

LAKELAND INDUSTRIES INC  
Form 10-Q  
December 10, 2008

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
WASHINGTON, D.C. 20549  
FORM 10-Q

(Mark one)

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

For the quarterly period ended October 31, 2008

OR

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

For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 0-15535

LAKELAND INDUSTRIES, INC.

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(Exact name of Registrant as specified in its charter)

Delaware  
(State of incorporation)

13-3115216  
(IRS Employer Identification  
Number)

701 Koehler Avenue, Suite 7,  
Ronkonkoma, New York  
(Address of principal executive offices)

11779  
(Zip Code)

(631) 981-9700  
(Registrant's telephone number, including area code)

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

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act.  
Yes  No

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes  No

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

Large accelerated filer  Accelerated filer   
Non-Accelerated filer  (Do not check if a smaller reporting company) Smaller reporting company

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12-b-2 of the Exchange Act).

Yes  No

As of July 31, 2008, the aggregate market value of the registrant's common stock held by non-affiliates of the registrant was \$54,940,120 based on the closing price of the common stock as reported on the National Association of Securities Dealers Automated Quotation System National Market System.

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Outstanding at December 8, 2008
Common Stock, \$0.01 par value per share	5,415,971

LAKELAND INDUSTRIES, INC.  
AND SUBSIDIARIES

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LAKELAND INDUSTRIES, INC.  
AND SUBSIDIARIES

PART I FINANCIAL INFORMATION

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Item 1. Financial Statements:

Introduction

SPECIAL NOTE REGARDING FORWARD-LOOKING STATEMENTS

This 10-Q may contain certain forward-looking statements. When used in this 10-Q or in any other presentation, statements which are not historical in nature, including the words “anticipate,” “estimate,” “should,” “expect,” “believe,” “intend,” “project” and similar expressions are intended to identify forward-looking statements. They also include statements containing a projection of sales, earnings or losses, capital expenditures, dividends, capital structure or other financial terms.

The forward-looking statements in this 10-Q are based upon our management’s beliefs, assumptions and expectations of our future operations and economic performance, taking into account the information currently available to us. These statements are not statements of historical fact. Forward-looking statements involve risks and uncertainties, some of which are not currently known to us that may cause our actual results, performance or financial condition to be materially different from the expectations of future results, performance or financial condition we express or imply in any forward-looking statements. Some of the important factors that could cause our actual results, performance or financial condition to differ materially from expectations are:

- Our ability to obtain fabrics and components from key suppliers such as DuPont and other manufacturers at competitive prices or prices that vary from quarter to quarter;
  - Risks associated with our international manufacturing and start up sales operations;
  - Potential fluctuations in foreign currency exchange rates;
  - Our ability to respond to rapid technological change;
  - Our ability to identify and complete acquisitions or future expansion;
  - Our ability to manage our growth;
- Our ability to recruit and retain skilled employees, including our senior management;
  - Our ability to accurately estimate customer demand;
- Competition from other companies, including some with much greater resources;
  - Risks associated with sales to foreign buyers;
- Restrictions on our financial and operating flexibility as a result of covenants in our credit facilities;
  - Our ability to obtain additional funding to expand or operate our business as planned;
  - The impact of a decline in federal funding for preparations for terrorist incidents;
    - The impact of potential product liability claims;
    - Liabilities under environmental laws and regulations;
    - Fluctuations in the price of our common stock;
    - Variations in our quarterly results of operations;
- The cost of compliance with the Sarbanes-Oxley Act of 2002 and rules and regulations relating to corporate governance and public disclosure;
- The significant influence of our directors and executive officer on our company and on matters subject to a vote of our stockholders;
  - The limited liquidity of our common stock;
- The other factors referenced in this 10-Q, including, without limitation, in the sections entitled “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” and “Business.”

We believe these forward-looking statements are reasonable; however, you should not place undue reliance on any forward-looking statements, which are based on current expectations. Furthermore, forward-looking statements speak only as of the date they are made. We undertake no obligation to publicly update or revise any forward-looking statements after the date of this 10-Q, whether as a result of new information, future events or otherwise. In light of these risks, uncertainties and assumptions, the forward-looking events discussed in this Form 10-Q might not occur. We qualify any and all of our forward-looking statements entirely by these cautionary factors.

LAKELAND INDUSTRIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED BALANCE SHEETS

ASSETS	October 31, 2008 (Unaudited)	January 31, 2008
Current assets:		
Cash	\$ 2,132,618	\$ 3,427,672
Accounts receivable, net of allowance for doubtful accounts of \$36,000 at October 31, 2008 and \$45,000 at January 31, 2008	16,505,775	14,927,666
Inventories, net of reserves of \$493,000 at October 31, 2008 and \$607,000 at January 31, 2008	55,031,523	48,116,173
Deferred income taxes	2,134,744	1,969,713
Other current assets	4,293,714	1,828,210
Total current assets	80,098,374	70,269,434
Property and equipment, net of accumulated depreciation of \$8,626,928 at October 31, 2008 and \$7,054,914 at January 31, 2008	13,702,952	13,324,648
Goodwill	8,420,241	871,297
Other assets	910,087	157,474
<b>TOTAL ASSETS</b>	<b>\$ 103,131,654</b>	<b>\$ 84,622,853</b>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current liabilities:		
Accounts payable	\$ 5,126,979	\$ 3,312,696
Accrued expenses and other current liabilities	2,463,300	1,684,161
Total current liabilities	7,590,279	4,996,857
Construction loan	1,499,918	1,882,085
Borrowings under revolving credit facility	25,517,466	8,871,000
Other non current liabilities	108,100	-----
Commitments and contingencies	-----	-----
Stockholders' equity:		
Preferred stock, \$.01 par; authorized 1,500,000 shares (none issued)		
Common stock, \$.01 par; authorized 10,000,000 shares; issued and outstanding 5,523,288 shares at October 31, 2008 and January 31, 2008	55,233	55,233
Less treasury stock, at cost, 107,317 shares at October 31, 2008 and 0 shares at January 31, 2008	(1,255,459)	-----
Additional paid-in capital	49,438,501	49,211,961
Other comprehensive loss	(3,354,991)	(36,073)
Retained earnings (1)	23,532,607	19,641,790
Stockholders' equity	68,415,891	68,872,911
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 103,131,654</b>	<b>\$ 84,622,853</b>

(1) A cumulative total of \$17,999,739 has been transferred from retained earnings to additional paid-in-capital and par value of common stock due to four separate stock dividends paid in 2002, 2003, 2005 and 2006, with \$6,386,916

included in the year ended January 31, 2008.

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



LAKELAND INDUSTRIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF INCOME  
(UNAUDITED)

	THREE MONTHS ENDED		NINE MONTHS ENDED	
	October 31,		October 31,	
	2008	2007	2008	2007
Net sales	\$ 25,159,948	\$ 23,452,983	\$ 80,005,141	\$ 70,781,406
Cost of goods sold	17,989,076	17,748,865	57,994,805	54,593,816
Gross profit	7,170,872	5,704,118	22,010,336	16,187,590
Operating expenses	5,110,642	4,355,330	16,308,254	12,928,909
Operating profit	2,060,230	1,348,788	5,702,082	3,258,681
Interest and other income, net	44,270	51,249	130,159	176,387
Interest expense	(284,463)	(94,344)	(637,958)	(205,470)
Income before income taxes	1,820,037	1,305,693	5,194,283	3,229,598
Provision for income taxes	446,876	375,536	1,303,466	936,543
Net income	\$ 1,373,161	\$ 930,157	\$ 3,890,817	\$ 2,293,055
Net income per common share*:				
Basic	\$ 0.25	\$ 0.17	\$ 0.71	\$ 0.42
Diluted	\$ 0.25	\$ 0.17	\$ 0.71	\$ 0.41
Weighted average common shares outstanding*:				
Basic	5,415,971	5,523,288	5,442,690	5,522,572
Diluted	5,456,536	5,544,619	5,480,689	5,542,144

\*Adjusted for the 10% stock dividend to shareholders of record on August 1, 2006.

