Lakeland Industries Inc. ~ LAKE (Nasdaq)

Investment Position: Accumulation Investment

Investment Overview

It took less than a month following the attacks of 9/11 for shares in Lakeland to double. The story went that Lakeland, a maker of protective clothing, was part of a new class of companies - companies that would produce the protective gear needed to live in a world dealing with terrorism. The story turned out to be non-fiction: Lakeland suits were worn at the World Trade Center clean-up, later during the Anthrax letter scares, and the FBI reportedly purchased all of Lakeland's Saranex-coated suits.

While the terrorism related safety products sold by Lakeland are definitely part of the company's appeal, attempting to quantify the future impact of anti-terror spending in America and around the world is impossible to do. We largely avoid speculating on Lakeland's 'terror hedge' qualities, and instead focus on the tangible directions the company is taking.

We believe that an investment in Lakeland is attractive because of its management. Sixty-seven year old co-founder and Chairman, Raymond J. Smith, remains an integral component to the direction of the company, as does President and CEO Christopher J. Ryan. Given that Mr. Smith and Mr. Ryan own approximately 9.56% and 6.52% of LAKE common stock respectively (As of April 12, 2006), it is safe to say that an investment in Lakeland is essentially an investment in the long-term vision of these individuals.

We are selecting Lakeland Industries for the Wish List because we believe that this well managed company can produce attractive returns over the long-term. Moreover, we believe that the company is effectively positioned to benefit as, and if, more emerging economies enact regulatory policies that follow OSHA in America, or industrial safety standards to help protect employees.

Despite our longer-term investment aspirations, we are aware that Lakeland could temporarily be held captive by cyclical trends in the U.S. economy. Accordingly, we would not be immune to locking in profits on share price appreciation if the fundamentals did not back such a rally. We use the word 'accumulate' to depict our investment position because we would prefer to purchase shares on weakness and/or at current market prices.

Business Overview

Founded in 1982, Lakeland, primarily using facilities in China and Decatur, Alabama, manufactures and sells safety garments and accessories for the industrial protective clothing market. The company has 6-different product lines, and these lines have unique considerations. For example, 'Limited Use/ Disposable Protective Clothing' derives part of its sales from the healthcare industry and thus can be recurring in nature, while 'High End Protective Suits' sales tend to be more sporadic; potentially benefiting from a chemical or biological attack scare or the dispersal of more government funds allocated to defend against such a threat.

Lakeland's Product Categories	
Limited Use/Disposable Protective Clothing	Gloves and Arm Guards
High-End Chemical Protective Suits	Reusable Woven Garments
Fire Fighting and Heat Protective Apparel	

Through 3 regional sales managers, the company brings product to market by utilizing a network of independent sales representatives and distributors. The company's distribution mix has changed very little in the past, and despite certain products competing with the likes of DuPont and Kimberly Clark, Lakeland was able to expand its distribution reach in fiscal 2005.

LAKE Sales/Marketing	2006	2005	2004	2003	2002	2001	2000	1999
In-house sales force	17	17	14	9	9	9	9	9
Independent sales representatives	42	42	42	44	44	44	44	44
Safety and mill supply distributors	800+	800+	500+	500+	500+	500+	500+	500+

The company differentiates itself from its competitors first and foremost by its product offerings. One of the most important such offerings stems from Lakeland's North American and International trademark licensing agreements for Tyvek(R), TyChem(R), and Kevlar(R) backed products. These products, made possible via the purchase of raw materials from the company's largest supplier, DuPont, have in recent decades become the standard for limited use/disposable protective clothing. As 'one of the largest independent customers of DuPont's Tyvek(R) and TyChem(R) apparel grade material', Lakeland plans to expand the use of these materials (especially Tyvek) into more industries.

While product quality and reliable distribution routes can serve to minimize the threat of commoditization (i.e. other things being equal larger companies could produce your basic hospital apron more cheaply than LAKE), Lakeland is also intensely involved in product innovation. For example, and with the goal of minimizing its reliance on one key supplier, Lakeland produces proprietary fabrics Micromax and Micromax NS. According to the company these materials *"provide protection from low risk contaminants or irritants, such as chemicals, pesticides, fertilizers, paint, grease and dust, and from limited exposure to hazardous waste and toxic chemicals, including acids, asbestos, lead and hydro-carbons (or PCBs) that pose health risks after exposure for long periods of time."* Suffice to say, product innovation is an important consideration for Lakeland, and, potentially, one of the main 'controllable' initiatives that could sustain or increase the company's margins in a mature U.S. market.

