude oil production from our Delhi and Tullos Fields to Plains Marketing L.P., a crude oil purchaser, at competitive spot field prices. A portion of our crude oil production is subject to a fixed price contract (excluding basis risk) with Plains Marketing that began March 1, 2005 for approximately 2,100 barrels per month through May 2006, and 2,700 barrels per month thereafter through August 31, 2006. We also purchased mpany s international subsidiaries and the impact of state and federal tax credits.

Net earnings attributable to the noncontrolling interest related to our subsidiaries that are not 100% owned by the Company were $177,000, $105,000 and $75,000 for fiscal years 2018, 2017 and 2016, respectively. The changes in the net earnings attributable to the noncontrolling interest for each year were due to changes in the levels of net income of the subsidiaries.

Net earnings in fiscal year 2018 were $5,188,000, or $1.87 per diluted share. Net earnings in fiscal year 2017 were $4,515,000, or $1.66 per diluted share, and net earnings in fiscal year 2016 were $3,802,000, or $1.42 per diluted share.

LIQUIDITY AND CAPITAL RESOURCES

Our principal sources of liquidity have historically been funds generated from operating activities, supplemented as needed by borrowings under our revolving credit facility. Additionally, certain machinery and equipment are financed by non-cancelable operating leases. We believe that these sources of funds will be sufficient to support ongoing business requirements, including capital expenditures, through fiscal year 2019.

At April 30, 2018, we had advances of $3.8 million and standby letters of credit aggregating $5.2 million outstanding under our unsecured $20 million revolving credit facility. See Note 3 of the Notes to Consolidated Financial Statements included in Item 8 of this Annual Report for additional information concerning our credit facility. We did not have any off balance sheet arrangements at April 30, 2018.

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The following table summarizes the cash payment obligations for our lease arrangements and long-term debt as of April 30, 2018:

PAYMENTS DUE BY PERIOD

($ in thousands)

Contractual Obligations	Total	1 Year	2-3 Years	4-5 Years	After 5 years
Operating Leases	$ 3,826	$ 1,190	$ 1,782	$ 854	$
Long-term Debt	2,431	1,167	1,264		
Total Contractual Cash Obligations	$ 6,257	$ 2,357	$ 3,046	$ 854	$

Operating activities provided cash of $3.2 million in fiscal year 2018, primarily from operating earnings, and an increase in accounts payable and other accrued expenses, partially offset by increases in receivables, inventories, and deferred revenue. Operating activities provided cash of $11.7 million in fiscal year 2017 primarily from operating earnings, a decrease in inventories, and increases in deferred revenue and accounts payable and other accrued expenses, partially offset by increases in receivables. The increase in cash and deferred revenue in fiscal year 2017 included a $4.4 million customer advance received at the end of the fiscal year in regard to a large international order.

The Company s financing activities used cash of $2,484,000 during fiscal year 2018 for cash dividends of $1,794,000 paid to stockholders, and cash dividends of $74,000 paid to minority interest holders and repayment of long-term debt of $918,000, partially offset by an increase in short-term borrowings of $294,000. The Company s financing activities used cash of $2,084,000 during fiscal year 2017 for repayment of short-term borrowings of $227,000, cash dividends of $1,570,000 paid to stockholders, and cash dividends of $56,000 paid to minority interest holders and repayment of long-term debt of $421,000. See Note 3 of the Notes to Consolidated Financial Statements included in Item 8 of this Annual Report for additional information concerning our credit facility.

The majority of the April 30, 2018 accounts receivable balances are expected to be collected during the first quarter of fiscal year 2019, with the exception of retention amounts on fixed-price contracts which are collected when the entire construction project is completed and all retention funds are paid by the owner.

As discussed above, no further benefits have been, or will be, earned under our pension plans after April 30, 2005, and no additional participants have been, or will be, added to the plans. We estimate that contributions of $1,000,000 will be made to the plans in fiscal year 2019. We made contributions of $600,000 and $555,000 to the plans in fiscal years 2018 and 2017, respectively.

Capital expenditures were $3.4 million, $2.6 million and $2.2 million in fiscal years 2018, 2017 and 2016, respectively. Capital expenditures in fiscal year 2018 were funded primarily from operations. Fiscal year 2019 capital expenditures are anticipated to be approximately $6 million, with the majority of these expenditures for manufacturing equipment and facilities improvements. The planned increase in fiscal year 2019 expenditures relates to strategic investments in manufacturing equipment to support the Company s continued sales growth. The fiscal year 2019 expenditures are expected to be funded primarily by operating activities, supplemented as needed by borrowings under our revolving credit facility.

Working capital was $35.9 million at April 30, 2018, up from $32.9 million at April 30, 2017, and the ratio of current assets to current liabilities was 2.3-to-1.0 at April 30, 2018 and 2.2-to-1.0 at April 30, 2017. The increase in working capital for fiscal year 2018 was primarily due to an increase in receivables and inventories, partially offset by a decrease in cash. The increase in working capital for fiscal year 2017 was primarily due to an increase in cash and receivables, partially offset by a decrease in inventories.

We paid cash dividends of $0.66 per share in fiscal year 2018. We paid cash dividends of $0.58 and $0.51 per share in fiscal years 2017 and 2016, respectively. We expect to pay dividends in the future in line with our actual and anticipated future operating results.

RECENT ACCOUNTING STANDARDS

New Accounting Standards In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers (ASU 2014-09). This update outlines a new comprehensive revenue recognition model that supersedes most current revenue recognition guidance and requires companies to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosures about the nature, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments. The FASB has issued several updates and/or practical expedients to ASU 2014-09.

ASU 2014-09 and the subsequent updates and/or practical expedients to the standard will be effective for the Company during the first quarter of our fiscal year 2019. ASU 2014-09 provides two methods of adopting the standard: using either a full retrospective approach or modified retrospective approach. We have elected the modified retrospective approach of adopting the standard.

We have conducted an assessment of how ASU 2014-09 is likely to affect us, identifying the Company s revenue streams and performance obligations. Our contracts with customers may be for single performance obligations or for multiple performance obligations. Under the new guidance, revenue is recognized when a customer obtains control of promised goods or service which will either be at a point-in-time or over-time. A large majority of products that the Company manufactures for customers have no alternative use as they are designed, engineered and manufactured to a customer specification and are expected to follow an over-time revenue recognition model. Under current guidance, the Company generally recognizes revenue upon shipment or delivery. Under the new guidance, revenue for products that follow an over-time revenue recognition model may be recognized prior to shipment or delivery dependent upon contract-specific terms based on when the customer is deemed to have obtained control. Based on the evaluation of our existing customer contracts and revenue streams, the majority of the Company s revenue will be recorded consistently under both the current and new revenue standards. However, the new revenue standard will accelerate the timing of revenue recognition for certain customer contracts as it requires emphasis on transfer of control rather than risks and rewards. The adjustment primarily relates to revenue recognized historically under bill-and-hold arrangements that will transition to an over-time revenue recognition methodology under the new standard. The cumulative impact of our accelerated revenue recognition under the new revenue standard is expected to result in an after tax net increase less than $500,000 to opening retained earnings as of May 1, 2018.

The adoption of the new revenue recognition guidance is not expected to materially impact our Consolidated Statement of Operations, Consolidated Balance Sheet, or Consolidated Statement of Cash Flows. We are still evaluating the degree to which expanded disclosures would be required in the Company s first quarter of fiscal year 2019.

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements-Going Concern: Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern, which requires management to evaluate whether there are conditions or events that raise substantial doubt about an entity s ability to continue as a going concern, and requires related footnote disclosures. This guidance was effective for fiscal years, and interim periods within those years, ending after December 15, 2016. The Company adopted this standard effective May 1, 2016. The adoption of this standard did not have a significant impact on the Company s consolidated financial position or results

of operations.

In April 2015, the FASB issued ASU 2015-03, Interest Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs. This guidance requires that debt issuance costs related to a recognized liability be

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presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. This guidance was effective for fiscal years, and interim periods within those years, beginning after December 15, 2015. The Company adopted this standard effective May 1, 2016. The adoption of this standard did not have a significant impact on the Company s consolidated financial position or results of operations.

In July 2015, the FASB issued ASU 2015-11, Inventory Simplifying the Measurement of Inventory. This guidance changes the measurement principle for inventory from the lower of cost or market to the lower of cost and net realizable value. Net realizable value is defined as estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. The Company adopted this standard effective May 1, 2017. The adoption of this standard did not have a significant impact on the Company s consolidated financial position or results of operations.

In November 2015, the FASB issued ASU 2015-17, Income Taxes Balance Sheet Classification of Deferred Taxes. This guidance eliminates the requirement to separate deferred income tax liabilities and assets into current and noncurrent amounts in a classified statement of financial position. Instead, the update requires that deferred tax liabilities and assets be classified as noncurrent in a classified statement of financial position. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, with early adoption permitted prospectively or retrospectively. The Company early adopted this standard prospectively beginning with the Consolidated Balance Sheet at April 30, 2016. Prior periods were not retrospectively adjusted.

In February 2016, the FASB issued ASU 2016-2, Leases. This guidance establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. The Company will adopt this standard in fiscal year 2020. The Company has not yet determined the effect, if any, that the adoption of this standard will have on the Company s financial position or results of operations.

In March 2016, the FASB issued ASU 2016-9, Stock Compensation Improvements to Employee Share-Based Payment Accounting. This guidance simplifies various aspects related to how share-based payments are accounted for and presented in the financial statements. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. The Company adopted this standard effective May 1, 2017. Prior periods were not retrospectively adjusted. The adoption of this standard did not have a significant impact on the Company s consolidated financial position or results of operations.

In June 2016, the FASB issued ASU 2016-13, Measurement of Credit Losses on Financial Instruments, which replaces the current incurred loss method used for determining credit losses on financial assets, including trade receivables, with an expected credit loss method. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019. The Company will adopt this standard in fiscal year 2021. The Company does not expect the adoption of this standard to have a significant impact on the Company s consolidated financial position or results of operations.

In August 2016, the FASB issued ASU 2016-15, Cash Flow Classification of Certain Cash Receipts and Cash Payments, which clarifies guidance on classification of certain transactions in the statement of cash flows, including classification of debt prepayments, debt extinguishment costs and contingent consideration payments after a business

combination. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company adopted this standard effective May 1, 2018. The Company does not expect the adoption of this standard to have a significant impact on the Company s consolidated financial position or results of operations.

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In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows Restricted Cash, which requires that the statement of cash flows reconcile the change during the period in total cash, cash equivalents and restricted cash. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company adopted this standard effective May 1, 2018. The Company does not expect the adoption of this standard to have a significant impact on the Company s consolidated financial position or results of operations

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment, which eliminates the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019. The Company will adopt this standard in fiscal year 2021. The Company does not expect the adoption of this standard to have a significant impact on the Company s consolidated financial position or results of operations.

In March 2017, the FASB issued ASU 2017-07, Compensation Retirement Benefits Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which requires that the service cost component of net periodic pension cost is presented in the same line as other compensation costs arising from services rendered by the respective employees during the year. The other components of net periodic pension cost are required to be presented in the income statement separately from the service cost component and outside of earnings from operations. This guidance allows for the service cost component to be eligible for capitalization when applicable. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company adopted this standard effective May 1, 2018. The Company does not expect the adoption of this standard to have a significant impact on the Company s consolidated financial position or results of operations.

In May 2017, the FASB issued ASU 2017-09, Compensation Stock Compensation Scope of Modification Accounting. This guidance was issued in an effort to reduce diversity in practice as it relates to applying modification accounting for changes to the terms and conditions of share-based payment awards. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted. The Company adopted this standard effective May 1, 2018. The Company does not expect the adoption of this standard to have a significant impact on the Company s financial position or results of operations.

In February 2018, the FASB issued ASU 2018-2, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This guidance provides the Company with an option to reclassify stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 from accumulated other comprehensive income to retained earnings. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. The Company will adopt this standard in fiscal year 2020. The Company has not yet determined the effect, if any, that the adoption of this standard will have on the Company s financial position or results of operations, if it should elect to make this reclassification.

OUTLOOK

Financial Outlook

The Company s ability to predict future demand for its products continues to be limited given its role as subcontractor or supplier to dealers for subcontractors. Demand for the Company s products is also dependent upon the number of laboratory construction projects planned and/or current progress in projects already under construction. The Company s earnings are also impacted by fluctuations in prevailing pricing for projects in the laboratory construction marketplace and increased costs of raw materials, including stainless steel, wood, and epoxy resin, and whether the Company is able to increase product prices to customers in amounts that correspond to such increases without materially and adversely affecting sales. Additionally, since prices are normally quoted

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on a firm basis in the industry, the Company bears the burden of possible increases in labor and material costs between the quotation of an order and delivery of a product. Looking forward, the Company is optimistic that fiscal year 2019 will result in sales and earnings growth as our order backlog and opportunities in the marketplace remain strong.