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

LAKELAND INDUSTRIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY  
(UNAUDITED)  
Nine months ended October 31, 2008

	Common Stock		Additional	Treasury Stock		Retained	Other	
	Shares	Amount	Paid-in Capital	Shares	Amount	Earnings	Comprehensive Income (Loss)	Total
Balance February 1, 2008	5,523,288	\$ 55,233	\$ 49,211,961	-----	\$ -----	\$ 19,641,790	\$ (36,073)	\$ 68,872,911
Net Income	-----	-----	-----	-----	-----	3,890,817	-----	3,890,817
Stock Repurchase Program	-----	-----	-----	107,317	(1,255,459)	-----	-----	(1,255,459)
Other Comprehensive Loss	-----	-----	-----	-----	-----	-----	(3,318,918)	(3,318,918)
Stock Based Compensation Restricted Stock Plan	-----	-----	194,996	-----	-----	-----	-----	194,996
Issuance of Director Stock Options	-----	-----	31,544	-----	-----	-----	-----	31,544
Balance October 31, 2008	5,523,288	\$ 55,233	\$ 49,438,501	107,317	\$ (1,255,459)	\$ 23,532,607	\$ (3,354,991)	\$ 68,415,891

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

LAKELAND INDUSTRIES, INC. AND SUBSIDIARIES  
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

	NINE MONTHS ENDED	
	October 31,	
	2008	2007
<b>Cash Flows from Operating Activities:</b>		
Net income	\$ 3,890,817	\$ 2,293,055
<b>Adjustments to reconcile net income to net cash used in operating activities:</b>		
Stock based compensation	226,540	170,772
Reserve for doubtful accounts	(9,000)	(13,000)
Reserve for inventory obsolescence	(114,000)	289,601
Depreciation and amortization	1,231,285	816,441
Deferred income tax	(165,032)	(157,591)
<b>Changes in operating assets and liabilities:</b>		
(Increase) decrease in accounts receivable	(369,967)	33,744
(Increase) in inventories	(3,492,428)	(5,809,366)
(Increase) decrease in other assets	(2,183,085)	1,369,535
(Decrease) in accounts payable, accrued expenses and other liabilities	(74,850)	(628,465)
Net cash used in operating activities	(1,059,720)	(1,635,274)
<b>Cash Flows from Investing Activities:</b>		
Purchases of property and equipment	(1,588,511)	(2,049,565)
Acquisition of Qualytextil, S.A.	(13,669,763)	-----
Net cash used in investing activities	(15,258,274)	(2,049,565)
<b>Cash Flows from Financing Activities:</b>		
Purchases of stock under stock repurchase program	(1,255,459)	-----
Proceeds from exercise of stock option	-----	6,690
Construction loan proceeds	-----	992,888
Net borrowings under loan agreements	2,933,933	3,450,000
Borrowing to fund Qualytextil Acquisition	13,344,466	-----
Net cash provided by financing activities	15,022,940	4,449,578
Net (decrease) increase in cash	(1,295,054)	764,739
Cash and cash equivalents at beginning of period	3,427,672	1,906,557
Cash and cash equivalents at end of period	\$ 2,132,618	\$ 2,671,296

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

LAKELAND INDUSTRIES, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

1. Business

Lakeland Industries, Inc. and Subsidiaries, a Delaware corporation, organized in April 1982, manufactures and sells a comprehensive line of safety garments and accessories for the industrial protective clothing and homeland security markets. The principal market for our products is the United States. No customer accounted for more than 10% of net sales during the three and nine month periods ended October 31, 2008 and 2007, respectively.

2. Basis of Presentation

The condensed consolidated financial statements included herein have been prepared by us, without audit, pursuant to the rules and regulations of the Securities and Exchange Commission and reflect all adjustments (consisting of only normal and recurring adjustments) which are, in the opinion of management, necessary to present fairly the consolidated financial information required therein. Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) have been condensed or omitted pursuant to such rules and regulations. While we believe that the disclosures are adequate to make the information presented not misleading, it is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and the notes thereto included in our Annual Report on Form 10-K filed with the Securities and Exchange Commission for the year ended January 31, 2008.

The results of operations for the three and nine month periods ended October 31, 2008 are not necessarily indicative of the results to be expected for the full year.

3. Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant inter-company accounts and transactions have been eliminated.

4. Inventories:

Inventories consist of the following:

	October 31, 2008	January 31, 2008
Raw materials	\$ 26,658,682	\$ 25,035,569
Work-in-process	3,306,596	2,873,001
Finished Goods	25,066,245	20,207,603
TOTAL	\$ 55,031,523	\$ 48,116,173

Inventories include freight-in, materials, labor and overhead costs and are stated at the lower of cost (on a first-in-first-out basis) or market.

5. Earnings Per Share:

Basic earnings per share are based on the weighted average number of common shares outstanding without consideration of common stock equivalents. Diluted earnings per share are based on the weighted average number of common and common stock equivalents. The diluted earnings per share calculation takes into account the shares that

may be issued upon exercise of stock options, reduced by the shares that may be repurchased with the funds received from the exercise, based on the average price during the period.

The following table sets forth the computation of basic and diluted earnings per share at October 31, 2008 and 2007.

	Three Months Ended October 31,		Nine Months Ended October 31,	
	2008	2007	2008	2007
<b>Numerator</b>				
Net Income	\$ 1,373,161	\$ 930,157	\$ 3,890,817	\$ 2,293,055
<b>Denominator</b>				
Denominator for basic earnings per share (Weighted-average shares which reflect 107,317 and 80,598 weighted average common shares in the treasury as a result of the stock repurchase program for the three months and the nine months ended October 31, 2008, respectively)	5,415,971	5,523,288	5,442,690	5,522,572
Effect of dilutive securities from restricted stock plan and from dilutive effect of stock options	40,565	21,331	37,999	19,572
Denominator for diluted earnings per share (adjusted weighted average shares)	5,456,536	5,544,619	5,480,689	5,542,144
Basic earnings per share	\$ 0.25	\$ 0.17	\$ 0.71	\$ 0.42
Diluted earnings per share	\$ 0.25	\$ 0.17	\$ 0.71	\$ 0.41

#### 6. Revolving Credit Facility

At October 31, 2008, the balance outstanding under our five year revolving credit facility amounted to \$25.5 million. In May 2008, the facility was increased from \$25 million to \$30 million (see Note 13). The credit facility is collateralized by substantially all of the assets of the Company. The credit facility contains financial covenants, including, but not limited to, fixed charge ratio, funded debt to EBIDTA ratio, inventory and accounts receivable collateral coverage ratio, with respect to which the Company was in compliance at October 31, 2008 and for the period then ended. The weighted average interest rate for the nine month period ended October 31, 2008 was 3.36%.

#### 7. Major Supplier

We purchased 50% of our raw materials from one supplier during the nine month period ended October 31, 2008. During the first quarter of this period, however, we purchased an abnormally low amount from this supplier. We normally purchase approximately 75% of our raw material from this supplier. We carried higher inventory levels throughout FY08 and limited our material purchases in Q1 of FY09. Such purchases resumed at normal levels in Q2 FY09. We expect this relationship to continue for the foreseeable future. If required, similar raw materials could be purchased from other sources; however, our competitive position in the marketplace would be adversely affected.