As for the 'uncontrollable' facets of the business, as stated the company is 'cyclical' – meaning a downturn in economic activity or specific industry activity could negatively impact demand for and the pricing of Lakeland's products. With Lakeland meshing together an impressive 11-year profits run it may be difficult for many investors to see exactly how 'cyclical' trends can be dangerous. However, a string of losses from 1990-1994 primarily due to a soft U.S. economy should serve as a reminder that bad times do in fact come. And while there is very little Lakeland can do to stop the U.S. economy's boom/bust tendencies, there is reason to believe that the company, whose balance sheet is in better shape than many of its competitors, is prepared to ride out any storm.

Another uncontrollable aspect worth considering is the competitive landscape. Given that Lakeland competes with a gaggle of smaller and similarly sized public companies, it is difficult to effectively monitor and forecast every important trend in the marketplace. For example, Alpha Pro Tech signing up with a new distributor or Mine Safety Appliances touting a new 'groundbreaking!' safety material may be important…but then again it may not. To make matters even more difficult, many smaller competitors are private, older companies whose financial condition is not readily available for analysis. As for the many larger players in the group (think Ansell Occupational Healthcare), the highly fragmented nature of the product line means that some companies are identifiable as threats to Lakeland's current product catalog while many others are not.

To better understand the competitive landscape a quote from Lakeland's latest 10K will suffice. Although lengthy, the series of events discussed below do a good job of pointing out some of the pertinent topics of interest:

"The industrial protective clothing industry is highly fragmented and consists of a large number of small, closely-held family businesses. DuPont, Lakeland and Kimberly Clark are the dominant disposable industrial protective apparel manufacturers. Since 1997, the markets for manufacturing and distribution have consolidated. A number of large distributors with access to capital have acquired smaller distributors. The acquisitions include Vallen Corporation's acquisitions of Safety Centers, Inc., All Supplies, Inc., Shepco Manufacturing Co., and Century Safety (Canada) and Hagemeyer's acquisition of Vallen Corporation; W.W. Grainger's acquisitions of Allied Safety, Inc., Lab Safety Supply, Inc., Acklands Limited, Gempler's safety supply division and Ben Meadows, Inc.; Air Gas' acquisitions of Rutland Tool & Supply Co., Inc., IPCO Safety Supply, Inc., Lyon Safety, Inc., Safety Supply, Inc., Safety West, Inc. and Delta Safety Supply, Inc.; and Fischer Scientific's acquisitions of Safety Services of America, Cole-Parner, Retsch and Emergo.

As these safety distributors consolidate and grow, we believe they are looking to reduce the number of safety manufacturing vendors they deal with and support, while at the same time shifting the burden of end user selling to the manufacturer. This creates a significant capital availability issue for small safety manufacturers as end user selling is more expensive, per sales dollar, than selling to safety distributors. As a result, the manufacturing sector in this industry is seeing follow-on consolidation. DuPont has acquired Marmac Manufacturing, Inc., Kappler, Inc., Cellucup, Melco, Mfg., and Regal Manufacturing since 1998, while in the related safety product industries Norcross Safety Products L.L.C. has acquired Morning Pride, Ranger-Servus, Salisbury, North and Pro Warrington and Christian Dalloz has acquired Bacou, USA which itself acquired Uvex Safety, Inc., Survivair, Howard Leight, Perfect Fit, Biosystems, Fenzy, Titmus, Optrel, OxBridge and Delta Protection."

For the record, Lakeland has been a consolidator: acquiring Mifflin Valley, Inc., on August 1, 2005, and, more recently, acquiring the Industrial Glove assets of RFB Latex, Ltd. (India) in November 2006 for $3.4 million. It is highly probable that the company will make more acquisitions in the future, and although the company is tightly held with family members in key positions, Lakeland could itself be an attractive target for others.

With quality products, reliable distribution, and an attractive balance sheet insofar as consolidation trends are concerned, Lakeland is positioned in an industry that is expected to grow at a compound annual growth rate of 6.5% (Global Industry Analysts, Inc., LAKE 10K). Moreover, the company is well positioned for what should be a shift in the opportunity spectrum. Quite frankly, with the U.S. already making up an estimated third of the global market for industrial work clothing, tomorrows brightest opportunities will clearly arise in different parts of the world. This is the case not only because many countries are expected to grow more rapidly than the U.S. in the future, but also because demand for protective gear in many emerging markets could increase when, and if, regulatory standards arrive to better protect employees. Lakeland is, and has been preparing for this opportunity shift, with notable interests in Mexico (since 1995), China (since 1996), and newer operations in India, Chile, and Japan.