Item 7A. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to market risk in the area of interest rates. This exposure is associated with advances outstanding under our bank line of credit and certain lease obligations for production machinery, all of which are priced on a floating rate basis. Advances outstanding under the bank line of credit were $3.8 million at April 30, 2018. In May 2013, the Company entered into an interest rate swap agreement whereby the interest rate payable by the Company on $3,450,000 of outstanding long-term debt was effectively converted to a fixed interest rate of 4.875% for the period beginning May 1, 2013 and ending August 1, 2017. In May 2013, the Company entered into an interest rate swap agreement whereby the interest rate payable by the Company on $2,600,000 of outstanding long-term debt was effectively converted to a fixed interest rate of 4.37% for the period beginning August 1, 2017 and ending May 1, 2020. In May 2013, the Company entered into an interest rate swap agreement whereby the interest rate payable by the Company on $1,218,000 of outstanding long-term debt was effectively converted to a fixed interest rate of 3.07% for the period beginning November 3, 2014 and ending May 1, 2020. We believe that our exposure to market risk is not material.

Item 8. Financial Statements and Supplementary Data

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE SHAREHOLDERS AND BOARD OF DIRECTORS

OF KEWAUNEE SCIENTIFIC CORPORATION

STATESVILLE, NORTH CAROLINA

Opinion on the Financial Statements

We have audited the accompanying consolidated balance sheets of Kewaunee Scientific Corporation and subsidiaries (the Company) as of April 30, 2018 and 2017 the related consolidated statements of operations, comprehensive income, stockholders equity and cash flows for each of the two years in the period ended April 30, 2018 and 2017, and the related notes (collectively referred to as the financial statements). In our opinion, the financial statements present fairly, in all material respects, the consolidated financial position of the Company at April 30, 2018 and 2017, and the results of its operations and cash flows for each of the two years in the period ended April 30, 2018 and 2017, in conformity with U.S. generally accepted accounting principles.

Basis for Opinion

These financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on the Company s financial statements based on our audits. We are a public accounting firm registered with the Public Company Accounting Oversight Board (United States) (PCAOB) and are required to be independent with respect to the Company in accordance with the U.S. federal securities laws and the applicable rules and regulations of the Securities and Exchange Commission and the PCAOB.

We conducted our audits in accordance with the standards of the PCAOB. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement, whether due to error or fraud. The Company is not required to have, nor were we engaged to perform, an audit of the Company s internal control over financial reporting (and accordingly, that we express no opinion). As part of our audits we are required to obtain an understanding of internal control over financial reporting but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion.

Our audits included performing procedures to assess the risks of material misstatement of the financial statements, whether due to error or fraud, and performing procedures that respond to those risks. Such procedures include examining, on a test basis, evidence regarding the amounts and disclosures in the financial statements. Our audits also included evaluating the accounting principles used and significant estimates made by management, as well as evaluating the overall presentation of the financial statements. We believe that our audits provide a reasonable basis for our opinion.

/s/ Ernst & Young LLP

We have served as the Company s auditor since 2016.

Charlotte, North Carolina

July 20, 2018

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REPORT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

TO THE SHAREHOLDERS AND BOARD OF DIRECTORS

OF KEWAUNEE SCIENTIFIC CORPORATION

STATESVILLE, NORTH CAROLINA

We have audited the accompanying consolidated statements of operations, comprehensive income, and stockholders equity of Kewaunee Scientific Corporation and subsidiaries (the Company) as of and for the year ended April 30, 2016. These consolidated financial statements are the responsibility of the Company s management. Our responsibility is to express an opinion on these consolidated financial statements 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 the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audit included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company s internal control over financial reporting. Accordingly, we express no such opinion. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the consolidated financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated results of their operations, comprehensive income, and stockholders equity of the Company as of and for the year ended April 30, 2016, in conformity with accounting principles generally accepted in the United States of America.

/s/ CHERRY BEKAERT LLP
Charlotte, North Carolina
July 21, 2016

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CONSOLIDATED STATEMENTS OF OPERATIONS

Years Ended April 30	**Kewaunee Scientific Corporation**		
$ and shares in thousands, except per share amounts	**2018**	2017	2016
Net sales	**$ 158,050**	$ 138,558	$ 128,626
Costs of products sold	**126,030**	111,951	104,918
Gross profit	**32,020**	26,607	23,708
Operating expenses	**22,934**	20,065	18,010
Operating earnings	**9,086**	6,542	5,698
Other income, net	**693**	496	347
Interest expense	**(299)**	(292)	(306)
Earnings before income taxes	**9,480**	6,746	5,739
Income tax expense	**4,115**	2,126	1,862
Net earnings	**5,365**	4,620	3,877
Less: net earnings attributable to the noncontrolling interest	**177**	105	75
Net earnings attributable to Kewaunee Scientific Corporation	**$ 5,188**	$ 4,515	$ 3,802
Net earnings per share attributable to Kewaunee Scientific Corporation stockholders			
Basic	**$ 1.91**	$ 1.67	$ 1.43
Diluted	**$ 1.87**	$ 1.66	$ 1.42
Weighted average number of common shares outstanding			
Basic	**2,720**	2,705	2,667
Diluted	**2,777**	2,726	2,687

The accompanying Notes are an integral part of these Consolidated Financial Statements.

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

Years Ended April 30	**Kewaunee Scientific Corporation**		
$ in thousands	**2018**	2017	2016
Net earnings	**$ 5,365**	$ 4,620	$ 3,877
Other comprehensive income (loss), net of tax			

Foreign currency translation adjustments	**(430)**	231	(217)
Change in unrecognized actuarial loss on pension obligations	**812**	1,012	448
Change in fair value of cash flow hedges	**37**	64	23
Comprehensive income, net of tax	**5,784**	5,927	4,131
Less comprehensive income attributable to the noncontrolling interest	**177**	105	75
Total comprehensive income attributable to Kewaunee Scientific Corporation	**$ 5,607**	$ 5,822	$ 4,056

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF STOCKHOLDERS EQUITY

Kewaunee Scientific Corporation

$ in thousands, except shares and per share amounts	**Common Stock**	**Additional Paid-in Capital**	**Treasury Stock**	**Retained Earnings**	**Accumulated Other Comprehensive Income (Loss)**	**Total Stockholders Equity**
Balance at April 30, 2015	$ 6,583	$ 1,841	$ (53)	$ 34,385	$ (7,880)	$ 34,876
Net earnings attributable to Kewaunee Scientific Corporation				3,802		3,802
Other comprehensive loss					254	254
Cash dividends paid, $0.51 per share				(1,361)		(1,361)
Stock options exercised, 84,000 shares	137	342				479
Stock based compensation		192				192
Balance at April 30, 2016	6,720	2,375	(53)	36,826	(7,626)	38,242
Net earnings attributable to Kewaunee Scientific Corporation				4,515		4,515
Other comprehensive income					1,307	1,307
Cash dividends paid, $0.58 per share				(1,570)		(1,570)
Stock options exercised, 50,075 shares	69	121				190
Stock based compensation		199				199
Balance at April 30, 2017	6,789	2,695	(53)	39,771	(6,319)	42,883
Net earnings attributable to Kewaunee Scientific Corporation				**5,188**		**5,188**
Other comprehensive income					**419**	**419**
Cash dividends paid, $0.66 per share				**(1,794)**		**(1,794)**
Stock options exercised, 36,800 shares	**52**	**(40)**				**12**
Stock based compensation		**351**				**351**
Balance at April 30, 2018	**$ 6,841**	**$ 3,006**	**$ (53)**	**$ 43,165**	**$ (5,900)**	**$ 47,059**

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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CONSOLIDATED BALANCE SHEETS

April 30	**Kewaunee Scientific Corporation**	
$ and shares in thousands, except per share amounts	**2018**	2017
ASSETS		
Current Assets		
Cash and cash equivalents	**$ 9,716**	$ 12,506
Restricted cash	**1,242**	1,435
Receivables, less allowance: $384 (2018); $191 (2017)	**32,660**	29,889
Inventories	**17,662**	14,935
Prepaid expenses and other current assets	**2,224**	1,047
Total Current Assets	**63,504**	59,812
Property, Plant and Equipment, Net	**14,661**	14,027
Other Assets		
Deferred income taxes	**2,031**	3,158
Other	**4,162**	3,919
Total Other Assets	**6,193**	7,077
Total Assets	**$ 84,358**	$ 80,916
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Short-term borrowings and interest rate swaps	**$ 3,885**	$ 3,591
Current portion of long-term debt	**1,167**	918
Accounts payable	**14,754**	11,995
Employee compensation and amounts withheld	**3,810**	2,765
Deferred revenue	**1,884**	5,806
Other accrued expenses	**2,062**	1,852
Total Current Liabilities	**27,562**	26,927
Long-term debt	**1,264**	2,431
Accrued pension and deferred compensation costs	**7,465**	8,301
Income taxes payable	**546**	
Total Liabilities	**36,837**	37,659
Commitments and Contingencies (Note 7)		
Stockholders Equity		
Common stock, $2.50 par value, Authorized 5,000 shares;		
Issued 2,736 shares (2018); 2,715 shares; (2017);		

Outstanding 2,733 shares (2018); 2,712 shares (2017);	**6,841**	6,789
Additional paid-in-capital	**3,006**	2,695
Retained earnings	**43,165**	39,771
Accumulated other comprehensive loss	**(5,900)**	(6,319)
Common stock in treasury, at cost: 3 shares	**(53)**	(53)
Total Kewaunee Scientific Corporation Stockholders Equity	**47,059**	42,883
Noncontrolling Interest	**462**	374
Total Equity	**47,521**	43,257
Total Liabilities and Stockholders Equity	**$ 84,358**	$ 80,916

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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CONSOLIDATED STATEMENTS OF CASH FLOWS

Years Ended April 30	**Kewaunee Scientific Corporation**		
$ in thousands	**2018**	2017	2016
Cash Flows from Operating Activities			
Net earnings	**$ 5,365**	$ 4,620	$ 3,877
Adjustments to reconcile net earnings to net cash provided by operating activities:			
Depreciation	**2,761**	2,702	2,592
Bad debt provision	**344**	37	74
Stock based compensation expense	**355**	199	192
Provision (benefit) for deferred income tax expense	**1,127**	234	(335)
Change in assets and liabilities:			
(Increase) decrease in receivables	**(3,115)**	(2,091)	1,197
(Increase) decrease in inventories	**(2,727)**	691	(2,881)
Increase in accounts payable and other accrued expenses	**4,560**	686	1,351
(Decrease) increase in deferred revenue	**(3,922)**	5,021	569
Other, net	**(1,565)**	(437)	635
Net cash provided by operating activities	**3,183**	11,662	7,271
Cash Flows from Investing Activities			
Capital expenditures	**(3,395)**	(2,611)	(2,187)
Decrease in restricted cash	**193**	132	709
Net cash used in investing activities	**(3,202)**	(2,479)	(1,478)
Cash Flows from Financing Activities			
Dividends paid	**(1,794)**	(1,570)	(1,361)
Dividends paid to noncontrolling interest in subsidiaries	**(74)**	(56)	(75)
Proceeds from short-term borrowings	**59,069**	51,407	48,706
Repayments on short-term borrowings	**(58,775)**	(51,634)	(49,843)
Payment toward purchase of noncontrolling interest in subsidiary			(888)
Payments on long-term debt	**(918)**	(421)	(422)
Net proceeds from exercise of stock options (including tax benefit)	**8**	190	479
Net cash used in financing activities	**(2,484)**	(2,084)	(3,404)
Effect of exchange rate changes on cash, net	**(287)**	185	(211)
(Decrease) Increase in Cash and Cash Equivalents	**(2,790)**	7,284	2,178
Cash and Cash Equivalents at Beginning of Year	**12,506**	5,222	3,044
Cash and Cash Equivalents at End of Year	**$ 9,716**	$ 12,506	$ 5,222

Supplemental Disclosure of Cash Flow Information			
Interest paid	**$ 295**	$ 292	$ 306
Income taxes paid	**$ 2,872**	$ 2,618	$ 2,387

The accompanying Notes are an integral part of these Consolidated Financial Statements.

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NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Summary of Significant Accounting Policies

Kewaunee Scientific Corporation and subsidiaries (collectively the Company) design, manufacture, and install laboratory, healthcare, and technical furniture products. The Company s products include steel, wood, and laminate furniture, fume hoods, biological safety cabinets, laminare flow and ductless fume hoods, adaptable modular and column systems, movable workstations and carts, epoxy resin worksurfaces, sinks and accessories and related design services. The Company s sales are made through purchase orders and contracts submitted by customers, dealers and agents, a national stocking distributor, and competitive bids submitted by the Company and its subsidiaries located in Singapore, India, and China. The majority of the Company s products are sold to customers located in North America, primarily within the United States. The Company s laboratory products are used in chemistry, physics, biology and other general science laboratories in the pharmaceutical, biotechnology, industrial, chemical, commercial, educational, government and health care markets. Technical products are used in facilities manufacturing computers and light electronics and by users of computer and networking furniture. Laminate casework is used in educational, healthcare and industrial applications.