#### 8. Employee Stock Compensation

The Company's Director's Plan permits the grant of share options and shares to its Directors for up to 60,000 shares of common stock as stock compensation in the aggregate. All stock options under this Plan are granted at the fair market value of the common stock at the grant date. This date is fixed only once a year upon a Board Member's re-election to the Board at the Annual Shareholders' meeting which is the third Wednesday in June pursuant to the Director's Plan and our Company By-Laws. Directors' stock options vest ratably over a 6 month period and generally expire 6 years from the grant date.

The following table represents our stock options granted, exercised, and forfeited during the nine months ended October 31, 2008:

Stock Options	Number of Shares	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at January 31, 2008	17,567	\$ 13.48	2.65 years	\$ 8,618
Granted in the nine months ended October 31, 2008	3,000	\$ 13.10	5.89 years	-----
Outstanding at October 31, 2008	20,567	\$ 13.42	2.52 years	\$ 12,800
Exercisable at October 31, 2008	17,567	\$ 13.48	2.15 years	\$ 12,800

#### Restricted Stock Plan and Performance Equity Plan

On June 21, 2006, the shareholders of the Company approved a restricted stock plan. A total of 253,000 shares of restricted stock were authorized under this plan. Under the restricted stock plan, eligible employees and directors are awarded performance-based restricted shares of the Corporation's common stock. The amount recorded as expense for the performance-based grants of restricted stock is based upon an estimate made at the end of each reporting period as to the most probable outcome of this plan at the end of the three year performance period. (e.g., baseline, minimum, maximum or zero). In addition to the grants vesting based solely on performance, certain awards pursuant to the plan have a time-based vesting requirement, under which awards vest from three to four years after issuance, subject to continuous employment and certain other conditions. Restricted stock has the same voting rights as other common stock. Restricted stock awards do not have voting rights, and the underlying shares are not considered to be issued and outstanding until vested.

The Company has granted up to a maximum of 147,280 restricted stock awards as of October 31, 2008. All of these restricted stock awards are non-vested at October 31, 2008 (104,435 shares at "baseline" and 62,580 shares at "minimum") and have a weighted average grant date fair value of \$12.95. The Company recognizes expense related to performance-based awards over the requisite service period using the straight-line attribution method based on the outcome that is probable.

As of October 31, 2008, unrecognized stock-based compensation expense related to restricted stock awards totaled \$1,363,596, before income taxes, based on the maximum performance award level. Such unrecognized stock-based compensation expense related to restricted stock awards totaled \$803,984 and \$257,340 at the baseline and minimum performance levels, respectively. The cost of these non-vested awards is expected to be recognized over a weighted-average period of three years. The board has estimated the Company's current performance level to be at the minimum level and expenses have been recorded accordingly. The performance based awards are not considered stock equivalents for EPS purposes

#### Stock-Based Compensation

The Company recognized total stock-based compensation costs of \$226,540, of which \$194,996 results from the 2006 Equity Incentive Plan, and \$31,544 results from the Non-Employee Directors Option Plan for the nine months



ended October 31, 2008 and \$170,772 and \$0 for the nine months ended October 31, 2007, respectively. These amounts are reflected in selling, general and administrative expenses. The total income tax benefit recognized for stock-based compensation arrangements was \$81,554 and \$61,478 for the nine months ended October 31, 2008 and 2007, respectively.

9. Manufacturing Segment Data

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

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	Three Months Ended October 31,				Nine Months Ended October 31,			
	2008		2007		2008		2007	
Domestic	\$ 18.8	75%	\$ 19.8	84.3%	\$ 61.3	77%	\$ 59.7	84.3%
International	\$ 6.4	25%	3.7	15.7%	\$ 18.7	23%	11.1	15.7%
Total	\$ 25.2	100%	\$ 23.5	100%	\$ 80.0	100%	\$ 70.8	100%

We manage our operations by evaluating each of our geographic locations. Our North American operations include our facilities in Decatur, Alabama (primarily the distribution to customers of the bulk of our products and the manufacture of our chemical, glove and disposable products), Jerez, Mexico (primarily disposable, glove and chemical suit production) St. Joseph, Missouri and Shillington, Pennsylvania (primarily fire, hi-visibility and woven products production). We also maintain three manufacturing facilities in China (primarily disposable and chemical suit production) and a glove manufacturing facility in New Delhi, India. On May 13, 2008 we acquired Qualytextil S.A. which manufactures primarily fire protective apparel for the Brazilian market. Our China facilities produce the majority of the Company's products. The accounting policies of these operating entities are the same as those described in Note 1 to our Annual Report on Form 10-K for the year ended January 31, 2008. We evaluate the performance of these entities based on operating profit which is defined as income before income taxes, interest expense and other income and expenses. We have sales forces in the U.S.A., Brazil, Canada, Europe, Chile, China and India which sell and distribute products shipped from the United States, Mexico, Brazil, China, and recently India.

The table below represents information about reported manufacturing segments for the three and nine month periods noted therein:

	Three Months Ended October 31, (in millions of dollars)		Nine Months Ended October 31, (in millions of dollars)	
	2008	2007	2008	2007
<b>Net Sales:</b>				
North America and other foreign	\$ 22.53	\$ 23.62	\$ 73.87	\$ 72.67
Brazil	2.44	-----	5.52	-----
China	5.31	4.14	16.75	10.6
India	.12	.04	.29	.13
Less inter-segment sales	(5.25)	(4.30)	(16.42)	(12.60)
Consolidated sales	\$ 25.16	\$ 23.50	\$ 80.00	\$ 70.80
<b>Operating Profit:</b>				
North America and other foreign	\$ 1.37	\$ .62	\$ 3.14	\$ 1.87
Brazil	.34	-----	1.14	-----
China	.63	1.02	2.38	2.0
India	(.22)	(.22)	(.63)	(.46)
Less inter-segment profit	(.06)	(.07)	(.33)	(.11)
Consolidated profit	\$ 2.06	\$ 1.35	\$ 5.70	\$ 3.30
<b>Identifiable Assets (at Balance Sheet date):</b>				
North America and other foreign	-----	-----	\$ 79.57	\$ 65.8
Brazil	-----	-----	6.63	-----
China	-----	-----	12.54	10.4
India	-----	-----	4.38	4.3
Consolidated assets	-----	-----	\$ 103.13	\$ 80.5
<b>Depreciation and Amortization Expense:</b>				

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North America and other foreign	\$	.14	\$	.16	\$	.64	\$	.47
Brazil		.11		-----		.11		-----
China		.07		.07		.21		.27
India		.09		.08		.27		.08
Consolidated depreciation expense	\$	.41	\$	.31	\$	1.23	\$	.82

10. Adoption of FIN 48

UNCERTAIN TAX POSITIONS. Effective February 1, 2007, the first day of fiscal 2008, the Company adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes," ("FIN 48"). FIN 48 prescribes recognition thresholds that must be met before a tax position is recognized in the financial statements and provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. Under FIN 48, an entity may only recognize or continue to recognize tax positions that meet a "more likely than not" threshold. The Company recorded the cumulative effect of applying FIN 48 as a \$419,000 debit to the opening balance of accumulated deficit as of February 1, 2007, the date of adoption.

The Company's policy is to recognize interest and penalties related to income tax issues as components of income tax expense. The Company had approximately \$90,000 of accrued interest as of July 31, 2008, prior to recording the effects of the settlement with the IRS.

The Company is subject to U.S. federal income tax, as well as income tax in multiple U.S. state and local jurisdictions and a number of foreign jurisdictions. The Company's Federal Income Tax returns for the fiscal years ended January 31, 2003, 2004 and 2005 have been audited by the Internal Revenue Service ("IRS").

On July 23, 2008, the Company reached a settlement with the IRS regarding its examination of the Company's Federal Income Tax returns for taxable years ending January 31, 2003, 2004 and 2005.