LAKE Sales ($)	2006	2005	2004	2003	2002
Domestic	89,107,000	86,320,000	81,763,000	72,126,000	71,962,000
International	9,633,000	9,000,000	7,954,000	5,700,000	4,469,000
Annual Growth Rate					
Domestic	3.23%	5.57%	13.36%	0.23%	
International	7.03%	13.15%	39.54%	27.55%	

Statistically Speaking

Lakeland has declared four dividends since 2002, with each taking the form of a 10% stock dividend to shareholders. Although there is reason to believe that the company will declare more stock dividends in the future, it is worth noting that after declaring a stock dividend in 2002 and 2003 that the company took a break in 2004 before resuming the same dividend policy in 2005 and 2006. Another break in 2007 and future years is highly probable.

Even when taking dividends and acquisitions into account, S&P says that Lakeland has been able to increase its tangible book value per outstanding share in each of the last 10-years. Not to nitpick, but for our purposes we try to follow a company's diluted share count, and in Lakeland's case this means that the company's tangible book *per diluted share* has not increased every single year over the last decade. Regardless, the long-term balance sheet story is nonetheless attractive, with the company's cash and receivables (pre-acquisition) being enough to take care of the company's entire debt load.

LAKE ($)	31-Oct-06	31-Jan-06	31-Jan-05	31-Jan-04	31-Jan-03	31-Jan-02	31-Jan-01	31-Jan-00
Cash	3,442,035	1,532,453	9,185,382	2,445,271	1,474,135	1,760,635	784,578	650,541
Accounts Receivable, net	13,101,408	14,221,281	13,117,374	12,570,320	10,364,188	9,600,738	10,858,288	8,379,477
Inventories, net	45,178,433	45,243,490	30,906,023	26,265,807	25,470,044	26,529,150	22,710,083	22,467,395
Other	4,242,529	2,722,236	1,919,225	2,003,376	1,550,697	1,654,303	1,745,890	962,698
Current Assets	65,964,405	63,719,460	55,128,004	43,284,774	38,859,064	39,544,826	36,098,839	32,460,111
Property & Equipment, net	7,587,325	7,754,765	5,014,240	3,921,308	3,356,835	2,218,459	1,978,070	1,851,964
Other Assets, net	2,790,710	118,330	171,010	97,745	358,001	654,200	551,057	457,175
Goodwill	871,297	871,297	0	0	248,834	0	0	0
Total Assets	77,213,737	72,463,852	60,313,254	47,303,827	42,822,734	42,417,485	38,627,966	34,770,250
Current Debt	4,204,562	3,839,300	4,152,163	21,509,178	20,934,095	22,778,426	20,051,978	16,551,223
Total Debt	12,515,534	11,667,816	5,846,583	22,276,857	21,463,310	23,690,531	22,091,454	19,364,866
Shareholders' Equity	64,698,203	60,796,036	54,466,671	25,026,970	21,359,424	18,726,954	16,536,512	15,405,384
Tangible Equity Per Diluted	11.54	11.93	12.17	6.95	6.46	5.77	5.64	5.76

Perhaps speculating that anti-terrorism related spending in the U.S. will permanently soften, that a recession is coming, and/or that Lakeland's international expansion plans will fail, investors have largely ignored the company's attractive balance sheet and priced the company at an attractive 1.19 times tangible book. For a company that has been successful for so long 1.19 times book is shocking.

LAKE Highlights (millions $)	2006	2005	2004	2003	2002	2001	2000	1999	1998	1997
Revenue	98.7	95.3	89.7	77.8	76.4	76.1	58.6	54.7	47.3	41.8
Operating Income	10.5	8.54	6.84	4.95	4.28	3.39	3.9	4.46	3.47	2.37
Depreciation	0.99	0.88	0.8	0.6	0.69	0.7	0.6	0.54	0.44	0.34
Interest Expense	0.17	0.21	0.53	0.64	0.88	1.25	0.82	0.77	0.5	0.51
Pretax Income	9.77	7.56	5.3	3.78	1.12	1.49	2.51	3.22	2.59	1.58
Net Income	6.33	5.02	3.64	2.6	1.97	1.12	1.75	2.08	1.6	1.06
Cash Flow	7.32	5.9	4.44	3.2	2.66	1.82	2.35	2.62	2.04	1.4
Capital Expenditures	4.59	0.84	1.37	1.73	0.83	0.75	0.6	0.39	0.8	0.28
Current Ratio	16.6	13.3	2	1.9	1.7	1.8	2	2	4.8	5.8
% Return on Assets	9.5	9.3	8.1	6.1	4.9	3.1	5.6	7.9	7.2	5.6
% Return on Equity	11	12.6	15.7	13	11.2	7	12	16.5	15	11.4
% Net Income of Revenue	6.4	5.3	4.1	3.3	2.6	1.5	3	3.8	3.4	2.5