Principles of Consolidation The Company s consolidated financial statements include the accounts of Kewaunee Scientific Corporation and its six international subsidiaries. A brief description of each subsidiary, along with the amount of the Company s controlling financial interests, is as follows: (1) Kewaunee Labway Asia Pte. Ltd., a commercial sale organization for the Company s products in Singapore, is 100% owned by the Company; (2) Kewaunee Scientific Corporation Singapore Pte. Ltd., a holding company in Singapore, is 100% owned by the Company;(3) Kewaunee Labway India Pvt. Ltd., a commercial sale organization for the Company s products in Bangalore, India, is 90% owned by the Company; (4) Kewaunee Scientific Corporation India Pvt. Ltd. in Bangalore, India, a manufacturing and assembly operation, is 100% owned by the Company; (5) Koncepo Scientech International Pvt. Ltd., a laboratory design and strategic advisory and construction management services firm, located in Bangalore, India, is 100% owned by the Company; and (6) Kewaunee Scientific (Suzhou) Co., Ltd., a commercial sale organization for the Company s products in China, is 100% owned by the Company. All intercompany balances, transactions, and profits have been eliminated. Included in the consolidated financial statements are net assets of $15,762,000 and $12,268,000 at April 30, 2018 and 2017, respectively, of the Company s subsidiaries. Net sales by the Company s subsidiaries in the amounts of $43,456,000, $25,477,000 and $25,579,000 were included in the consolidated statements of operations for fiscal years 2018, 2017, and 2016, respectively.

Cash and Cash Equivalents Cash and cash equivalents consist of cash on hand and highly liquid investments with original maturities of three months or less. During the years ended April 30, 2018 and 2017, the Company had cash deposits in excess of FDIC insured limits. The Company has not experienced any losses from such deposits.

Restricted Cash Restricted cash includes bank deposits of subsidiaries used for performance guarantees against customer orders.

Accounts Receivable and Allowance for Doubtful Accounts Accounts receivable are stated at the amount owed by the customer, net of allowances for estimated doubtful accounts. The Company evaluates the collectability of its trade accounts receivables based on a number of factors. In circumstances where management is aware of a customer s inability to meet its financial obligations to the Company, or a project dispute makes it unlikely that all of the receivable owed by a customer will be collected, a specific reserve for bad debts is estimated and recorded to reduce the recognized receivable to the estimated amount the Company believes will ultimately be collected. In addition to specific customer identification of potential bad debts, a general reserve for bad debts is estimated and recorded based on past loss history and an overall assessment of past due trade accounts receivable amounts outstanding. Accounts

are written off when it is clearly established that the

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receivable is a bad debt. Recoveries of receivables previously written off are recorded when received. The activity in the allowance for doubtful accounts for each of the three years ended April 30 was:

$ in thousands	**2018**	2017	2016
Balance at beginning of year	**$ 191**	$ 202	$ 171
Bad debt provision	**344**	37	74
Doubtful accounts written off (net)	**(151)**	(48)	(43)
Balance at end of year	**$ 384**	$ 191	$ 202

Unbilled Receivables Accounts receivable included unbilled receivables that represent amounts earned which have not yet been billed in accordance with contractually stated billing terms. The amount of unbilled receivables at April 30, 2018 and 2017 was $1,007,000 and $450,000, respectively.

Inventories The majority of inventories are valued at the lower of cost or market under the last-in, first-out (LIFO) double extension method. The LIFO method allocates the most recent costs to cost of products sold; and, therefore, recognizes into operating results fluctuations in costs of raw materials more quickly than other methods. Inventories at our international subsidiaries are measured on the first-in, first-out (FIFO) method.

Property, Plant and Equipment Property, plant and equipment are stated at cost less accumulated depreciation. Depreciation is determined for financial reporting purposes principally on the straight-line method over the estimated useful lives of the individual assets or, for leaseholds, over the terms of the related leases, if shorter. Property, plant and equipment consisted of the following at April 30:

$ in thousands	**2018**	2017	Useful Life
Land	**$ 41**	$ 41	N/A
Building and improvements	**16,489**	15,892	10-40 years
Machinery and equipment	**38,118**	35,635	5-10 years
Total	**54,648**	51,568	
Less accumulated depreciation	**(39,987)**	(37,541)	
Net property, plant and equipment	**$ 14,661**	$ 14,027	

Management reviews the carrying value of property, plant and equipment for impairment whenever changes in circumstances or events indicate that such carrying value may not be recoverable. If projected undiscounted cash flows are not sufficient to recover the carrying value of the potentially impaired asset, the carrying value is reduced to estimated fair value. There were no impairments in fiscal years 2018, 2017, or 2016.

Other Assets Other assets at April 30, 2018 and 2017 included $4,050,000 and $3,748,000, respectively, of assets held in a trust account for non-qualified benefit plans and $65,000 and $75,000, respectively, of cash surrender values of life insurance policies. Life insurance policies are recorded at the amount that could be realized under the insurance contract as of the date of the Company s consolidated balance sheet with the change in cash surrender or contract value being recorded as income or expense during each period.

On December 7, 2017, the Company experienced a criminal network cyber-attack that led to a disruption of its domestic operations, including manufacturing, engineering, administration, and sales operations. As of December 12, 2017 the Company had restored its domestic operations. Included in other current assets is a $255,000 claim against the Company s insurance carrier for expenses incurred in regards to this cyber-attack.

Use of Estimates The presentation of consolidated financial statements in conformity with generally accepted accounting principles in the United States of America requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results

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could differ from these estimates. Significant estimates impacting the accompanying consolidated financial statements include the allowance for uncollectible accounts receivable, inventory valuation, self-insurance reserves, and pension liabilities.

Fair Value of Financial Instruments A financial instrument is defined as cash equivalents, evidence of an ownership interest in an entity, or a contract that creates a contractual obligation or right to deliver or receive cash or another financial instrument from another party. The Company s financial instruments consist primarily of cash and equivalents, mutual funds, cash surrender value of life insurance policies, term loans and short-term borrowings. The carrying value of these assets and liabilities approximate their fair value.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Expanded disclosures about instruments measured at fair value require the Company to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The fair value hierarchy is based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value as follows:

Level 1 Quoted prices in active markets for identical assets or liabilities as of the reporting date.

Level 2 Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities as of the reporting date.

Level 3 Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following tables summarize the Company s fair value hierarchy for its financial assets and liabilities measured at fair value on a recurring and nonrecurring basis as of April 30, 2018 and 2017 (in thousands):

	2018			
	Level 1	**Level 2**	**Level 3**	**Total**
Financial Assets				
Trading securities held in non-qualified compensation plans (1)	**$ 4,050**	**$**	**$**	**$ 4,050**
Cash surrender value of life insurance policies (1)		**65**		**65**
Total	**$ 4,050**	**$ 65**	**$**	**$ 4,115**
Financial Liabilities				
Non-qualified compensation plans (2)	**$**	**$ 4,462**	**$**	**$ 4,462**
Interest rate swap derivatives		**5**		**5**

Total	**$**	**$ 4,467**	**$**	**$ 4,467**

	2017			
	Level 1	Level 2	Level 3	Total
Financial Assets				
Trading securities held in non-qualified compensation plans (1)	$ 3,748	$	$	$ 3,748
Cash surrender value of life insurance policies (1)		75		75
Total	$ 3,748	$ 75	$	$ 3,823
Financial Liabilities				
Non-qualified compensation plans (2)	$	$ 4,186	$	$ 4,186
Interest rate swap derivatives		62		62
Total	$	$ 4,248	$	$ 4,248

(1) The Company maintains two non-qualified compensation plans which include investment assets in a rabbi trust. These assets consist of marketable securities, which are valued using quoted market prices multiplied by the number of shares owned, and life insurance policies, which are valued at their cash surrender value.

(2) Plan liabilities are equal to the individual participants account balances and other earned retirement benefits.

Revenue Recognition Product sales and installation revenue are recognized when all of the following criteria have been met: (1) products have been shipped, or customers have purchased and accepted title to the goods, but because of construction delays, have requested that the Company temporarily store the finished goods on the customer s behalf; service revenue for installation of products sold is recognized as the installation services are performed, (2) persuasive evidence of an arrangement exists, (3) the price to the customer is fixed, and (4) collectability is reasonably assured. The Company utilizes either the percentage of completion or completed contract method based on facts and circumstances of individual contracts.

Deferred revenue consists of customer deposits and advance billings of the Company s products where sales have not yet been recognized. Accounts receivable includes retainage in the amounts of $2,724,000 and $2,839,000 at April 30, 2018 and 2017, respectively. Shipping and handling costs are included in cost of product sales. Because of the nature and quality of the Company s products, any warranty issues are determined in a relatively short period after the sale and are infrequent in nature, and as such, warranty costs are immaterial to the Company s consolidated financial position and results of operations and are expensed as incurred.

Product sales resulting from fixed-price construction contracts involve a signed contract for a fixed price to provide the Company s laboratory furniture and fume hoods for a construction project. In these instances, the Company is usually in the role of a subcontractor, but in some cases may enter into a contract directly with the end-user of the products. Contract arrangements normally do not contain a general right of return relative to the delivered items. Product sales resulting from fixed-price construction contracts are generated from multiple-element arrangements that require separate units of accounting and estimates regarding the fair value of individual elements. The Company has determined that its multiple-element arrangements that qualify as separate units of accounting are (1) product sales and (2) installation services. There is objective and reliable evidence of fair value for both the product sales and installation services and allocation of arrangement consideration for each of these units is based on their relative fair values. Each of these elements represent individual units of accounting, as the delivered item has value to a customer on a stand-alone basis. The Company s products are regularly sold on a stand-alone basis to customers which provides objective evidence of the fair value of the product portion of the multi-element contract and thus represents the

Company s best estimate of selling price.

The fair value of installation services is separately calculated using expected costs of installation services. Many times the value of installation services is calculated using price quotations from subcontractors to the Company who perform installation services on a stand-alone basis.

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Product sales resulting from purchase orders involve a purchase order received by the Company from its dealers or stocking distributor. This category includes product sales for standard products, as well as products which require some customization. Any customization requirements are approved by the customer prior to manufacture of the customized product. Sales from purchase orders are recognized under the terms of the purchase order which generally are freight on board (FOB) shipping point and do not include rights of return. Accordingly, these sales are recognized at the time of shipment.

Credit Concentration Credit risk is generally not concentrated with any one customer or industry, although the Company does enter into large contracts with individual customers from time to time. The Company performs credit evaluations of its customers. Revenues from three of the Company s domestic dealers represented in the aggregate approximately 33%, 38%, and 40%, of the Company s sales in fiscal years 2018, 2017, and 2016, respectively. Accounts receivable for two domestic customers represented approximately 31% and 25% of the Company s total accounts receivable as of April 30, 2018 and 2017, respectively.

Insurance Effective January 1, 2016, the Company moved from a fully-insured health care program to a self-insured program. The Company accrues estimated losses for claims incurred but not reported (IBNR) using actuarial models and assumptions based on historical loss experience. The Company has also purchased specific stop-loss insurance to limit claims above a certain amount. The Company adjusts insurance reserves, as needed, in the event that future loss experience differs from historical loss patterns.

Income Taxes In accordance with ASC 740, Income Taxes, the Company uses the liability method in measuring the provision for income taxes and recognizing deferred tax assets and liabilities on the balance sheet. Provision has not been made for income taxes on unremitted earnings of foreign subsidiaries as these earnings are deemed to be permanently reinvested. ASC 740 clarifies the financial statement recognition threshold and measurement attribute of a tax position taken or expected to be taken in a tax return. Under ASC 740, the Company applies a more-likely-than-not recognition threshold for all tax uncertainties. ASC 740 only allows the recognition of those tax benefits that have a greater than 50% likelihood of being sustained upon examination by the taxing authorities. The Company did not have any significant uncertain tax positions at April 30, 2018 and 2017. The Company early adopted ASU 2015-17, Balance Sheet Classification of Deferred Taxes in fiscal year 2016 and applied prospective treatment of the standard. Prior periods were not retrospectively adjusted. (See Note 4)

Research and Development Costs Research and development costs are charged to cost of products sold in the periods incurred. Expenditures for research and development costs were $1,537,000, $1,163,000 and $1,167,000 for the fiscal years ended April 30, 2018, 2017 and 2016, respectively.

Advertising Costs Advertising costs are expensed as incurred, and include trade shows, training materials, sales, samples, and other related expenses. Advertising costs for the years ended April 30, 2018, 2017 and 2016 were $395,000, $352,000 and $311,000, respectively.

Derivative Financial Instruments The Company records derivatives on the consolidated balance sheets at fair value and establishes criteria for designation and effectiveness of hedging relationships. The nature of the Company s business activities involves the management of various financial and market risks, including those related to changes in interest rates. The Company does not enter into derivative instruments for speculative purposes. In May 2013, the Company entered into an interest rate swap agreement whereby the interest rate payable by the Company on $3,450,000 of outstanding long-term debt was effectively converted to a fixed interest rate of 4.875% for the period beginning May 1, 2013 and ending August 1, 2017. In May 2013, the Company entered into an interest rate swap agreement whereby the interest rate payable by the Company on $2,600,000 of outstanding long-term debt was effectively converted to a fixed interest rate of 4.37% for the period beginning August 1, 2017 and ending May 1,

2020. In May 2013, the Company entered into an interest rate swap agreement whereby the interest rate payable by the Company on $1,218,000 of outstanding long-term debt was effectively converted to a fixed interest rate of 3.07% for the period beginning November 3, 2014 and

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ending May 1, 2020. The Company entered into these interest rate swap arrangements to mitigate future interest rate risk associated with its long-term debt and has designated these as cash flow hedges. (See Note 3)

Foreign Currency Translation The financial statements of subsidiaries located in India, China, and Kewaunee Scientific Corporation Singapore Pte. Ltd. are measured using the local currency as the functional currency. Kewaunee Labway Asia Pte. Ltd. is measured using the U.S. dollar as its functional currency. Assets and liabilities of the Company s foreign subsidiaries using local currencies are translated into United States dollars at fiscal year-end exchange rates. Sales, expenses, and cash flows are translated at weighted average exchange rates for each period. Net translation gains or losses are included in other comprehensive income, a separate component of stockholders equity. The Company does not provide for U.S. income taxes on foreign currency translation adjustments, since it does not provide for taxes on undistributed earnings of foreign subsidiaries. Gains and losses from foreign currency transactions of these subsidiaries are included in operating expenses.