The Company agreed with the IRS to settle the audit for the amount of \$91,000, which includes interest of \$24,000. The impact of this settlement results in an additional state tax liability of \$12,000, which includes interest of \$3,000. The settlement also resulted in the Company recording a deferred tax asset of \$28,000. Accordingly, the Company reported a reduction in income tax expense of \$207,000 for this transaction in its second quarter report for July 31, 2008.

An audit of the Company's US federal tax returns for the year ended January 31, 2007 has just commenced.

11. Related Party Transactions

In connection with the asset purchase agreement, dated August 1, 2005, between the Company and Mifflin Valley, Inc., the Company entered into a five year lease agreement with the seller (now an employee of the Company) to rent the manufacturing facility in Shillington, Pennsylvania owned by the seller at an annual rental of \$57,504, or a per square foot rental of \$3.25. This amount was obtained prior to the acquisition from an independent appraisal of the fair market rental value per square feet. In addition the Company has, starting January 1, 2006 rented a second 12,000 sq ft of warehouse space in Blandon, Pennsylvania from this employee, on a month to month basis, for the monthly amount of \$3.00 per square foot.

On March 1, 1999, we entered into a one year (renewable for four additional one year terms) lease agreement with Harvey Pride, Jr., our Vice President of Manufacturing, for a 2,400 sq. ft. customer service office located next to our existing Decatur, Alabama facility at an annual rent of \$18,000. This lease was renewed on April 28, 2008 at \$18,000 until March 30, 2009 with 5% increases in both 2010 and 2011.

12. Derivative Instruments and Foreign Currency Exposure



The Company has foreign currency exposure, principally through its investment in Brazil, sales in Canada and the UK and production in Mexico and China. Management has commenced a hedging program to offset this risk by purchasing forward contracts to sell the Canadian Dollar, Euro and Great Britain Pound. Such contracts are largely timed to expire with the last day of the fiscal quarter, with a new contract purchased on the first day of the following quarter, to match the operating cycle of the company. Management has decided not to hedge its long position in the Chinese Yuan or the Brazilian Real.

The Company accounts for its foreign exchange derivative instruments under Statement of Financial Accounting Standards (“SFAS”) No. 133, “Accounting for Derivative Instruments and Hedging Activities,” as amended. This standard requires recognition of all derivatives as either assets or liabilities at fair value and may result in additional volatility in both current period earnings and other comprehensive income as a result of recording recognized and unrecognized gains and losses from changes in the fair value of derivative instruments.

The Company had no derivative instruments outstanding at October 31, 2008 for foreign exchange. The Company had one derivative instrument outstanding at October 31, 2007, which was treated as a cash flow hedge intended for forecasted purchases of merchandise by the Company’s Canadian subsidiary. The change in the fair market value of the effective hedge portion of the foreign currency forward exchange contracts was zero. During the nine month period ended October 31, 2008, the Company recorded an immaterial loss in cost of goods sold for the remaining portion of the foreign currency forward exchange contract that did not qualify for hedge accounting treatment. The derivative instrument was in the form of a foreign currency “participating forward” exchange contract. The “participating forward” feature affords the Company full protection on the downside and the ability to retain 50% of any gains, in exchange for a premium at inception. Such premium is built into the contract in the form of a different contract rate in the amount of \$0.016.

#### Interest Rate Risk Management

We are exposed to interest rate risk from debt. We have hedged against the risk of changes in the interest rate associated with our variable rate Revolving Credit (See Note 6) by entering into a variable-to-fixed interest rate swap agreement, designated as fair value hedges, with a total notional amount of \$18 million as of October 31, 2008. We assume no hedge ineffectiveness as each interest rate swap meets the short-cut method requirements under SFAS 133 for fair value hedges of debt instruments. As a result, changes in the fair value of the interest rate swaps are offset by changes in the fair value of the debt, both are reported in interest and other income and no net gain or loss is recognized in earnings.

The fair values of all derivatives recorded on the consolidated balance sheet are as follows:

	October 31, 2008	January 31, 2008
<b>Unrealized Gains:</b>		
Foreign currency exchange contracts	-----	-----
<b>Unrealized (Losses):</b>		
Foreign currency exchange contracts	-----	\$ 77,000
Interest rate swaps	\$ 33,825	-----

The Brazilian financial statements, when translated into USD pursuant to FAS 52, “Foreign Currency Translation” resulted in a Currency Translation Adjustment (CTA) of \$(3,235,889), which is included in Other Comprehensive Loss on the Balance Sheet.



## 13. Acquisition of Qalytextil, SA and Increase in Revolving Credit Line

On May 13, 2008 (the "Final Closing Date"), Lakeland Industries, Inc. completed the acquisition of 100% of all outstanding stock (the "Acquisition") of Qalytextil, S.A., ("Qalytextil") a corporation organized under the laws of Brazil, pursuant to a Stock Purchase Agreement (the "Stock Purchase Agreement"). Qalytextil is a supplier of protective apparel in Brazil.

The Acquisition was financed through Lakeland's existing revolving credit facility as amended. Further, in related transactions to accommodate the Qalytextil acquisition, Wachovia Bank, N.A. has increased the Revolving Line of Credit from \$25,000,000 to \$30,000,000 and has reworked several covenants to allow for the acquisition.

The Purchase Price was determined to be a multiple of seven times the 2007 EBITDA of Qalytextil, some of which was used to repay outstanding debts at closing. The 2007 EBITDA was \$R3,118,000 (\$1.9 million) and the total amount paid at closing, including the repayment of such outstanding debts, is \$R21,826,000 (approximately \$13.3 million).

In connection with the closing of such acquisition, a total of \$R6.3 million (\$3.9 million) was used to repay outstanding debts of Qalytextil, \$R7.8 million (\$4.7 million) was retained in the various escrow funds as described, and the balance of \$R7.7 million (\$4.7 million) was paid to the Sellers at closing.

There are provisions for an adjustment of the initial Purchase Price, based on results of 2008 EBITDA. The Post-Closing audit as of April 30, 2008 resulted in no adjustments to the Purchase Price.

There is also a provision for a Supplementary Purchase Price - Subject to Qalytextil's EBITDA in 2010 being equal to or greater than \$R4,449,200 (\$2.7 million), the Purchaser shall then pay to the Sellers the difference between six (6) times Qalytextil's EBITDA in 2010 and seven (7) times the 2007 EBITDA (\$R21,826,000.00) (\$13.3 million), less any unpaid disclosed or undisclosed contingencies (other than Outstanding Debts) from pre-closing which exceeds \$R100,000.00 (\$.06 million) ("Supplementary Purchase Price"). The Supplementary Purchase Price in no event shall be greater than \$R27,750,000.00 (\$16.8 million) additional over the initial Purchase Price, subject to certain restrictions. (USD amounts are based on the exchange rate at the date of the transaction 1.645BRL = 1 USD)

All sellers also have executed employment contracts with terms expiring December 31, 2011 which contain a non-compete provision extending seven years from termination of employment.

The Company is currently evaluating the fair market value of the assets purchased including intangible assets. Adjustments to the preliminary assets valuation as and when acquired may result when this evaluation is complete. There is no significant purchased research and development cost involved.