This is not to say that Lakeland will necessarily replicate or best the performance improvements logged for the 3-years ending 2006. Quite frankly, the company has benefited from temporary incidents in recent years

(SARS in 2003 and ricin letters in 2004), and net margins (blue bold above) may in fact be set to retreat in the years ahead. Moreover, when taking into consideration that the almost 90% (our estimate) of the $5+ billion from the Bio Terrorism Preparedness and Response Act of 2002 has been spent, the expectation that margins will soften hardens.

But while a reduction in U.S. government bio preparedness spending could prove a challenge, opportunities in domestic fire fighting, in continuing hospital preparedness, and in international markets still exist. Lakeland's balance sheet is screaming survival as investors turn a deaf ear.

	Quarters Ending						
LAKE ($)	**31-Oct-06**	**31-Jul-06**	**30-Apr-06**	**31-Jan-06**	**31-Oct-05**	**31-Jul-05**	**30-Apr-05**
Net Sales	23,262,933	24,086,862	27,222,025	25,224,796	22,717,196	25,089,146	25,708,928
Cost of Goods Sold	17,626,698	17,621,040	20,689,295	18,947,695	17,034,455	19,293,516	19,542,049
Gross profit	5,636,235	6,465,822	6,532,730	6,277,101	5,682,741	5,795,630	6,166,879
Gross Profit Margin	24%	27%	24%	25%	25%	23%	24%
Total Operating Expenses	4,579,291	4,384,931	4,365,914	3,557,088	3,652,724	3,589,281	3,620,845
TOP as a % of Rev	20%	18%	16%	14%	16%	14%	14%
Operating Profit	1,056,944	2,080,891	2,166,816	2,720,013	2,030,017	2,206,349	2,546,034
Interest Expense	-79,696	-116,080	-70,693	-123,951	-38,842	-3,582	-430
Net Income	980,050	1,354,519	1,461,775	1,655,274	1,312,903	1,648,210	1,712,977
Diluted	5,531,497	5,524,110	5,023,388	5,021,887	5,524,109	5,523,164	5,021,476
Stress Points: Expansion plans are costing more money and interest expenses are rising.						Gross margins firm.	

Insiders On The Inside

With 20% of LAKE's stock controlled by directors and executive officers, it is possible that the small shareholders interests are not fully taken into account. One potentially worrisome trend is that company directors and executive officers, not to mention foreign employees in Mexico and China, have historically (and currently) been involved in leasing buildings and land to and offering financing to Lakeland. Innocently, the company claims that in the past the company used such creative arrangements "because our access to third party financing was insufficient" (10Q). Although we have no reason to suggest otherwise, we would obviously not like to see these types of deals being made.

Conclusion and Investment Opinion

Although LAKE only came to be in 1982, Chairman Raymond J. Smith was actually one of the first people to actively start selling Tyvek garments in 1966 through a company called 'Disposables Inc.' When the Occupational Safety and Health Act arrived in 1970, the market for disposable protective garments started to grow, and 'Disposables' benefited. However, when Mr. Smith, a minority shareholder and President of Disposables, was fired in1982 he was asked to sign a non-compete clause…He elected instead to find attorney Patrick Murphy, who prodded Smith not to sign but instead start a new company. As 'fundinguniverse.com' notes:

"Although DuPont was no longer selling Tyvek to new customers, it made an exception in Smith's case. In a very short time, 59 days from the day Smith was fired, Lakeland shipped its first product."

24-years later, Raymond's Smith's son, Paul C. Smith, who has been with the Lakeland since 1998, purchased his first 357 shares in the company…potentially starting another chapter.

Although Lakeland does not pay a reliable dividend and shares could potentially be hurt by a recession, we are nonetheless selecting the stock based upon the conclusion that the company is well run and attractively priced. Given that the company's balance sheet is in better shape than many of its competitors, this suggests that an industry slow down could result in Lakeland – either through timely acquisitions and/or the demise of some competitors – emerging from the highly fragmented competitive landscape stronger.

While the company's long-term growth rates may ultimately be determined by regulatory efforts (or lack thereof) in emerging economies, the 'terror hedge' slant is also a consideration (as much as we want to ignore it). We hope and pray that things could be different, but unfortunately the world is a very dangerous place and protecting people from threats such as bio-terrorism, SARS, bird flu, etc. is a must.

Sincerely,

Brady Willett
Todd Alway