Earnings Per Share Basic earnings per share is based on the weighted average number of common shares outstanding during the year. Diluted earnings per share reflects the conversion of restricted stock units (RSUs) and assumed exercise of outstanding options under the Company s Omnibus Incentive Plan, except when RSUs and options have an antidilutive effect. There were no antidilutive RSUs or options outstanding at April 30, 2018. Options to purchase 39,200 and 110,100 shares at April 30, 2017 and 2016, respectively were not included in the computation of diluted earnings per share, because the option exercise prices were greater than the average market price of the common shares at that date, and accordingly such options would have an antidilutive effect.

The following is a reconciliation of basic to diluted weighted average common shares outstanding:

Shares in thousands	**2018**	2017	2016
Weighted average common shares outstanding			
Basic	**2,720**	2,705	2,667
Dilutive effect of stock options	**57**	21	20
Weighted average common shares outstanding diluted	**2,777**	2,726	2,687

Accounting for Stock Options Compensation costs related to stock options and other stock awards granted by the Company are charged against operating expenses during their vesting period, under ASC 718, Compensation Stock Compensation . The Company issued 23,907 restricted stock units (RSUs) under the 2017 Omnibus Incentive Plan in fiscal year 2018. The Company granted stock options for 45,200 and 40,200 shares during fiscal years 2017 and 2016, respectively. (See Note 5)

Reclassifications Certain 2017 and 2016 amounts have been reclassified to conform to the 2018 presentation in the consolidated statements of cash flows. Such reclassifications had no impact on net earnings.

New Accounting Standards In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers (ASU 2014-09). This update outlines a new comprehensive revenue recognition model that supersedes most current revenue recognition guidance and requires companies to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 also requires additional disclosures about the nature, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments. The FASB has issued several

updates and/or practical expedients to ASU 2014-09.

ASU 2014-09 and the subsequent updates and/or practical expedients to the standard will be effective for the Company during the first quarter of our fiscal year 2019. ASU 2014-09 provides two methods of adopting the standard: using either a full retrospective approach or modified retrospective approach. We have elected the modified retrospective approach of adopting the standard.

We have conducted an assessment of how ASU 2014-09 is likely to affect us, identifying the Company s revenue streams and performance obligations. Our contracts with customers may be for single performance obligations or for multiple performance obligations. Under the new guidance, revenue is recognized when a customer obtains control of promised goods or service which will either be at a point-in-time or over-time. A large majority of products that the Company manufactures for customers have no alternative use as they are designed, engineered and manufactured to a customer specification and are expected to follow an over-time revenue recognition model. Under current guidance, the Company generally recognizes revenue upon shipment or delivery. Under the new guidance, revenue for products that follow an over-time revenue recognition model may be recognized prior to shipment or delivery dependent upon contract-specific terms based on when the customer is deemed to have obtained control. Based on the evaluation of our existing customer contracts and revenue streams, the majority of the Company s revenue will be recorded consistently under both the current and new revenue standards. However, the new revenue standard will accelerate the timing of revenue recognition for certain customer contracts as it requires emphasis on transfer of control rather than risks and rewards. The adjustment primarily relates to revenue recognized historically under bill-and-hold arrangements that will transition to an over-time revenue recognition methodology under the new standard. The cumulative impact of our accelerated revenue recognition under the new revenue standard is expected to result in an after tax net increase less than $500,000 to opening retained earnings as of May 1, 2018.

The adoption of the new revenue recognition guidance is not expected to materially impact our Consolidated Statement of Operations, Consolidated Balance Sheet, or Consolidated Statement of Cash Flows. We are still evaluating the degree to which expanded disclosures would be required in the Company s first quarter of fiscal year 2019.

In August 2014, the FASB issued ASU 2014-15, Presentation of Financial Statements-Going Concern: Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern, which requires management to evaluate whether there are conditions or events that raise substantial doubt about an entity s ability to continue as a going concern, and requires related footnote disclosures. This guidance was effective for fiscal years, and interim periods within those years, ending after December 15, 2016. The Company adopted this standard effective May 1, 2016. The adoption of this standard did not have a significant impact on the Company s consolidated financial position or results of operations.

In April 2015, the FASB issued ASU 2015-03, Interest Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs. This guidance requires that debt issuance costs related to a recognized liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability. This guidance was effective for fiscal years, and interim periods within those years, beginning after December 15, 2015. The Company adopted this standard effective May 1, 2016. The adoption of this standard did not have a significant impact on the Company s consolidated financial position or results of operations.

In July 2015, the FASB issued ASU 2015-11, Inventory Simplifying the Measurement of Inventory. This guidance changes the measurement principle for inventory from the lower of cost or market to the lower of cost and net realizable value. Net realizable value is defined as estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal, and transportation. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. The Company adopted this standard effective May 1, 2017. The adoption of this standard did not have a significant impact on the Company s consolidated financial position or results of operations.

In November 2015, the FASB issued ASU 2015-17, Income Taxes Balance Sheet Classification of Deferred Taxes. This guidance eliminates the requirement to separate deferred income tax liabilities and assets into current and noncurrent amounts in a classified statement of financial position. Instead, the update requires that deferred tax

liabilities and assets be classified as noncurrent in a classified statement of financial position. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, with early adoption permitted prospectively or retrospectively. The Company early adopted this standard

prospectively beginning with the Consolidated Balance Sheet at April 30, 2016. Prior periods were not retrospectively adjusted.

In February 2016, the FASB issued ASU 2016-2, Leases. This guidance establishes a right-of-use (ROU) model that requires a lessee to record a ROU asset and a lease liability on the balance sheet for all leases with terms longer than 12 months. Leases will be classified as either finance or operating, with classification affecting the pattern of expense recognition in the income statement. A modified retrospective transition approach is required for lessees for capital and operating leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements, with certain practical expedients available. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. The Company will adopt this standard in fiscal year 2020. The Company has not yet determined the effect, if any, that the adoption of this standard will have on the Company s financial position or results of operations.

In March 2016, the FASB issued ASU 2016-9, Stock Compensation Improvements to Employee Share-Based Payment Accounting. This guidance simplifies various aspects related to how share-based payments are accounted for and presented in the financial statements. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. The Company adopted this standard effective May 1, 2017. Prior periods were not retrospectively adjusted. The adoption of this standard did not have a significant impact on the Company s consolidated financial position or results of operations.

In June 2016, the FASB issued ASU 2016-13, Measurement of Credit Losses on Financial Instruments, which replaces the current incurred loss method used for determining credit losses on financial assets, including trade receivables, with an expected credit loss method. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019. The Company will adopt this standard in fiscal year 2021. The Company does not expect the adoption of this standard to have a significant impact on the Company s consolidated financial position or results of operations.

In August 2016, the FASB issued ASU 2016-15, Cash Flow Classification of Certain Cash Receipts and Cash Payments, which clarifies guidance on classification of certain transactions in the statement of cash flows, including classification of debt prepayments, debt extinguishment costs and contingent consideration payments after a business combination. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company adopted this standard effective May 1, 2018. The Company does not expect the adoption of this standard to have a significant impact on the Company s consolidated financial position or results of operations.

In November 2016, the FASB issued ASU 2016-18, Statement of Cash Flows Restricted Cash, which requires that the statement of cash flows reconcile the change during the period in total cash, cash equivalents and restricted cash. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company adopted this standard effective May 1, 2018. The Company does not expect the adoption of this standard to have a significant impact on the Company s consolidated financial position or results of operations

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment, which eliminates the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2019. The Company will adopt this standard in fiscal year 2021. The Company does not expect the adoption of this standard to have a significant impact on the Company s consolidated financial position or results of operations.

In March 2017, the FASB issued ASU 2017-07, Compensation Retirement Benefits Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Cost, which requires that the service cost component of net periodic pension cost is presented in the same line as other compensation costs

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arising from services rendered by the respective employees during the year. The other components of net periodic pension cost are required to be presented in the income statement separately from the service cost component and outside of earnings from operations. This guidance allows for the service cost component to be eligible for capitalization when applicable. This guidance is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017. The Company adopted this standard effective May 1, 2018. The Company does not expect the adoption of this standard to have a significant impact on the Company s consolidated financial position or results of operations.

In May 2017, the FASB issued ASU 2017-09, Compensation Stock Compensation Scope of Modification Accounting. This guidance was issued in an effort to reduce diversity in practice as it relates to applying modification accounting for changes to the terms and conditions of share-based payment awards. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2017, with early adoption permitted. The Company adopted this standard effective May 1, 2018. The Company does not expect the adoption of this standard to have a significant impact on the Company s financial position or results of operations.

In February 2018, the FASB issued ASU 2018-2, Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income. This guidance provides the Company with an option to reclassify stranded tax effects resulting from the Tax Cuts and Jobs Act of 2017 from accumulated other comprehensive income to retained earnings. This guidance is effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018, with early adoption permitted. The Company will adopt this standard in fiscal year 2020. The Company has not yet determined the effect, if any, that the adoption of this standard will have on the Company s financial position or results of operations, if it should elect to make this reclassification.

Note 2 Inventories

Inventories consisted of the following at April 30:

$ in thousands	**2018**	2017
Finished goods	**$ 4,751**	$ 3,179
Work-in-process	**2,278**	1,950
Materials and components	**10,633**	9,806
Total inventories	**$ 17,662**	$ 14,935

At April 30, 2018 and 2017, the Company s international subsidiaries inventories were $1,908,000 and $2,205,000, respectively, measured using the first-in, first-out (FIFO) method. If all of the Company s inventories had been determined using the FIFO method at April 30, 2018 and 2017, reported inventories would have been $887,000 and $748,000 greater, respectively. During fiscal year 2018, the LIFO index was higher than 100% due to higher prices for certain raw materials. This increase resulted in the addition of LIFO inventory quantities carried at lower costs prevailing in prior years as compared to the cost of purchases in fiscal year 2017, the effect of which increased the costs of product sales by $139,000. During fiscal year 2017, the LIFO index was higher than 100% due to higher prices for certain raw materials. This increase resulted in the addition of LIFO inventory quantities carried at lower costs prevailing in prior years as compared to the cost of purchases in fiscal year 2016, the effect of which increased the costs of product sales by $14,000.

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Note 3 Long-term Debt and Other Credit Arrangements

On May 6, 2013, the Company entered into a credit and security agreement (the Loan Agreement) with a new lender consisting of (1) a $20 million revolving credit facility (Line of Credit) which matured on May 1, 2018 and was extended to March 1, 2021 on March 12, 2018, (2) a term loan in the amount of $3,450,000 which matures on May 1, 2020 (Term Loan A) and (3) a term loan in the amount of $1,550,000 which matures on May 1, 2020 (Term Loan B and together with Term Loan A, the Term Loans). The Loan Agreement provided funds to refinance all existing indebtedness to the Company s previous lender and for working capital and other general corporate purposes. In addition, the credit facility provided a sub-line for the issuance of up to $6.5 million of letters of credit at April 30, 2018 and April 30, 2017.

At April 30, 2018, there were advances of $3.8 million and $5.2 million in letters of credit outstanding, leaving $11.0 million available under the Line of Credit. The borrowing rate under the Line of Credit at that date was 3.50%. Monthly interest payments under the Line of Credit were payable at the Daily One Month LIBOR interest rate plus 1.50% per annum. Payments are due under Term Loan A in consecutive equal monthly principal payments in the amount of $79,000 until May 1, 2020, and at that time, all principal, accrued unpaid interest and other charges outstanding under Term Loan A shall be due and payable in full. The interest rate on Term Loan A, after consideration of related interest rate swap agreements, is a fixed rate per annum equal to 4.37%. Payments are due under Term Loan B in consecutive equal monthly principal payments in the amount of $18,000 until May 1, 2020, and at that time, all principal, accrued unpaid interest and other charges outstanding under Term Loan B shall be due and payable in full. The interest rate on Term Loan B, after consideration of the related interest rate swap agreement, effective November 3, 2014, converted to a fixed rate per annum of 3.07%. The fair value of the interest rate swap derivatives were $5,000 and $62,000 at April 30, 2018 and 2017, respectively. Scheduled annual principal payments for the term loans are $1,167,000, $1,167,000 and $97,000 for fiscal years 2019, 2020, and 2021, respectively. Term Loan A and Term Loan B are secured by liens against certain machinery and equipment.

At April 30, 2018, there were bank guarantees issued by foreign banks outstanding to customers in the amount of $1,625,000, $21,000, $1,000, and $63,000 with expiration dates in fiscal years 2019, 2020, 2021 and 2023, respectively, collateralized by a $5.0 million letter of credit under the Line of Credit and certain assets of the Company s subsidiaries in India. The Loan Agreement includes financial covenants with respect to certain ratios, including (a) senior funded debt to EBITDA, (b) fixed charge coverage, and (c) asset coverage. At April 30, 2018, the Company was in compliance with all of the financial covenants.

