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Franklin Electric *CO INC*



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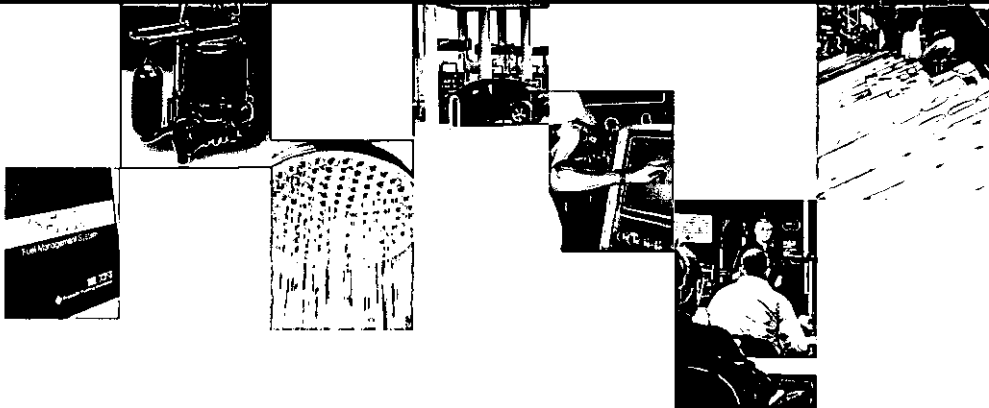


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2006 Annual Report



About The Company

Franklin Electric is a global leader in the production and marketing of water and fuel pumping systems and is a technical leader in submersible motors, drives, controls and monitoring devices. Franklin's products are present in approximately one of every two water wells and filling stations worldwide.

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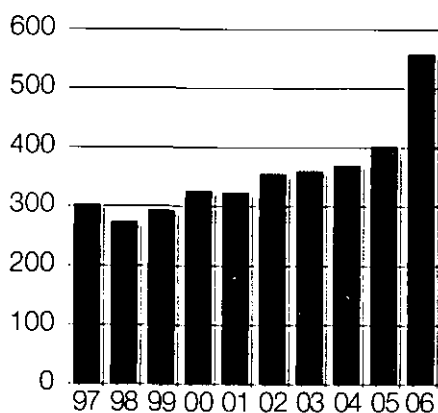
2006 Financial Highlights

In thousands, except per share amounts

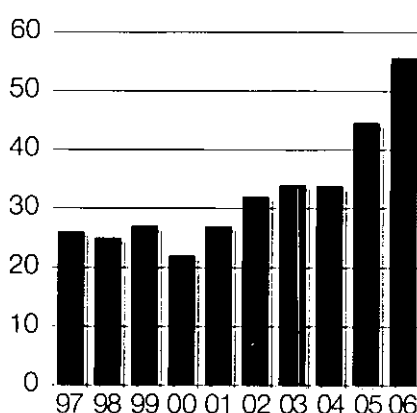
	2006	2005	2004
Operations:			
Net sales.....	\$ 557,948	\$ 403,413	\$ 370,070
Income from continuing operations	\$ 56,762	\$ 45,796	\$ 38,368
Balance Sheet:			
Debt net of cash, equivalents and investments	\$ 28,397	\$ (74,497)	\$ (35,548)
Shareowners' equity.....	\$ 345,831	\$ 267,562	\$ 234,333
Cash Flow:			
Net cash flow from operating activities.....	\$ 55,389	\$ 74,164	\$ 57,507
Capital expenditures.....	\$ 23,190	\$ 17,845	\$ 21,110
Other Data:			
Income from continuing operations to sales.....	10.2%	11.4%	10.4%
Return on average capital employed from continuing operations.....	28.4%	31.2%	27.4%
Weighted average common shares outstanding.....	23,284	23,181	23,033
Income Per Share:			
Diluted continuing operations	\$ 2.43	\$ 1.97	\$ 1.67
Dividends per common share	\$ 0.43	\$ 0.38	\$ 0.31

Note: The 2006 financial highlights exclude the sales and earnings of the Engineered Motor Products Division (EMPD) which was sold during the fourth quarter of 2006, for all periods presented.