The operations of Qalytextil have been included in the Lakeland consolidated results commencing May 1, 2008. A condensed balance sheet at the acquisition date follows:

Current assets	(\$000 USD)
Cash and equivalents	\$ 34
Accounts receivables	1,199
Inventory	3,309
Other current assets	210
Total current assets	4,752
Fixed assets	1,249



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Intangible (Brands and Patents)	186
Other non-current assets	606
Total assets	6,791
Current Liabilities	
Loans	3,093
Trade payables and other current liabilities	3,477
Total current liabilities	6,570
Other non-current liabilities	
Net assets acquired	82
	137

Total cost of acquisition of Qualytextil, SA	\$ 13,670
Less net assets acquired	(137)
Less debt repayment at closing	(3,890)
Goodwill at closing	9,643
FAS 52 foreign currency translation adjustment at October 31, 2008	(2,094)
Goodwill at October 31, 2008 arising from Qualytextil, SA	\$ 7,549

Lakeland results on a pro-forma basis with Qualytextil results included as if acquired at beginning of each period shown are as follows:

	Q1 FY 09	Q2 FY 09	Q3 FY 09	Q3 FY 09 YTD	Q1 FY 08	Q2 FY 08	Q3 FY 08	Q3 FY 08 YTD
Sales	\$ 29,245	\$ 27,565	\$ 25,160	\$ 81,970	\$ 27,112	\$ 23,519	\$ 26,411	\$ 77,042
N e t								
Income	1,158	1,625	1,373	4,156	580	934	1,559	3,073
EPS	\$ 0.21	\$ 0.30	\$ 0.25	\$ 0.76	\$ 0.11	\$ 0.17	\$ 0.28	\$ 0.56

For Brazilian tax purposes, the Company expects to deduct goodwill over a five year period commencing upon the merger of its holding company into the operating company in Brazil which took place in November 2008.

There was a strike of Brazilian customs workers from mid-March to mid-May, 2008. This delayed many orders due to delays of imported raw materials. April sales were significantly lower than normal. May sales included this additional backlog from April. Since the acquisition was effective as of May 1, the revenue and profits included in the quarter ending July 31, 2008 were higher than would otherwise have occurred. Management estimates the benefit to May revenue and net income as approximately \$402,000 and \$160,000, respectively, or \$0.03 earnings per share.

#### 14. Fraud Involving China Plant Manager

In October 2008, a senior manager in charge of one of the Company's plants in China was terminated. He has been charged by Chinese authorities with selling non-woven fabric waste from garment production over the last eight years and personally keeping the proceeds. Such proceeds amount to approximately RMB4,000,000 (approximately USD\$580,000). Such proceeds allegedly originated periodically over the last eight years and were not significant in any one year. VAT taxes, custom duties, income taxes, interest fines and penalties are estimated to approximate the same amount of RMB4,000,000 (approximately USD \$580,000). The Company has received these funds from the former manager and estimates this will be sufficient to fund the estimated liabilities to the Chinese Government.

Further, the Company had been searching for an additional building to expand its China operations. In May 2008, this senior manager steered the Company into purchasing a building only 5 miles from our existing plants in AnQui City. The Company agreed to purchase this building for RMB4.2 million (approximately USD \$614,000). This senior manager was an undisclosed owner of this building. Further, a forged land lease was also issued. The Company has unwound this transaction and has received the return in full of the RMB4,000,000 million it paid in Q3 for this building. Such amount is included in Other Current Assets on the October 31, 2008 Balance Sheet. The Company also negotiated a four year lease for this property which will be reflected as prepaid rent for the RMB1.5 million spent by the Company for improvements.



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

You should read the following summary together with the more detailed business information and consolidated financial statements and related notes that appeared in our Form 10-K and Annual Report and in the documents that were incorporated by reference into our Form 10-K for the year ended January 31, 2008. This Form 10-Q may contain certain "forward-looking" information within the meaning of the Private Securities Litigation Reform Act of 1995. This information involves risks and uncertainties. Our actual results may differ materially from the results discussed in the forward-looking statements.

Overview

We manufacture and sell a comprehensive line of safety garments and accessories for the industrial protective clothing and homeland security markets. Our products are sold by our in-house sales force and independent sales representatives to a network of over 1000 safety, fire and mill supply distributors. These distributors in turn supply end user industrial customers such as integrated oil, chemical/petrochemical, automobile, steel, glass, construction, smelting, janitorial, pharmaceutical and high technology electronics manufacturers, as well as hospitals and laboratories. In addition, we supply federal, state and local governmental agencies and departments such as fire and police departments, airport crash rescue units, the Department of Defense, the Centers for Disease Control, and numerous other agencies of the federal, state and local governments.

We have operated manufacturing facilities in Mexico since 1995, in China since 1996, in India since 2006 and in Brazil since May of 2008. Beginning in 1995, we moved the labor intensive sewing operation for our limited use/disposable protective clothing lines to China and Mexico. Our facilities and capabilities in China, Mexico, India and Brazil allow access to a less expensive labor pool than is available in the United States and permit us to purchase certain raw materials at a lower cost than they are available domestically. As we have increasingly moved production of our products to our facilities in Mexico and China, we have seen improvements in the profit margins for these products. We continue to move production of our reusable woven garments and gloves to these facilities and expect to continue this process through fiscal 2009. As a result, we expect to see continuing profit margin improvements for these product lines over time.

Critical Accounting Policies and Estimates

The preparation of our financial statements in conformity with accounting principles generally accepted in the United States requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, net sales and expenses, and disclosure of contingent assets and liabilities. We base estimates on our past experience and on various other assumptions that we believe to be reasonable under the circumstances and we periodically evaluate these estimates.

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

**Revenue Recognition.** The Company derives its sales primarily from its limited use/disposable protective clothing and secondarily from its sales of high-end chemical protective suits, fire fighting and heat protective apparel, gloves and arm guards, and reusable woven garments. Sales are recognized when goods are shipped at which time title and the risk of loss passes to the customer. Sales are reduced for sales returns and allowances. Payment terms are generally net

30 days for United States sales and net 90 days for international sales.

Substantially all the Company's sales are made through distributors. There are no significant differences across product lines or customers in different geographical areas in the manner in which the Company's sales are made.

Rebates are offered to a limited number of our distributors, who participate in a rebate program. Rebates are predicated on total sales volume growth over the previous year. The Company accrues for any such anticipated rebates on a pro-rata basis throughout the year.

Our sales are generally final; however requests for return of goods can be made and must be received within 90 days from invoice date. No returns will be accepted without a written authorization. Return products may be subject to a restocking charge and must be shipped freight prepaid. Any special made-to-order items are not returnable. Customer returns have historically been insignificant.

Customer pricing is subject to change on a 30-day notice; exceptions based on meeting competitors pricing are considered on a case by case basis.

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

Allowance for Doubtful Accounts. We establish an allowance for doubtful accounts to provide for accounts receivable that may not be collectible. In establishing the allowance for doubtful accounts, we analyze the collectability of individual large or past due accounts customer-by-customer. We establish reserves for accounts that we determine to be doubtful of collection.

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

Valuation of Goodwill and Other Intangible Assets. On February 1, 2002, we adopted Statement of Financial Accounting Standards (SFAS) No. 142, "Goodwill and Other Intangible Assets," which provides that goodwill and other intangible assets are no longer amortized, but are assessed for impairment annually and upon occurrence of an event that indicates impairment may have occurred. Goodwill impairment is evaluated utilizing a two-step process as required by SFAS No. 142. Factors that we consider important that could identify a potential impairment include: significant underperformance relative to expected historical or projected future operating results; significant changes in the overall business strategy; and significant negative industry or economic trends. When we determine that the carrying value of intangibles and goodwill may not be recoverable based upon one or more of these indicators of impairment, we measure any potential impairment based on a projected discounted cash flow method. Estimating future cash flows requires our management to make projections that can differ materially from actual results.

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

separate insurance to cover the excess liability over set single claim amounts and aggregate annual claim amounts.