At April 30, 2017, there were advances of $3.5 million and $4.2 million in letters of credit outstanding under the Line of Credit. The borrowing rate at that date was 2.50%. At April 30, 2017, there were foreign bank guarantees outstanding to customers in the amount of $1,403,000, $112,000 and $117,000 with expiration dates in fiscal years 2018, 2019, and 2020, respectively. At April 30, 2017, the Company was in compliance with all of the financial covenants.

Amounts outstanding under the term loans were as follows as of April 30:

$ in thousands	**2018**	2017
Term Loan A payable	**$ 1,970**	$ 2,667
Term Loan B payable	**461**	682
Less: current portion	**(1,167)**	(918)

Long-term debt	**$ 1,264**	$ 2,431

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Note 4 Income Taxes

On December 22, 2017, the Tax Cuts and Jobs Act (the 2017 Tax Act) was signed into law. The 2017 Tax Act includes a broad range of tax reform provisions affecting businesses, including lower corporate tax rates, changes in business deductions, and international tax provisions. In response to the 2017 Tax Act, the U.S. Securities and Exchange Commission staff issued Staff Accounting Bulletin No. 118 (SAB 118) to address the application of U.S. GAAP in situations where a registrant does not have the necessary information available, prepared, or analyzed (including computations) in reasonable detail to complete the accounting for certain income tax effects of the 2017 Tax Act. SAB 118 provides that the measurement period is complete when a company s accounting is complete and that the measurement period shall not extend beyond one year from the enactment date. SAB 118 provides guidance for registrants under three scenarios: (i) measurement of certain income tax effects is complete, (ii) measurement of certain income tax effects can be reasonably estimated, and (iii) measurement of certain income tax effects cannot be reasonably estimated.

The 2017 Tax Act lowered the federal statutory tax rate from 35% to 21%. As the Company has a fiscal year ending April 30, it is subject to a blended tax rate for the 2018 fiscal year. Therefore, a blended rate of 29.73% was computed as the federal statutory rate for fiscal year 2018.

The Company has analyzed the income tax effects of the 2017 Tax Act and determined that measurement of the income tax effects can be reasonably estimated, and, as such, provisional amounts have been recorded. The Company believes that all provisional amounts reflected in its financial statements are based on the best estimates that can be made at this time. The Company will continue to analyze all impacts of the 2017 Tax Act and will update provisional amounts as required.

In accordance with ASC 740, Income Taxes , which requires deferred taxes to be re-measured in the year of an income tax rate change, the Company recorded a deferred income tax expense of $680,000 for the year ended April 30, 2018 as a result of applying a lower U.S. federal income tax rate to the Company s net deferred tax assets. The Company revalued the U.S. deferred tax balances based on the tax rates effective for the following fiscal year at the new federal rate of 21% for amounts that did not reverse during the 2018 fiscal year and revalued the deferred tax balances that reversed in the 2018 fiscal year at the Company s 2018 fiscal year statutory rate of 33.33%.

The 2017 Tax Act also includes a one-time transition tax on accumulated unrepatriated foreign earnings. For the year ended April 30, 2018, the Company recorded a provisional income tax expense of $649,000 on accumulated unrepatriated foreign earnings, including foreign earnings through December 31, 2017. In addition, the Company has not yet completed the calculation of the related income tax pools for all of its foreign subsidiaries. The Company anticipates additional future impacts at a U.S., state and local tax level related to the 2017 Tax Act as statutory and interpretive guidance continues to become available from applicable tax authorities needed to record the complete tax expense. For the year ended April 30, 2018, the Company included federal and state provisional income tax expense based on available statutory and interpretive guidance on the provisions of the tax laws that were in effect at April 30, 2018.

The Company is entitled to elect to pay the one-time transition tax over a period of eight years. The Company intends to make this election and has recorded $546,000 of the provisional expense as other non-current liabilities in the Company s Consolidated Balance Sheet for April 30, 2018. No additional income taxes have been provided for any remaining undistributed foreign earnings not subject to the transition tax, or any additional outside basis difference inherent in these entities, as these amounts continue to be indefinitely reinvested in foreign operations.

The Company is currently in the process of evaluating the new Global Intangible Low-Taxed Income (GILTI) provisions and has not yet elected an accounting policy with respect to whether to reflect GILTI in its deferred tax calculations or not. Therefore, the Company has not made any adjustments related to the GILTI tax in its consolidated financial statements. Under the SEC guidance noted above, the Company will continue to analyze and assess the effects of the GILTI provisions of the Act.

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Income tax expense consisted of the following:

$ in thousands	**2018**	2017	2016
Current tax expense:			
Federal	**$ 1,719**	$ 891	$ 974
State and local	**311**	120	117
Foreign	**1,414**	1,467	1,122
Total current tax expense	**3,444**	2,478	2,213
Deferred tax expense (benefit):			
Federal	**401**	(108)	(431)
State and local	**28**	24	98
Foreign	**242**	(268)	(18)
Total deferred tax expense (benefit)	**671**	(352)	(351)
Net income tax expense	**$ 4,115**	$ 2,126	$ 1,862

The reasons for the differences between the above net income tax expense and the amounts computed by applying the statutory federal income tax rate to earnings before income taxes are as follows:

$ in thousands	**2018**	2017	2016
Income tax expense at statutory rate	**$ 2,818**	$ 2,294	$ 1,952
State and local taxes, net of federal income tax benefit (expense)	**162**	100	102
Tax credits (state, net of federal benefit)	**(370)**	(110)	(407)
Effects of differing US and foreign tax rates	**(97)**	(7)	173
Rate reduction impact on deferred tax assets	**680**		
Federal and state transition tax on unrepatriated foreign earnings	**649**		
Increase (decrease) in valuation allowance	**175**	82	(10)
Other items, net	**98**	(233)	52
Net income tax expense	**$ 4,115**	$ 2,126	$ 1,862

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Significant items comprising deferred tax assets and liabilities as of April 30 were as follows:

$ in thousands	**2018**	2017
Deferred tax assets:		
Accrued employee benefit expenses	**$ 418**	$ 549
Allowance for doubtful accounts	**41**	67
Deferred compensation	**1,205**	1,792
Tax credits	**221**	208
Unrecognized actuarial loss, defined benefit plans	**1,825**	3,223
Inventory Reserves	**378**	360
Net operating loss carryforwards	**261**	224
Other	**79**	113
Total deferred tax assets	**4,428**	6,536
Deferred tax liabilities:		
Book basis in excess of tax basis of property, plant and equipment	**(1,043)**	(1,600)
Prepaid pension	**(1,093)**	(1,696)
Total deferred tax liabilities	**(2,136)**	(3,296)
Less: valuation allowance	**(261)**	(82)
Net deferred tax assets	**$ 2,031**	$ 3,158
Deferred tax assets classified in the balance sheet:		
Non-current	**2,031**	3,158
Net deferred tax assets	**$ 2,031**	$ 3,158

Unremitted earnings of subsidiaries outside the United States are considered to be reinvested indefinitely at April 30, 2018. It is not practicable to determine the deferred tax liability for temporary differences related to those unremitted earnings. At April 30, 2018, the Company had state tax credit carryforwards in the amount of $221,000, net of federal benefit, expiring beginning in 2018. At April 30, 2018, the Company had $1,240,000 gross net operating losses in jurisdictions outside of the United States, of which $624,000 is set to expire in years 2020 to 2023. After a review of the expiration schedule of the net operating loss carryforwards and future taxable income required to utilize such carryforwards before their expiration, the Company recorded an additional valuation allowance of $175,000 at April 30, 2018. The Company files federal, state and local tax returns with statutes of limitation generally ranging from 3 to 4 years. The Company is generally no longer subject to federal tax examinations for years prior to fiscal year 2014 or state and local tax examinations for years prior to fiscal year 2013. Tax returns filed by the Company s significant foreign subsidiaries are generally subject to statutes of limitations of 3 to 7 years and are generally no longer subject to examination for years prior to fiscal year 2012.

Note 5 Stock Options and Share-Based Compensation

The Company adopted ASU 2016-9, Stock Compensation Improvements to Employee Share-Based Payment Accounting standard prospectively effective May 1, 2017. Prior periods were not retrospectively adjusted. The Company elected prospectively to account for forfeitures as they occur rather than apply an estimated rate to share-based compensation expense.

The stockholders approved the 2017 Omnibus Incentive Plan (2017 Plan) on August 30, 2017, which enables the Company to grant a broad range of equity, equity-related, and non-equity types of awards, with potential recipients including directors, consultants and employees. This plan replaces the 2010 Stock Option Plan for Directors and the 2008 Key Employee Stock Option Plan. No new awards will be granted under the prior plans.

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All outstanding options granted under the prior plans will remain subject to the prior plans. At the date of approval of the 2017 Plan there were 280,100 shares available for issuance under the prior plans. These shares and any outstanding awards that subsequently cease to be subject to such awards are available under the 2017 Plan. The 2017 Plan did not increase the total number of shares available for issuance under the Company s equity compensation plans. At April 30, 2018 there were 263,942 shares available for future issuance.

The Company issued restricted stock units (RSUs) under the 2017 Plan and recorded stock-based compensation expense of $141,000 during fiscal year 2018 in accordance with ASC 718, Compensation Stock Compensation. The RSUs include both a service and performance component vesting over a three year period. The recognized expense is based upon the vesting period for service criteria and estimated attainment of the performance criteria at the end of the three year period based on the ratio of cumulative days incurred to total days over the three year period. The remaining estimated compensation expense of $394,000 will be recorded over the remaining two year period.

The stockholders approved the 2010 Stock Option Plan for Directors (2010 Plan) in fiscal year 2011 which allowed the Company to grant options on an aggregate of 100,000 shares of the Company s common stock. Under this plan, each eligible director was granted options to purchase 10,000 shares at the fair market value at the date of grant for a term of five years. These options are exercisable in four equal installments, one-fourth becoming exercisable on the next August 1 following the date of grant, and one-fourth becoming exercisable on August 1 of each of the next three years. At April 30, 2018, there were no shares available for future grants under the 2010 Plan.

The stockholders approved the 2008 Key Employee Stock Option Plan (2008 Plan) in fiscal year 2009 which allowed the Company to grant options on an aggregate of 300,000 shares of the Company s common stock. On August 26, 2015, the stockholders approved an amendment to this plan to increase the number of shares available under the 2008 Plan by 300,000. Under the plan, options were granted at not less than the fair market value at the date of grant and options are exercisable in such installments, for such terms (up to 10 years), and at such times, as the Board of Directors may determine at the time of the grant. At April 30, 2018, there were no shares available for future grants under the 2008 Plan.

The Company recorded stock-based compensation expense in accordance with ASC 718. In order to determine the fair value of stock options on the date of grant, the Company applied the Black-Scholes option pricing model. Inherent in the model are assumptions related to expected stock-price volatility, option life, risk-free interest rate, and dividend yield. The Company did not grant any stock options during fiscal year 2018. For stock options granted during the fiscal years 2017 and 2016, the Company believes that its historical share option experience does not provide a reasonable basis upon which to estimate expected term. The stock options granted have the plain-vanilla characteristics as defined in SEC Staff Accounting Bulletin No. 107 (SAB 107). The Company utilized the Safe Harbor option Simplified Method to determine the expected term of these options in accordance with the guidance of SAB 107 for options granted. The Company intends to continue to utilize the Simplified Method for future grants in accordance with the guidance of SAB 110 until such time that the Company believes that its historical share option experience will provide a reasonable basis to estimate expected term. The fair value of the options granted as shown below was estimated using the Black-Scholes model with the following assumptions:

	2017 2008 Plan	2016 2008 Plan
Options granted	45,200	40,200
Weighted average expected stock price volatility	29.17%	30.45%

Expected option life	6.25 years	6.25 years
Average risk-free interest rate	2.10%	1.97%
Average dividend yield	3.00%	2.78%
Estimated fair value of each option	$ 5.04	$ 3.97

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The stock-based compensation expense is recorded over the vesting period (4 years) for the options granted, net of tax. The Company recorded $172,000, $199,000 and $192,000 of compensation expense and $42,000, $74,000 and $72,000 deferred income tax benefit in fiscal years 2018, 2017 and 2016, respectively. The remaining compensation expense of $209,000 and deferred income tax benefit of $51,000 will be recorded over the remaining vesting periods.

The Company issued new shares of common stock and treasury stock to satisfy options exercised during fiscal years 2018, 2017 and 2016. Stock option activity and weighted average exercise price are summarized as follows:

	2018		2017		2016	
	Number of Shares	**Weighted Average Exercise Price**	Number of Shares	Weighted Average Exercise Price	Number of Shares	Weighted Average Exercise Price
Outstanding at beginning of year	**180,350**	**$ 17.29**	185,375	$ 14.68	239,575	$ 13.24
Granted			45,200	22.92	40,200	16.92
Canceled	**(6,300)**	**19.09**	(150)	10.64	(10,400)	16.37
Exercised	**(36,800)**	**14.31**	(50,075)	12.72	(84,000)	11.44
Outstanding at end of year	**137,250**	**$ 18.01**	180,350	$ 17.29	185,375	$ 14.68
Exercisable at end of year	**79,100**	**$ 16.28**	78,650	$ 14.22	92,075	$ 12.83

The number of options outstanding, exercisable, and their weighted average exercise prices were within the following ranges at April 30, 2018:

	Exercise Price Range	
	$8.59-$11.78	**$15.85-$23.62**
Options outstanding	**17,550**	**119,700**
Weighted average exercise price	**$ 11.35**	**$ 18.98**
Weighted average remaining contractual life	**4.03 years**	**6.68 years**
Aggregate intrinsic value	**$ 414,000**	**$ 1,911,000**
Options exercisable	**17,550**	**61,550**
Weighted average exercise price	**$ 11.35**	**$ 17.69**
Aggregate intrinsic value	**$ 414,000**	**$ 1,062,000**

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Note 6 Accumulated Other Comprehensive Income (Loss)

The Company s other comprehensive income (loss) consists of unrealized gains and losses on the translation of the assets, liabilities, and equity of its foreign subsidiaries, changes in the fair value of its cash flow hedges, and additional minimum pension liability adjustments, net of income taxes. The before tax income (loss), related income tax effect, and accumulated balances are as follows:

$ in thousands	**Cash Flow Hedges**	**Foreign Currency Translation Adjustment**	**Minimum Pension Liability Adjustment**	**Total Accumulated Other Comprehensive Income (Loss)**
Balance at April 30, 2015	(127)	(1,011)	(6,742)	(7,880)
Effect of changes in tax rates	1		88	89
Foreign currency translation adjustment		(217)		(217)
Change in fair value of cash flow hedges	37			37
Change in unrecognized actuarial loss on pension obligations			716	716
Income tax effect	(15)		(356)	(371)
Balance at April 30, 2016	(104)	(1,228)	(6,294)	(7,626)
Effect of changes in tax rates	1		30	31
Foreign currency translation adjustment		231		231
Change in fair value of cash flow hedges	104			104
Change in unrecognized actuarial loss on pension obligations			1,609	1,609
Income tax effect	(41)		(627)	(668)
Balance at April 30, 2017	(40)	(997)	(5,282)	(6,319)
Effect of changes in tax rates	**3**		**996**	**999**
Foreign currency translation adjustment		**(430)**		**(430)**
Change in fair value of cash flow hedges	**57**			**57**
Change in unrecognized actuarial loss on pension obligations			**(586)**	**(586)**
Income tax effect	**(23)**		**402**	**379**
Balance at April 30, 2018	**$ (3)**	**$ (1,427)**	**$ (4,470)**	**$ (5,900)**

Note 7 Commitments and Contingencies

The Company leases both its primary distribution facility and warehouse facility under non-cancelable operating leases. The Company also leases some of its machinery and equipment under non-cancelable operating leases. Most of these leases provide the Company with renewal and purchase options, and most leases of machinery and equipment have certain early cancellation rights. Rent expense for these operating leases was $2,340,000, $2,225,000 and $2,283,000 in fiscal years 2018, 2017, and 2016, respectively. Future minimum payments under the above

non-cancelable lease arrangements for the years ending April 30 are as follows:

$ in thousands	**Operating**
2019	$ 1,190
2020	995
2021	787
2022	538
2023	316
Total minimum lease payments	$ 3,826

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The Company is involved in certain claims and legal proceedings in the normal course of business which management believes will not have a material adverse effect on the Company s consolidated financial condition or results of operations.

Note 8 Retirement Benefits

Defined Benefit Plans

The Company has non-contributory defined benefit pension plans covering some of its domestic employees. These plans were amended as of April 30, 2005, no further benefits have been, or will be, earned under the plans, subsequent to the amendment date, and no additional participants will be added to the plans. The defined benefit plan for salaried employees provides pension benefits that are based on each employee s years of service and average annual compensation during the last 10 consecutive calendar years of employment as of April 30, 2005. The benefit plan for hourly employees provides benefits at stated amounts based on years of service as of April 30, 2005. The Company uses an April 30 measurement date for its defined benefit plans. The change in projected benefit obligations and the change in fair value of plan assets for the non-contributory defined benefit pension plans for each of the years ended April 30 are summarized as follows:

$ in thousands	**2018**	2017
Accumulated Benefit Obligation, April 30	**$ 21,544**	$ 21,313
Change in Projected Benefit Obligations		
Projected benefit obligations, beginning of year	**$ 21,313**	$ 21,156
Interest cost	**875**	927
Actuarial loss	**480**	299
Actual benefits paid	**(1,124)**	(1,069)
Projected benefit obligations, end of year	**21,544**	21,313
Change in Plan Assets		
Fair value of plan assets, beginning of year	**17,198**	15,817
Actual return on plan assets	**1,866**	1,895
Employer contributions	**600**	555
Actual benefits paid	**(1,124)**	(1,069)
Fair value of plan assets, end of year	**18,540**	17,198
Funded status under	**$ (3,004)**	$ (4,115)
Amounts Recognized in the Consolidated Balance Sheets consist of:		
Noncurrent liabilities	**$ (3,004)**	$ (4,115)

Amounts recognized in accumulated other comprehensive income (loss) consist of:				
Net actual loss	**$**	**7,481**	$	8,686
Deferred tax benefit		**(1,825)**		(3,223)
After-tax actuarial loss	**$**	**5,656**	$	5,463

Weighted-Average Assumptions Used to Determine Benefit Obligations at April 30		
Discount rate	**4.10%**	4.10%
Rate of compensation increase	**N/A**	N/A
Mortality table	**RP-2014**	RP-2014
Projection scale	**MP-2017**	MP-2016

$ in thousands	2018	2017
Weighted-Average Assumptions Used to Determine Net Periodic Benefit Cost for Years Ended April 30		
Discount rate	**4.10%**	4.50%
Expected long-term return on plan assets	**7.75%**	8.00%
Rate of compensation increase	**N/A**	N/A

The components of the net periodic pension cost for each of the fiscal years ended April 30 are as follows:

$ in thousands	2018	2017	2016
Interest cost	**$ 875**	$ 927	$ 912
Expected return on plan assets	**(1,314)**	(1,244)	(1,363)
Recognition of net loss	**1,133**	1,257	1,223
Net periodic pension cost	**$ 694**	$ 940	$ 772

The estimated net actuarial loss for the defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost during fiscal year 2019 is $910,000.

The Company s funding policy is to contribute to the plans when pension laws and economics either require or encourage funding. Contributions for fiscal year 2019 are anticipated to be $1,000,000. Contributions of $600,000 and $555,000 were made to the plan in fiscal years 2018 and 2017, respectively.

The following benefit payments are expected to be paid from the benefit plans in the fiscal years ending April 30:

$ in thousands	Amount
2019	$ 1,330
2020	1,360
2021	1,410
2022	1,430
2023	1,450
2024 & Beyond	7,250

The expected long-term portfolio return is established via a building block approach with proper consideration of diversification and rebalancing. Historical markets are studied and long-term historical relationships between equities and fixed-income securities are preserved consistent with the widely accepted capital market principle that assets with higher volatility generate a greater return over the long-term. Current market factors such as inflation and interest rates are evaluated before long-term capital market assumptions are determined. Peer data and historical returns are also reviewed to check for reasonableness and appropriateness.

The Company uses a Yield Curve methodology to determine its GAAP discount rate. Under this approach, future benefit payment cash flows are projected from the pension plan on a projected benefit obligation basis. The payment stream is discounted to a present value using an interest rate applicable to the timing of each respective cash flow. The graph of these time-dependent interest rates is known as a yield curve. The interest rates comprising the Yield Curve are determined through a statistical analysis performed by the IRS and issued each month in the form of a pension

discount curve. For this purpose, the universe of possible bonds consists of a set of bonds which are designated as corporate, have high quality ratings (AAA or AA) from nationally recognized statistical rating organizations, and have at least $250 million in par amount outstanding on at least one day during the reporting period. A 1% increase/decrease in the discount rate for fiscal years 2018 and 2017 would decrease/increase pension expense by approximately $243,000 and $240,000, respectively.

The Company uses a total return investment approach, whereby a mix of equities and fixed-income investments are used to attempt to maximize the long-term return on plan assets for a prudent level of risk. Risk tolerance is

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established through careful consideration of plan liabilities, plan funded status, and corporate financial condition. The investment portfolio contains a diversified blend of equity and fixed-income investments. Furthermore, equity investments are diversified across U.S. and non-U.S. stocks, as well as growth, value, and small and large capitalizations. The target allocations based on the Company s investment policy were 75% in equity securities and 25% in fixed-income securities at April 30, 2018 and April 30, 2017. A 1% increase/decrease in the expected return on assets for fiscal years 2018 and 2017 would decrease/increase pension expense by approximately $170,000 and $152,000, respectively.

Plan assets by asset categories as of April 30 were as follows:

$ in thousands	**2018**		2017	
Asset Category	**Amount**	**%**	Amount	%
Equity Securities	**$ 9,643**	**52**	$ 10,611	62
Fixed Income Securities	**4,599**	**25**	6,466	37
Cash and Cash Equivalents	**4,298**	**23**	121	1
Totals	**$ 18,540**	**100**	$ 17,198	100

The following tables present the fair value of the assets in our defined benefit pension plans at April 30:

		2018	
Asset Category	**Level 1**	**Level 2**	**Level 3**
Large Cap	**$ 4,929**	$	$
Small/Mid Cap	**2,405**		
International	**1,889**		
Fixed Income	**4,599**		
Liquid Alternatives	**420**		
Cash and Cash Equivalents	**4,298**		
Totals	**$ 18,540**	$	$

		2017	
Asset Category	Level 1	Level 2	Level 3
Large Cap	$ 8,060	$	$
Small/Mid Cap	1,728		
International	823		
Fixed Income	6,466		
Cash and Cash Equivalents	121		
Totals	$ 17,198	$	$

Level 1 retirement plan assets include United States currency held by a designated trustee and equity funds of common and preferred securities issued by domestic and foreign corporations. These equity funds are traded actively on exchanges and price quotes for these shares are readily available.

Defined Contribution Plan

The Company has a defined contribution plan covering substantially all domestic salaried and hourly employees. The plan provides benefits to all employees who have attained age 21, completed three months of service, and who elect to participate. The plan provides that the Company make matching contributions equal to 100% of the employee s qualifying contribution up to 3% of the employee s compensation, and make matching contributions equal to 50% of the employee s contributions between 3% and 5% of the employee s compensation, resulting in

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a maximum employer contribution equal to 4% of the employee s compensation. Additionally, the plan provides that the Company may elect to make a non-matching contribution for participants employed by the Company on December 31 of each year. The Company included 1% of the participant s qualifying compensation in the annual contributions to the plan in fiscal years 2018, 2017 and 2016 of $1,159,000, $1,118,000 and $1,057,000, respectively.

Note 9 Segment Information

The Company s operations are classified into two business segments: Domestic and International. The Domestic business segment principally designs, manufactures, and installs scientific and technical furniture, including steel and wood laboratory cabinetry, fume hoods, laminate casework, flexible systems, worksurfaces, workstations, workbenches, and computer enclosures. The International business segment, which consists of six foreign subsidiaries as identified in Note 1, provides the Company s products and services, including facility design, detailed engineering, construction, and project management from the planning stage through testing and commissioning of laboratories.

Intersegment transactions are recorded at normal profit margins. All intercompany balances and transactions have been eliminated. Certain corporate expenses shown below have not been allocated to the business segments.

The following table shows revenues, earnings, and other financial information by business segment for each of the three years ended April 30:

$ in thousands	Domestic	International	Corporate	Total
Fiscal Year 2018				
Revenues from external customers	**$ 114,594**	**$ 43,456**	**$**	**$ 158,050**
Intersegment revenues	**11,333**	**4,104**	**(15,437)**	
Depreciation	**2,532**	**229**		**2,761**
Earnings (loss) before income taxes	**10,732**	**4,986**	**(6,238)**	**9,480**
Income tax expense (benefit)	**5,892**	**1,656**	**(3,433)**	**4,115**
Net earnings attributable to noncontrolling interest		**177**		**177**
Net earnings (loss) attributable to Kewaunee Scientific Corporation	**4,840**	**3,153**	**(2,805)**	**5,188**
Segment assets	**60,879**	**23,479**		**84,358**
Expenditures for segment assets	**2,826**	**569**		**3,395**
Revenues (excluding intersegment) from customers in foreign countries	**1,468**	**43,456**		**44,924**
Fiscal Year 2017				
Revenues from external customers	$ 113,081	$ 25,477	$	$ 138,558
Intersegment revenues	4,463	3,691	(8,154)	
Depreciation	2,478	224		2,702
Earnings (loss) before income taxes	8,221	3,507	(4,982)	6,746
Income tax expense (benefit)	2,522	1,199	(1,595)	2,126
Net earnings attributable to noncontrolling interest		105		105
Net earnings (loss) attributable to Kewaunee Scientific Corporation	5,699	2,203	(3,387)	4,515
Segment assets	57,246	23,670		80,916
Expenditures for segment assets	2,572	39		2,611

Revenues (excluding intersegment) from customers in foreign countries	1,568	25,477	27,045

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$ in thousands	Domestic	International	Corporate	Total
Fiscal Year 2016				
Revenues from external customers	$ 103,047	$ 25,579	$	$ 128,626
Intersegment revenues	3,612	3,309	(6,921)	
Depreciation	2,375	217		2,592
Earnings (loss) before income taxes	7,471	2,738	(4,470)	5,739
Income tax expense (benefit)	1,834	1,104	(1,076)	1,862
Net earnings attributable to noncontrolling interest		75		75
Net earnings (loss) attributable to Kewaunee Scientific Corporation	5,637	1,559	(3,394)	3,802
Segment assets	54,030	18,375		72,405
Expenditures for segment assets	1,995	192		2,187
Revenues (excluding intersegment) from customers in foreign countries	1,794	25,579		27,373

Note 10 Purchase of Noncontrolling Interest

On June 24, 2013, the Company entered into an Agreement (the Agreement) whereby it purchased the 49% minority ownership of its subsidiary, Kewaunee Labway Asia Pte. Ltd. (the Subsidiary) for a total purchase price of $3,555,000. The purchase was recorded in the consolidated balance sheet as a $1,874,000 reduction in retained earnings, a $1,681,000 reduction in noncontrolling interest, an increase of other current accrued expenses of $887,500, and an increase of other non-current liabilities of $887,500. On the date of the Agreement, the Company paid cash of $1,780,000 to the minority stockholder. In June 2014, the Company paid the second installment of $887,500. The final installment of $887,500 was paid in June 2015. The Subsidiary and its subsidiary in India, Kewanee Labway India Pvt. Ltd., serve as the Company s principal sales and distribution organization for sales to international customers.