Significant Balance Sheet Fluctuation October 31, 2008 as compared to January 31, 2008

Cash decreased by \$1.3 million as a result of normal fluctuations in uncollected funds deposited and a reduction of excess cash in China. Accounts receivable increased by \$1.6 million. Inventory increased by \$6.9 million primarily due to an increase in Tyvek inventory purchasing levels, and our acquisition in Brazil. An increase in raw material of \$1.4 million was mainly due to our Brazil acquisition. Overall inventories increased by \$6.8 million from their January 2008 levels resulting from lower sales of Tyvek products in Q3 FY08 compared with purchasing commitments to vendors and our acquisition in Brazil. Raw material purchasing continued at higher levels than normal in order to take advantage of discounts offered by suppliers. Deferred income taxes increased by a \$.17 million tax benefit for the India and Mexican operations. Other current assets increased principally due to the accrual of \$.96 million in rebates related to the purchase of raw material. Accounts payable increased by \$1.8 million.

At October 31, 2008 the Company had an outstanding loan balance of \$25.5 million under its facility with Wells Fargo-Wachovia Bank, N.A. compared with \$8.9 million at January 31, 2008 largely to finance the purchase of the increase in inventory referred to above and the acquisition of Qvalytextil, SA in Brazil in May 2008. Total stockholders' equity decreased principally by the \$3.3 million other comprehensive loss (mainly due to foreign exchange rate fluctuations) and the \$1.3 million stock buyback program, partially offset by the net income of \$3.9 million for the period and equity compensation of \$.2 million.

Three months ended October 31, 2008 as compared to the three months ended October 31, 2007

Net Sales. Net sales increased \$1.7 million or 7.3% to \$25.2 million for the three months ended October 31, 2008 from \$23.5 million for the three months ended October 31, 2007. The net increase was mainly due to foreign sales. Domestic sales of disposables were down \$1.2 million or 8.2%. Wovens sales were off \$.9 million or 42.7%, mainly due to the downturn in the economy. Glove sales were off slightly. Chemical sales were strong at \$.4 million increase, or 16.1% and Reflective sales nearly doubled, up \$.7 million or 97.9% as a result of new safety standards and penetration of reflective sales to existing customers. Qvalytextil sales included in the current quarter were \$2.4 million. External sales from China increased by \$.2 million, or 21%, driven by sales to the new Australian distributor. Canadian sales decreased by \$.27 million, or 17%, UK sales increased by \$.13 million, or 15%, Chile sales decreased by \$.07 million, or 21%. US domestic sales decreased by \$1.1 million or 5.6% due to the slowing economy.

Gross Profit. Gross profit increased \$1.5 million or 26% to \$7.2 million for the three months ended October 31, 2008 from \$5.7 million for the three months ended October 31, 2007. Gross profit as a percentage of net sales increased to 28.5% for the three months ended October 31, 2008 from 24.3% for the three months ended October 31, 2007, primarily due to the inclusion of Brazilian operations at a 49.3% gross profit, the end of the prior year's sales rebate program to meet competitive conditions, certain higher-priced Tyvek being charged to the prior year cost of goods sold, offset by gross losses in India of \$.13 million resulting from delayed start up conditions

Operating Expenses. Operating expenses increased \$.76 million, or 17% to \$5.1 million for the three months ended October 31, 2008 from \$4.4 million for the three months ended October 31, 2007. As a percentage of sales, operating expenses increased to 20.3% for the three months ended October 31, 2008 from 18.6% for the three months ended October 31, 2007. The \$.76 million increases in operating expenses in the three months ended October 31, 2008 as compared to the three months ended October 31, 2007

- \$.086 million operating expenses incurred by Qvalytextil S.A., in Brazil now included in the three months ended October 31, 2008, not previously included.



- \$0.10 million increase in sales travel, trade shows and administrative travel costs to Brazil.
- \$0.05 million higher freight out costs resulting from prevailing carrier rates exclusive of Brazil.
- (\$0.07) million reduced R&D costs reflecting the completion of R&D on the ChemMax product line in the prior year.

- (\$0.08) million reduced operating expenses in India.
- (\$0.10) million miscellaneous net decreases.

Operating profit. Operating profit increased 50% to \$2.1 million for the three months ended October 31, 2008 from \$1.4 million for the three months ended October 31, 2007. Operating margins were 8.2% for the three months ended October 31, 2008 compared to 5.8% for the three months ended October 31, 2007.

Interest Expenses. Interest expenses increased by \$.2 million for the three months ended October 31, 2008 as compared to the three months ended October 31, 2007 due to higher borrowing levels outstanding mainly due to the funding for the Qvalytextil acquisition, partially offset by lower interest rates in the current year.

Income Tax Expense. Income tax expenses consist of federal, state, and foreign income taxes.

Income tax expenses increased \$.07 million, or 19%, to \$.45 million for the three months ended October 31, 2008 from \$.38 million for the three months ended October 31, 2007. Lakeland's effective tax rates were 25% and 29% for the three months ended October 31, 2008 and 2007, respectively. Included in the current year tax expense is the inclusion of Brazilian operations with an effective tax rate of 16%. Our effective tax rate for 2008 was impacted by higher statutory rates in China and some losses in India not eligible for tax credits and benefitted from some foreign exchange gains in Canada and UK. The effective tax rate for 2007 reflected an unusually low mix of domestic profits combined with higher profits in China. The 2007 China profits were taxed at a statutory rate of 15%. The China statutory tax rate increased to 25% effective January 1, 2008.

Net Income. Net income increased \$.44 million, or 48% to \$1.4 million for the three months ended October 31, 2008 from \$.93 million for the three months ended October 31, 2007. The increase in net income primarily resulted from the inclusion of the Qvalytextil acquisition and an increase in sales and profits across all operations.

Nine months ended October 31, 2008 as compared to the nine months ended October 31, 2007

Net Sales. Net sales increased \$9.2 million, or 13% to \$80 million for the nine months ended October 31, 2008 from \$70.8 million for the nine months ended October 31, 2007. The increase in sales was mainly in international sales. Sales decreased in disposable garments of \$1.7 million in the U.S. and \$.1 million in Canada primarily due to competitive market conditions and competitors rebate programs, counter balanced by growth in sales in Chile and United Kingdom subsidiaries of \$1.1 million and by increased external sales from China of \$4.5 million. The Company expects to reopen its Indian facility in December 2008, so the resumption of glove sales should take full effect in the first quarter of fiscal 2009. Sales of wovens and gloves were flat compared to the same period last year. Sales from Brazil of \$5.5 million were included in the current year-to-date sales reflecting sales in Q2 and Q3, not included in prior year's sales. Reflective sales are up \$1.2 million for the nine months this year compared with last year, or 52.2%.

Gross Profit. Gross profit increased \$5.8 million or 36% to \$22 million for the nine months ended October 31, 2008 from \$16.2 million for the nine months ended October 31, 2007. Gross profit as a percentage of net sales increased to 27.5% for the nine months ended October 31, 2008 from 22.9% for the nine months ended October 31, 2007, primarily due to the inclusion of Brazilian operations at a 53% gross profit, a one-time plant restructuring charge in Mexico of \$.5 million in the previous year, the end of a sales rebate program in the prior year to meet competitive conditions, offset by gross losses in India of \$.5 million resulting from delayed start-up conditions.

Operating Expenses. Operating expenses increased \$3.4 million, or 26% to \$16.3 million for the nine months ended October 31, 2008 from \$12.9 million for the nine months ended October 31, 2007. As a percentage of sales, operating expenses increased to 20.4% for the nine months ended



October 31, 2008 from 18.3% for the nine months ended October 31, 2007. This increase as a percent of sales is largely due to Brazil operations, which runs at a higher margin with higher operating expenses. The increase in operating expenses in the nine months ended October 31, 2008 as compared to the nine months ended October 31, 2007 included:

- \$1.78 million operating expenses incurred by Qualytextil SA, in Brazil now included in the nine months ended October 31, 2008.
- \$0.59 million additional freight out costs resulting from significantly higher prevailing carrier rates and higher volume.
  - \$0.41 million in additional selling expenses, travel and commission exclusive of Brazil.
    - \$0.30 million in costs relating to the proxy contest.
- \$0.28 million increased operating costs in China as the result of the large increase included in direct international sales made by China, are now allocated to SGA costs, previously allocated to cost of goods sold.
  - \$0.16 million higher operating expenses in Chile due to higher volume.
    - \$0.14 million miscellaneous increases.
  - (\$0.12) million lower start-up expenses in India.
  - (\$0.15) million in reduced currency fluctuation costs.