Note 11 Consolidated Quarterly Data (Unaudited)

Selected quarterly financial data for fiscal years 2018 and 2017 were as follows:

$ in thousands, except per share amounts	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
Fiscal Year 2018				
Net sales	**$ 33,881**	**$ 41,471**	**$ 38,190**	**$ 44,508**
Gross profit	**6,821**	**7,911**	**8,354**	**8,934**
Net earnings	**1,192**	**1,765**	**918**	**1,490**
Less: net earnings attributable to the noncontrolling interest	**44**	**41**	**35**	**57**
Net earnings attributable to Kewaunee Scientific Corporation	**1,148**	**1,724**	**883**	**1,433**
Net earnings per share attributable to Kewaunee Scientific Corporation				
Basic	**0.42**	**0.64**	**0.32**	**0.53**
Diluted	**0.42**	**0.62**	**0.31**	**0.52**
Cash dividends paid per share	**0.15**	**0.17**	**0.17**	**0.17**
Fiscal Year 2017				
Net sales	$ 37,279	$ 36,329	$ 30,371	$ 34,579

Gross profit	7,139	7,104	5,032	7,332
Net earnings	1,330	1,537	358	1,395
Less: net earnings attributable to the noncontrolling interest	30	51	17	7
Net earnings attributable to Kewaunee Scientific Corporation	1,300	1,486	341	1,388
Net earnings per share attributable to Kewaunee Scientific Corporation				
Basic	0.48	0.55	0.13	0.51
Diluted	0.48	0.54	0.13	0.51
Cash dividends paid per share	0.13	0.15	0.15	0.15

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CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We hereby consent to the incorporation by reference in the Registration Statements on Form S-8 (No. 333-98963, No. 333-160276, No. 333-176447, No. 333-213413, and No. 333-220389) of Kewaunee Scientific Corporation of our report dated July 21, 2016 relating to the consolidated financial statements which report appears in this Form 10-K.

/s/ CHERRY BEKAERT LLP

Charlotte, North Carolina

July 20, 2018

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in the Registration Statements (Form S-8 No. 333-98963, No. 333-160276, No. 333-176447, No. 333-213413, and No. 333-220389), of our report dated July 20, 2018 with respect to the consolidated financial statements of Kewaunee Scientific Corporation, included in this Annual Report (Form 10-K) for the year ended April 30, 2018.

/s/ ERNST & YOUNG LLP

Charlotte, North Carolina

July 20, 2018

Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure

None

Item 9A. Controls and Procedures

Conclusion Regarding the Effectiveness of Disclosure Controls and Procedures

We maintain disclosure controls and procedures that are intended to ensure that the information required to be disclosed in our filings under the Securities Exchange Act of 1934 (the Exchange Act) is properly and timely recorded, processed, summarized, and reported. Our management, including the Chief Executive Officer and Chief Financial Officer, have conducted an evaluation of the effectiveness of disclosure controls and procedures as of April 30, 2018 pursuant to Exchange Act Rule 13a-14. Based on that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that the disclosure controls and procedures are effective to provide reasonable assurance that we are able to collect, process, record, and disclose, within the required time periods, the information we are required to disclose in the reports filed with the Securities and Exchange Commission. In designing disclosure controls and procedures, we recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving desired control objectives, and that management necessarily is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Nevertheless, we believe that our disclosure controls and procedures are effective.

As disclosed under Item 9A. Controls and Procedures in our Annual Report on Form 10-K for the year ended April 30, 2017, management identified a material weakness in internal control over financial reporting relating to the

misapplication of certain aspects of the Company s multi-element and percentage of completion revenue recognition policies.

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The Company has implemented changes to the design of its controls and procedures surrounding the execution of the Company s multi-element and percentage of completion revenue recognition policies, which included, but were not limited to, drafting additional policy guidance, training key personnel and developing additional detective and monitoring controls. As of April 30, 2018, management has concluded, through testing, that these controls are operating effectively and the material weakness remediated.

In addition, as disclosed in the Company s Form 10-Q for the period ended October 31, 2017, on December 7, 2017, the Company experienced a criminal network cyber-attack that led to a disruption of its domestic operations, including manufacturing, engineering, administration, and sales operations. The Company engaged a leading cybersecurity firm to perform a forensic investigation of this attack and as a result of the investigation has identified a material weakness in its logical access control over its IT systems. As of April 30, 2018, management has concluded, through testing, that these controls are operating effectively and the material weakness remediated.

Management s Report on Internal Control Over Financial Reporting

Management is responsible for establishing and maintaining adequate internal control over financial reporting for the Company. 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 accounting principles generally accepted in the United States. Management conducted an evaluation of the effectiveness of internal control over financial reporting based on the framework in *Internal Control Integrated Framework (2013)* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Based on this evaluation, Management concluded the Company maintained effective internal control over financial reporting as of April 30, 2018.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. In addition, 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.

This annual report does not include an attestation report of our registered public accounting firm regarding internal control over financial reporting. Management s report was not subject to attestation by our registered public accounting firm pursuant to rules of the Securities and Exchange Commission that permit us to provide only management s report in this Annual Report.

Changes in Internal Control Over Financial Reporting

There have been no significant changes in our internal controls over financial reporting, other than those implemented to remediate the aforementioned material weakness in the Company s logical access control over its IT systems, that occurred during our fourth fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Item 9B. Other Information

None.

PART III

Item 10. Directors, Executive Officers and Corporate Governance

(a) The information appearing in the sections entitled Election of Directors and Meetings and Committees of the Board included in our Proxy Statement for use in connection with our annual

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meeting of stockholders to be held on August 29, 2018 (the Proxy Statement) is incorporated herein by reference. The Proxy Statement will be filed with the SEC within 120 days of our most recently completed fiscal year.

(b) The names and ages of our executive officers as of June 30, 2018 and their business experience during the past five years are set forth below:

Executive Officers

Name	Age	Position
David M. Rausch	59	President and Chief Executive Officer
Thomas D. Hull III	42	Vice President, Finance, Chief Financial Officer, Treasurer and Secretary
Dana L. Dahlgren	62	Vice President, Sales and Marketing Americas
Elizabeth D. Phillips	41	Vice President, Human Resources
Kurt P. Rindoks	60	Vice President, Product Development and International Sourcing
Michael G. Rok	52	Vice President, Manufacturing Operations
Boopathy Sathyamurthy	49	Vice President, Kewaunee Scientific Corporation Singapore Pte. Ltd. Managing Director, International Operations

David M. Rausch has served as President and Chief Executive Officer since July 1, 2013. He joined the Company in March 1994 as Manager of Estimating and was promoted to Southeast Regional Sales Manager in December 1996, then to Director of Sales for Network Storage Systems products in May 2000. In August 2001, he was promoted to Project Sales Manager, and in this position, he also had direct management responsibility for the Estimating Department. Mr. Rausch was elected Director of Contract Management in June 2004 and elected Vice President of Construction Services in June 2007. In June 2011, he was elected Senior Vice President of Construction Services and General Manager of the Laminate Furniture Division, and in March 2012, he was elected President and Chief Operating Officer.

Thomas D. Hull III joined the Company in November 2015 as Vice President, Finance, Chief Financial Officer, Treasurer and Secretary. Mr. Hull held several management positions with Ernst & Young, LLP in Pittsburgh, Pennsylvania from 1998 through 2011. From 2011, he served as the Vice President of Finance, Accounting, and Information Technology with ATI Specialty Materials in Charlotte, North Carolina.

Dana L. Dahlgren joined the Company in November 1989 as a Regional Sales Manager and was promoted to Director of Sales and Marketing of the Laboratory Products Group in September 1998. Mr. Dahlgren was elected Vice President of Sales and Marketing of the Laboratory Products Group in June 2004 and was elected Vice President of Sales and Marketing Americas in April 2014.

Elizabeth D. Phillips joined the Company in August 2006 as Human Resources and Training Manager. She was promoted to Director of Human Resources in June 2007 and was elected Vice President of Human Resources in June 2009. Prior to joining the Company, she was Director of Human Resources for Vanguard Furniture Co., Inc., a manufacturer of household furniture, from April 2004 until August 2006.

Kurt P. Rindoks joined the Company in January 1985 as an engineer. He was promoted to Director of Product Development in August 1991 and assumed the additional responsibilities of Director of Engineering in July 1995. He has served as Vice President of Engineering and Product Development since September 1996. Since 2004 he has headed the Company s international sourcing efforts and in October 2016 was named Vice President Engineering and International Sourcing. Additionally, from May 1998 through October 2001, he served as General Manager of the Company s Resin Materials Division.

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Michael G. Rok joined the Company in May 2016 as Vice President of Manufacturing Operations. Prior to joining the Company, Mr. Rok worked for Danaher Corporation from March 2002 to April 2016, serving in various Manufacturing/Operations leadership roles for the KaVo Kerr Group and Veeder-Root Company. Mr. Rok most recently served as the Vice President of Operations, North American for KaVo Kerr Group.

Boopathy Sathyamurthy was elected Vice President of Kewaunee Scientific Corporation Singapore Pte. Ltd., the holding company for Kewaunee s subsidiaries in India, Singapore, and China, in September 2014. He has served as Managing Director of International Operations, which includes responsibilities for all sales and operations in Asia, as well as sales efforts in the Middle East, since September 2013. Mr. Sathyamurthy joined the Kewaunee organization in 2000 as General Manager of India Operations and Kewaunee Labway India Pvt. Ltd. He was subsequently promoted to Managing Director of Kewaunee Labway India Pvt. Ltd. and Kewaunee Scientific Corporation India Pvt. Ltd.

Section 16(a) Beneficial Ownership Reporting Compliance

The information appearing in the section entitled Securities Ownership of Certain Beneficial Owners Section 16(a) Beneficial Ownership Reporting Compliance in the Proxy Statement is incorporated herein by reference.

Code of Ethics

A copy of our code of ethics that applies to our Chief Executive Officer and Chief Financial Officer, entitled Ethics Obligations for Chief Executive Officer and Employees with Financial Reporting Responsibilities, is available free of charge through our website at **www.kewaunee.com**.

Audit Committee

The information appearing in the section entitled Election of Directors Meetings and Committees of the Board in our Proxy Statement is incorporated herein by reference.

Item 11. Executive Compensation

The information appearing in the sections entitled Compensation Discussion and Analysis, Compensation Tables, Agreements with Certain Executives, and Election of Directors Compensation Committee Interlocks and Insider Participation in the Proxy Statement is incorporated herein by reference.

Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters

The information appearing in the sections entitled Security Ownership of Directors and Executive Officers and Security Ownership of Certain Beneficial Owners in the Proxy Statement is incorporated herein by reference.

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The following table sets forth certain information as of April 30, 2018 with respect to compensation plans under which our equity securities are authorized for issuance:

Plan Category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity Compensation Plans approved by Security Holders:			
2008 Key Employee Stock Option Plan	127,250	$ 18.13	
2010 Stock Option Plan for Directors	10,000	$ 16.48	
2017 Omnibus Incentive Plan	23,907		263,942
Equity Compensation Plans not approved by Security Holders:			

Refer to Note 5 of the Company s consolidated financial statements for additional information.

Item 13. Certain Relationships and Related Transactions, and Director Independence

The information appearing in the sections entitled Election of Directors and Agreements with Certain Executives in the Proxy Statement is incorporated herein by reference.

Item 14. Principal Accountant Fees and Services

The information appearing in the section entitled Ratification of Appointment of Independent Registered Public Accounting Firm Audit Fees and Non-Audit Fees in the Proxy Statement is incorporated herein by reference.

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PART IV

Item 15. Exhibits and Financial Statement Schedules

The following documents are filed or incorporated by reference as part of this Annual Report:

		Page
(a)(1)	Consolidated Financial Statements	
	Report of Independent Registered Public Accounting Firm Ernst & Young LLP	19
	Report of Independent Registered Public Accounting Firm Cherry Bekaert LLP	20
	Consolidated Statements of Operations Years ended April 30, 2018, 2017 and 2016	21
	Consolidated Statements of Comprehensive Income Years ended April 30, 2018, 2017 and 2016	21
	Consolidated Statements of Stockholders Equity Years ended April 30, 2018, 2017 and 2016	22
	Consolidated Balance Sheets April 30, 2018 and 2017	23
	Consolidated Statements of Cash Flows Years ended April 30, 2018, 2017 and 2016	24
	Notes to Consolidated Financial Statements	25
	Consents of Independent Registered Public Accounting Firms	46

(a)(2) Consolidated Financial Statement Schedules

Financial statement schedules have been omitted because the information required has been separately disclosed in the consolidated financial statements or related notes.

(a)(3) Exhibits

Exhibits required by Item 601 of Regulation S-K are listed in the Exhibit Index, which is attached hereto at pages 52 through 54 and which is incorporated herein by reference.

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KEWAUNEE SCIENTIFIC CORPORATION

Exhibit Index

			Page Number (or Reference)
3	Articles of incorporation and bylaws		
	3.1	Conformed copy of Restated Certificate of Incorporation (reflecting all amendments to date)	(1)
	3.3	By-Laws (as amended as of December 9, 2015)	(16)
10	Material Contracts		
	10.1*	Re-Established Retirement Plan for Salaried Employees of Kewaunee Scientific Corporation (as amended and restated effective as of May 1, 2012)	(5)
	10.1A*	First Amendment to the Re-Established Retirement Plan for Salaried Employees of Kewaunee Scientific Corporation	(9)
	10.1B*	Second Amendment to the Re-Established Retirement Plan for Salaried Employees of Kewaunee Scientific Corporation	(19)
	10.1C*	Third Amendment to the Re-Established Retirement Plan for Salaried Employees of Kewaunee Scientific Corporation	(20)
	10.1D*	Fourth Amendment to the Re-Established Retirement Plan for Salaried Employees of Kewaunee Scientific Corporation	(1)
	10.2*	Re-Established Retirement Plan for Hourly Employees of Kewaunee Scientific Corporation (as amended and restated effective as of May 1, 2012)	(5)
	10.2A*	First Amendment to the Re-Established Retirement Plan for Hourly Employees of Kewaunee Scientific Corporation	(9)
	10.2B*	Second Amendment to the Re-Established Retirement Plan for Hourly Employees of Kewaunee Scientific Corporation	(19)
	10.2C*	Third Amendment to the Re-Established Retirement Plan for Hourly Employees of Kewaunee Scientific Corporation	(20)
	10.2D*	Fourth Amendment to the Re-Established Retirement Plan for Hourly Employees of Kewaunee Scientific Corporation	(1)
	10.30*	Kewaunee Scientific Corporation Executive Severance Pay Policy	(2)
	10.34*	401(k) Incentive Savings Plan for Salaried and Hourly Employees of Kewaunee Scientific Corporation (as amended and restated effective June 29, 2015)	(14)
	10.40*		(3)

	Change of Control Employment Agreement restated as of December 4, 2008 between Dana L. Dahlgren and the Company	
10.40B*	Extension Agreement, dated August 27, 2014, with respect to the Change of Control Employment Agreement of Dana L. Dahlgren	(9)
10.40C*	Extension Agreement, dated December 7, 2017, with respect to the Change of Control Employment Agreement of Dana L. Dahlgren	(1)
10.41*	Change of Control Employment Agreement restated as of December 4, 2008 between Kurt P. Rindoks and the Company	(3)

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		Page Number (or Reference)
10.41B*	Extension Agreement, dated August 27, 2014, with respect to the Change of Control Employment Agreement of Kurt P. Rindoks	(9)
10.41C*	Extension Agreement, dated December 7, 2017, with respect to the Change of Control Employment Agreement of Kurt P. Rindoks	(1)
10.51*	Amended and Restated 2008 Key Employee Stock Option Plan effective August 26, 2015	(13)
10.53*	Change of Control Employment Agreement restated as of December 4, 2008 between Elizabeth D. Phillips and the Company	(3)
10.53B*	Extension Agreement, dated August 27, 2014, with respect to the Change of Control Employment Agreement of Elizabeth D. Phillips	(9)
10.53C*	Extension Agreement, dated December 7, 2017, with respect to the Change of Control Employment Agreement of Elizabeth D. Phillips	(1)
10.54*	Offer Letter to Thomas D. Hull dated October 14, 2015	(15)
10.55*	Change of Control Employment Agreement dated as of November 2, 2015 between Kewaunee Scientific Corporation and Thomas D. Hull	(15)
10.56*	Offer Letter to Michael G. Rok dated March 16, 2016	(19)
10.57*	Change of Control Employment Agreement dated as of May 2, 2016 between Kewaunee Scientific Corporation and Michael G. Rok	(19)
10.58*	Kewaunee Scientific Corporation 2010 Stock Option Plan for Directors	(4)
10.61	Credit and Security Agreement dated as of May 6, 2013 between Wells Fargo Bank, National Association and Kewaunee Scientific Corporation including the forms of notes executed thereunder	(6)
10.61A	First Amendment to Credit and Security Agreement dated July 9, 2013	(7)
10.61B	Second Amendment to Credit and Security Agreement dated June 10, 2014	(8)
10.61C	Third Amendment to Credit and Security Agreement and First Amendment to Revolving Line of Credit Note dated as of June 3, 2015	(10)
10.61D	Fourth Amendment to Credit and Security Agreement and First Amendment to Revolving Line of Credit Note dated as of March 12, 2018	(23)
10.66*	Restated and Amended Change of Control Employment Agreement, dated August 27, 2014, between the Company and David M. Rausch	(9)
10.66A*	Extension Agreement, dated December 7, 2017, with respect to the Change of Control Employment Agreement of David M. Rausch	(1)
10.67*	Fiscal Year 2016 Incentive Bonus Plan	(11)
10.68*	401Plus Executive Deferred Compensation Plan (as amended and restated January 1, 2009)	(12)
10.68A*		(12)

	Amendment No. One to the Kewaunee Scientific Corporation 401Plus Executive Deferred Compensation Plan	
10.68B*	Amendment No. Two to the Kewaunee Scientific Corporation 401Plus Executive Deferred Compensation Plan	(22)
10.69*	Pension Equalization Plan (as amended and restated January 1, 2009)	(12)

		Page Number (or Reference)
10.69A*	Amendment No. One to the Kewaunee Scientific Corporation Pension Equalization Plan	(12)
10.71*	Fiscal Year 2017 Incentive Bonus Plan	(17)
10.72*	Kewaunee Scientific Corporation 2017 Omnibus Incentive Plan	(21)
16.1	Letter of Cherry Bekaert LLP dated June 28, 2016	(18)
21.1	Subsidiaries of the Company	(1)
23.1	Consent dated July 20, 2018 of Cherry Bekaert LLP, Independent Registered Public Accounting Firm (incorporated by reference to page 46 of this Report on Form 10-K)	(1)
23.2	Consent dated July 20, 2018 of Ernst & Young LLP, Independent Registered Public Accounting Firm (incorporated by reference to page 46 of this Report on Form 10-K)	(1)
31.1	Certification of Principal Executive Officer of the Company pursuant to Exchange Act Rule 13a-14(a) or Rule 15d-14(a)	(1)
31.2	Certification of Principal Financial Officer of the Company pursuant to Exchange Act Rule 13a-14(a) or Rule 15d-14(a)	(1)
32.1	Certification of Principal Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	(1)
32.2	Certification of Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002	(1)
101.INS	XBRL Instance Document	(1)
101.SCH	XBRL Taxonomy Extension Schema Document	(1)
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document	(1)
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document	(1)
101.LAB	XBRL Taxonomy Extension Label Linkbase Document	(1)
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document	(1)

* The referenced exhibit is a management contract or compensatory plan or arrangement.
(All other exhibits are either inapplicable or not required.)

Footnotes

(1) Filed with this Form 10-K with the Securities and Exchange Commission.

(2) Filed as an exhibit to the Kewaunee Scientific Corporation Quarterly Report to the Securities and Exchange Commission on Form 10-Q (Commission File No. 0-5286) for the quarterly period ended October 31, 2005 and incorporated herein by reference.
(3) Filed as an exhibit to the Kewaunee Scientific Corporation Annual Report to the Securities and Exchange Commission on Form 10-K (Commission File No. 0-5286) for the fiscal year ended April 30, 2009, and incorporated herein by reference.
(4) Filed as Appendix A to the Kewaunee Scientific Corporation Proxy Statement for its Annual Meeting of Stockholders on August 25, 2010 (Commission File No. 0-5286) filed on July 23, 2010, and incorporated herein by reference.

(5) Filed as an exhibit to the Kewaunee Scientific Corporation Quarterly Report to the Securities and Exchange Commission on Form 10-Q (Commission File No. 0-5286) for the quarterly period ended October 31, 2012, and incorporated herein by reference.
(6) Filed as an exhibit to the Kewaunee Scientific Corporation Current Report on Form 8-K (Commission File No. 0-5286) filed on May 9, 2013, and incorporated herein by reference.
(7) Filed as an exhibit to the Kewaunee Scientific Corporation Current Report on Form 8-K (Commission File No. 0-5286) filed on July 11, 2013, and incorporated herein by reference.
(8) Filed as an exhibit to the Kewaunee Scientific Corporation Annual Report to the Securities and Exchange Commission on Form 10-K (Commission File No. 0-5286) for the fiscal year ended April 30, 2014, and incorporated herein by reference.
(9) Filed as an exhibit to the Kewaunee Scientific Corporation Current Report on Form 8-K (Commission File No. 0-5286) filed on September 2, 2014, and incorporated herein by reference.
(10) Filed as an exhibit to the Kewaunee Scientific Corporation Current Report on Form 8-K (Commission File No. 0-5286) filed on June 3, 2015, and incorporated herein by reference.
(11) Filed as an exhibit to the Kewaunee Scientific Corporation Current Report on Form 8-K (Commission File No. 0-5286) filed on June 29, 2015 and incorporated herein by reference.
(12) Filed as an exhibit to the Kewaunee Scientific Corporation Annual Report to the Securities and Exchange Commission on Form 10-K (Commission File No. 0-5286) for the fiscal year ended April 30, 2015, and incorporated herein by reference.
(13) Filed as Appendix A to the Kewaunee Scientific Corporation Proxy Statement for its Annual Meeting of Stockholders on August 28, 2015 (Commission File No. 0-5286) filed on July 24, 2015, and incorporated herein by reference.
(14) Filed as an exhibit to the Kewaunee Scientific Corporation Quarterly Report to the Securities and Exchange Commission on Form 10-Q (Commission File No. 0-5286) for the quarterly period ended October 31, 2015 and incorporated herein by reference.
(15) Filed as an exhibit to the Kewaunee Scientific Corporation Current Report on form 8-K (Commission File No. 0-5286) filed on November 3, 2015 and incorporated herein by reference.
(16) Filed as an exhibit to the Kewaunee Scientific Corporation Current Report on form 8-K (Commission File No. 0-5286) filed on December 10, 2015 and incorporated herein by reference.
(17) Filed as an exhibit to the Kewaunee Scientific Corporation Current Report on Form 8-K (Commission File No. 0-5286) filed on June 24, 2016, and incorporated herein by reference.
(18) Filed as an exhibit to the Kewaunee Scientific Corporation Current Report on Form 8-K (Commission File No. 0-5286) filed on June 28, 2016, and incorporated herein by reference.
(19) Filed as an exhibit to the Kewaunee Scientific Corporation Annual Report to the Securities and Exchange Commission on Form 10-K (Commission File No. 0-5286) for the fiscal year ended April 30, 2016, and incorporated herein by reference.
(20) Filed as an exhibit to the Kewaunee Scientific Corporation Quarterly Report to the Securities and Exchange Commission on Form 10-Q (Commission File No. 0-5286) for the quarterly period ended January 31, 2017 and incorporated herein by reference.
(21) Filed as Appendix A to the Kewaunee Scientific Corporation Proxy Statement for its Annual Meeting of Stockholders on August 30, 2017 (Commission File No. 0-5286) filed on July 21, 2017 and incorporated herein by reference.
(22) Filed as an exhibit to the Kewaunee Scientific Corporation Quarterly Report to the Securities and Exchange Commission on Form 10-Q (Commission File No. 0-5286) for the quarterly period ended January 31, 2018 and incorporated herein by reference.
(23) Filed as an exhibit to the Kewaunee Scientific Corporation Current Report on form 8-K (Commission File No. 0-5286) filed on March 16, 2018 and incorporated herein by reference.

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SIGNATURES

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

KEWAUNEE SCIENTIFIC CORPORATION

By: /s/ David M. Rausch
David M. Rausch
President and Chief Executive Officer

Date: July 20, 2018

Pursuant to the requirements of the Securities Exchange Act of 1934, the following persons on behalf of the Registrant and in the capacities and on the dates indicated have signed this report below.

(i)	Principal Executive Officer /s/ David M. Rausch David M. Rausch President and Chief Executive Officer	)	
(ii)	Principal Financial and Accounting Officer /s/ Thomas D. Hull III Thomas D. Hull III Vice President, Finance Chief Financial Officer, Treasurer and Secretary	)	
(iii)	A majority of the Board of Directors:	)	July 20, 2018
/s/ Keith M. Gehl Keith M. Gehl	/s/ John D. Russell John D. Russell	)	
/s/ Margaret B. Pyle Margaret B. Pyle	/s/ Donald F. Shaw Donald F. Shaw	)	
/s/ David M. Rausch David M. Rausch	/s/ William A. Shumaker William A. Shumaker	)	

/s/ David S. Rhind	)
David S. Rhind	)
	)
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