**Operating Profit.** Operating profit increased 75% to \$5.7 million for the nine months ended October 31, 2008 from \$3.3 million for the nine months ended October 31, 2007. Operating margins were 7.1% for the nine months ended October 31, 2008 compared to 4.6% for the nine months ended October 31, 2007.

**Interest Expenses.** Interest expenses increased by \$.43 million for the nine months ended October 31, 2008 as compared to the nine months ended October 31, 2007 because of higher amounts borrowed and lower interest rates under the Company's credit facility.

**Income Tax Expense.** Income tax expenses consist of federal, state, and foreign income taxes. Income tax expenses increased \$.37 million, or 39%, to \$1.3 million for the nine months October 31, 2008 from \$.94 million for the nine months ended October 31, 2007. Lakeland's effective tax rates were 25% and 29% for the nine months ended October 31, 2008 and 2007, respectively. Included in the current year tax expense is a reduction of \$207,000 of income tax expense resulting from the settlement with the IRS (see Note 10) and the inclusion of Brazilian operations with an effective tax rate of 16%. The 2007 period reflected a 12.5% statutory rate for China (raised to 25% effective January 1, 2008) and was impacted by the \$500,000 charge for the Mexican plant restructuring in the previous year for which no tax credit was available. Without this \$500,000 charge, the effective rate for the 2007 period would have been 25.1%.

**Net Income.** Net income increased \$1.6 million, or 70% to \$3.9 million for the nine months ended October 31, 2008 from \$2.3 million for the nine months ended October 31, 2007. The increase in net income primarily resulted from the acquisition in Brazil, the result of meeting competitive conditions in the disposable garment division both in the U.S. and Canada and the Mexican restructuring in the prior year, offset by the combined operating losses of \$.7 million of the new foreign operations.

#### Liquidity and Capital Resources

**Cash Flows.** As of October 31, 2008 we had cash and cash equivalents of \$2.1 million and working capital of \$72.5 million; a decrease of \$1.3 million and an increase of \$7.2 million, respectively, from January 31, 2008. Our primary sources of funds for conducting our business activities have been cash flow provided by operations and borrowings under our credit facilities described below. We require liquidity and working capital primarily to fund increases in inventories and accounts receivable associated with our net sales and, to a lesser extent, for capital expenditures.

Net cash used in operating activities of \$1.1 million for the nine months ended October 31, 2008 was due primarily to net income of \$3.9 million, an increase in other assets of \$2.2 million, and an increase in inventories of \$3.5 million, with an decrease in accounts receivable of \$.4 million. Net cash used in investing activities of \$15.3 million in the nine months ended October 31, 2008, was mainly due to the Qualytextil acquisition, and also the purchases of property and equipment.

We currently have one credit facility - a \$30 million revolving credit, of which \$25.5 million of borrowings were outstanding as of October 31, 2008. Our credit facility requires that we comply with specified financial covenants relating to fixed charge ratio, debt to EBITDA coverage, and inventory and accounts receivable collateral coverage ratios. These restrictive covenants could affect our financial and operational flexibility or impede our ability to operate or expand our business. Default under our credit facility would allow the lender to declare all amounts outstanding to be immediately due and payable. Our lender has a security interest in substantially all of our assets to secure the debt under our credit facility. As of October 31, 2008, we were in compliance with all covenants contained in our credit facility.

We believe that our current cash position of \$2.1 million, our cash flow from operations along with borrowing availability under our \$30 million revolving credit facility will be sufficient to meet our currently anticipated operating, capital expenditures and debt service requirements for at least the next 12 months.

**Capital Expenditures.** Our capital expenditures principally relate to purchases of manufacturing equipment, computer equipment, and leasehold improvements, as well as payments related to the construction of our new facilities in China. Our facilities in China are not encumbered by commercial bank mortgages, and thus Chinese commercial mortgage loans may be available with respect to these real estate assets if we need additional liquidity. Our capital expenditures are expected to be approximately \$1.2 million for capital equipment, primarily computer equipment and apparel manufacturing equipment in fiscal 2010.

**Foreign Currency Exposure.** The Company has foreign currency exposure, principally through its investment in Brazil, sales in Canada and the UK and production in Mexico and China. Management has commenced a hedging program to offset this risk by purchasing forward contracts to sell the Canadian Dollar, Euro and Great Britain Pound. Such contracts are largely timed to expire with the last day of the fiscal quarter, with a new contract purchased on the first day of the following quarter, to match the operating cycle of the company. Management has decided not to hedge its long positions in the Chinese Yuan and Brazilian Real.

The Company accounts for its foreign exchange derivative instruments under Statement of Financial Accounting Standards ("SFAS") No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended. This standard requires recognition of all derivatives as either assets or liabilities at fair value and may result in additional volatility in both current period earnings and other comprehensive income as a result of recording recognized and unrecognized gains and losses from changes in the fair value of derivative instruments.

The Company had one derivative instrument outstanding at October 31, 2007 which was treated as a cash flow hedge intended for forecasted purchases of merchandise by the Company's Canadian subsidiary no longer outstanding at October 31, 2008. The change in the fair market value of the effective hedge portion of the foreign currency forward exchange contracts was a loss of \$77,000, for the nine month period ended October 31, 2008 which was released into operations based on the timing of the sales of the underlying inventory. The release to operations was reflected in cost of products sold. During the period ended October 31, 2007, the Company recorded an immaterial loss in cost of goods sold for the remaining portion of the foreign currency forward exchange contract that did not qualify for hedge accounting treatment. The derivative instrument was in the form of a foreign currency "participating forward" exchange contract. The "participating forward" feature affords the Company full protection on the downside and the ability to retain 50% of any gains, in exchange for a premium at inception. Such premium is built into the contract in the form of a different contract rate in the amount of \$0.016.

The company has a net investment in Brazil denominated in foreign currency of approximately 22 million Brazilian Reals. Management has decided not to hedge this investment at this time. Applying translation methodology per SFAS 52 results in a Currency Translation Adjustment of \$3.3 million, included in Other Comprehensive Loss in Stockholders' Equity on the Balance Sheet at October 31, 2008. We are exposed to interest rate risk from debt. We have hedged against the risk of changes in the interest rate associated with our variable rate Revolving Credit (See Note 12) by entering into a variable-to-fixed interest rate swap agreement, designated as fair value hedges, with a total notional amount of \$18 million as of October 31, 2008. We assume no hedge ineffectiveness as each interest rate swap meets the short-cut method requirements under SFAS 133 for fair value hedges of debt instruments. As a result, changes in the fair value of the interest rate swaps are offset by changes in the fair value of the debt, both are reported in interest and other income and no net gain or loss is recognized in earnings.

The fair values of all derivatives recorded on the consolidated balance sheet are as follows:

	October 31, 2008	January 31, 2008
<b>Unrealized Gains:</b>		
Foreign currency exchange contracts	-----	-----
<b>Unrealized (Losses):</b>		
Foreign currency exchange contracts	-----	\$ 77,000
Interest rate swaps	\$ 33,825	\$ 0

### Item 3. Quantitative and Qualitative Disclosures About Market Risk

There have been no significant changes in market risk from that disclosed in our Annual Report on Form 10-K for the fiscal year ended January 31, 2008.

### Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures - Lakeland Industries, Inc.'s Chief Executive Officer and Chief Financial Officer, after evaluating the effectiveness of Lakeland Industries, Inc.'s disclosure controls and procedures (as defined in Rule 13a-15(e) or 15d-15(c) under the Securities Exchange Act) as of the end of the period covered by this report, have concluded that, based on the evaluation of these controls and procedures, the Company's disclosure controls and procedures were not effective as of October 31, 2008. Our Chief Executive Officer and Chief Financial Officer have concluded that we have a material weakness in our internal control over our China operations and financial reporting as of October 31, 2008.

A control system, no matter how well conceived and operated, can provide only reasonable assurance that the objectives of the control system are met. Our management, including our chief executive officer and chief financial officer, does not expect that our disclosure controls and procedures or internal control over financial reporting will prevent all errors and fraud. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues within our company have been detected. These inherent limitations include the reality that judgments in decision-making can be faulty, and that breakdowns can occur because of simple errors or mistakes. The design of any control system is also based, in part, upon certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Over time, controls may become inadequate because of changes in conditions, or the degree of compliance with the policies or procedures may

deteriorate. Because of the inherent limitations in a control system, misstatements due to error or fraud may occur and not be detected.

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



Management has identified a material weakness in its internal control over our China operations and financial reporting. A senior manager in charge of one of the Company's plants in China was terminated after being charged by China authorities with, over the last eight years, selling non-woven fabric waste from garment production and personally keeping the proceeds. This control deficiency is the result of fraud and inadequate controls governing non-woven fabric waste. See further discussion in Footnote 14 to the financial statements herein.

**Previous Material Weaknesses-** In its report at April 30, 2008, management had previously identified a material weakness in its period-end financial reporting process relating to employee withholding for medical insurance. The employee withholding for medical insurance was not offset against the expenses as a result of human error and was not identified on review due to the favorable claim experience resulting in lowered expenses. This control deficiency resulted in an adjustment to our April 30, 2008 financial statements and could have resulted in an overstatement of cost of sales and operating expenses that would have resulted in an understatement of net earnings in the amount of \$127,000 to the interim financial statements if not detected and prevented.

Management had also previously identified two material weaknesses at January 31, 2008, in its period-end financial reporting process relating to the elimination of inter-company profit in inventory and the inadequate review of inventory cutoff procedures and financial statement reconciliations from one of our China subsidiaries. The material weakness which related to the elimination of inter-company profit in inventory resulted from properly designed controls that did not operate as intended due to human error. The material weakness that resulted in the inventory cut-off error was as a result of the improper reconciliation of the conversion of one of our China subsidiaries' financial statements from Chinese GAAP to U.S. GAAP. We engaged a CPA firm in China to assist management in this conversion, and the Chinese CPA firm's review as well as management's final review did not properly identify the error in the reconciliation. These control deficiencies resulted in audit adjustments to our January 31, 2008 financial statements and could have resulted in a misstatement to cost of sales that would have resulted in a material misstatement to the annual and interim financial statements if not detected and prevented.

As described below under the heading "Changes in Internal Controls Over Financial Reporting," we have previously taken a number of steps designed to improve our accounting for our Chinese subsidiaries, the elimination of intercompany profit in inventory, and employee withholding for medical insurance.

**Changes in Internal Control Over Financial Reporting –** Except as described below, there have been no changes in our internal control over financial reporting since January 31, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**Remediation -** In response to the material weaknesses identified at January 31, 2008, we continue the process of initiating additional review procedures to reduce the likelihood of future human error and are transitioning to internal accounting staff with greater knowledge of U.S. GAAP to improve the accuracy of the financial reporting of our Chinese subsidiary. We have automated key elements of the calculation of intercompany profits in inventory and formalized the review process of the data needed to calculate this amount. With the implementation of this corrective action we believe that the previously identified material weakness relating to intercompany profit elimination has been remediated as of the first quarter of the fiscal year 2009.

In response to the material weakness identified at April 30, 2008, we have initiated additional review procedures to reduce the likelihood of future human error on the assets and liabilities trial balance amounts. Management believes that the remediation relating to the weakness relating to the Chinese subsidiaries is now completely in effect.

Effective in full at October 31, 2008, management has taken primary responsibility to prepare the US GAAP financial reporting based on China GAAP financial statements. This function was previously performed by outside accountants

in China. Further, US corporate management is now also reviewing the China GAAP financial statements. In addition, in July 2008, an internal auditor was hired in China who will report directly to the US corporate internal audit department and who will work closely with US management.

In response to the material weakness identified at October 31, 2008, we will initiate a China Internal Control Committee. Such Committee will review, examine and evaluate China operating activities, and plan, design and implement internal control procedures and policies. The Committee will report to the Chief Financial Officer. In particular, the Committee will focus on: strengthening controls over waste/scrap sales, upgrading local accounting manager authority and responsibility, and creating new banking and inventory controls.

We believe the above remediation steps will provide us with the infrastructure and processes necessary to accurately prepare our financial statements on a quarterly basis.

Lakeland Industries, Inc.'s management, with the participation of Lakeland Industries, Inc.'s Chief Executive Officer and Chief Financial Officer, has evaluated whether any change in the Company's internal control over financial reporting occurred during the third quarter of fiscal 2009. Based on that evaluation, management concluded that there have not been changes in Lakeland Industries, Inc.'s internal control over financial reporting during the third quarter of fiscal 2009 that have materially affected, or is reasonably likely to materially affect, Lakeland Industries, Inc.'s internal control over financial reporting.

## PART II. OTHER INFORMATION

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

Item 4.

None

Item 6.

Exhibits and Reports on Form 8-K:

### Exhibits:

- a. 31.1 Certification Pursuant to Rule 13a-14(b) and Rule 15d-14(b) of the Exchange Act, Signed by Chief Executive Officer (filed herewith)
- b. 31.2 Certification Pursuant to Rule 13a-14(b) and Rule 15d-14(b) of the Exchange Act, Signed by Chief Financial Officer (filed herewith)
- c. 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Signed by Chief Executive Officer (filed herewith)
- d. 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, Signed by Chief Financial Officer (filed herewith)

### Reports on Form 8-K:

- a - On August 1, 2008, the Company filed a Form 8-K under item 8.01 stating that on July 23, 2008, the Company reached a settlement with the Internal Revenue Service regarding its examination of the Company's Federal Income Tax returns for taxable years ending January 31, 2003, 2004 and 2005.
- b -

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On August 7, 2008, the Company filed a Form 8-K/A under items 5.03 and 8.01. Item 5.03 states that on June 18, 2008 the Board of Directors of the Company amended and restated the Bylaws of the Company. Item 8.01 states that on June 18, 2008 the Board of Directors of the Company adopted various amendments to the Bylaws.

- c - On September 9, 2008, the Company filed a Form 8-K under items 2.02 for the purpose of furnishing a press release announcing the Company's Q2 FY09 financial results for the reporting period ended July 31, 2008.
- d - On September 23, 2008, the Company filed a Form 8-K under items 1.01 and 2.03. Item 1.01 states that on September 23, 2008 the Company entered into an interest rate swap agreement with Wachovia Bank, N.A. pursuant to a confirmation that incorporates the 1992 ISDA master Agreement, as amended in 2006. Item 2.03 states Creation of a direct financial obligation or an obligation under an off-balance sheet arrangement of a registrant.

SIGNATURES

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

LAKELAND INDUSTRIES,  
INC.

(Registrant)

Date: December 10, 2008

/s/ Christopher J. Ryan  
Christopher J. Ryan,  
Chief Executive Officer,  
President,  
Secretary and General Counsel  
(Principal Executive Officer  
and Authorized  
Signatory)

Date: December 10, 2008

/s/Gary Pokrassa  
Gary Pokrassa,  
Chief Financial Officer  
(Principal Accounting Officer  
and Authorized  
Signatory)