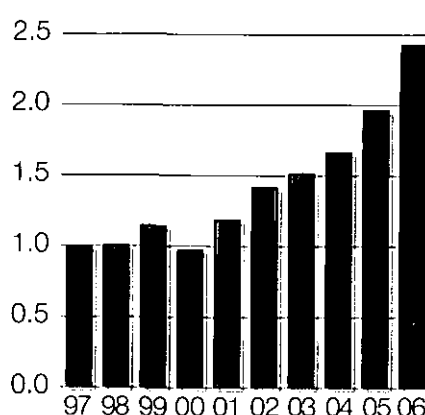
\$ Sales (millions)



\$ Income (millions)



\$ Earnings Per Share (dollars)



Chairman's Letter

I am pleased to report another year of substantial achievement – blending superior financial results with initiatives that pave the way for our future success.

As Chief Executive Officer of Franklin Electric, I have two primary objectives – sustain Franklin's heritage of superior financial performance and enhance the Company's long-term capability to grow and prosper in an increasingly competitive global marketplace. Franklin people worldwide made solid progress on both of these objectives in 2006, achieving record earnings while undertaking major marketing, technical, and manufacturing initiatives that will enhance the Company's growth and cost position.

Financial Highlights for 2006 include:

- Fully diluted earnings per share from continuing operations were a record \$2.43, up \$.46 or 23% compared to 2005.
- During the year Franklin invested \$23 million for capital expenditures and \$159 million for acquisitions. Even with these investments,

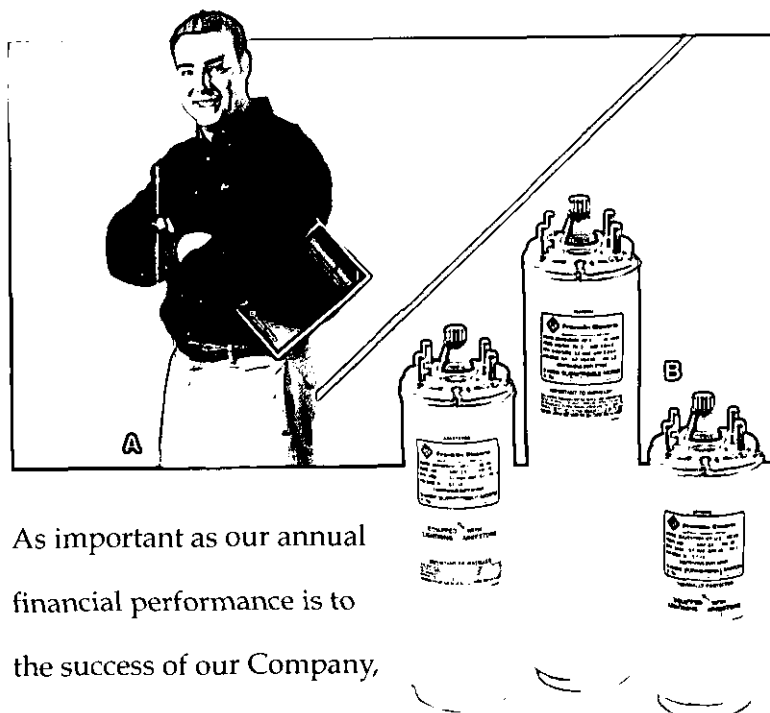
Water well under construction in Wells County, Indiana.

Franklin Tech provides continual education for the water well contractor.



because of the Company's strong operating cash flow, year-end net debt was \$28 million and the debt-to-equity ratio was 8%. The Company continues to have substantial capacity to capitalize on future strategic opportunities.

- The Company's dividend was increased from an annual rate of \$.40 per share to \$.44 per share, the 13th increase in the past 13 years.



As important as our annual financial performance is to the success of our Company, our primary mission remains to build Franklin's long-term capability to prosper and grow in the global pumping systems marketplace. It is with this in mind that we are undertaking several major strategic initiatives that will have a long-term positive impact on the Company's growth and competitive cost position.

Strategic Focus

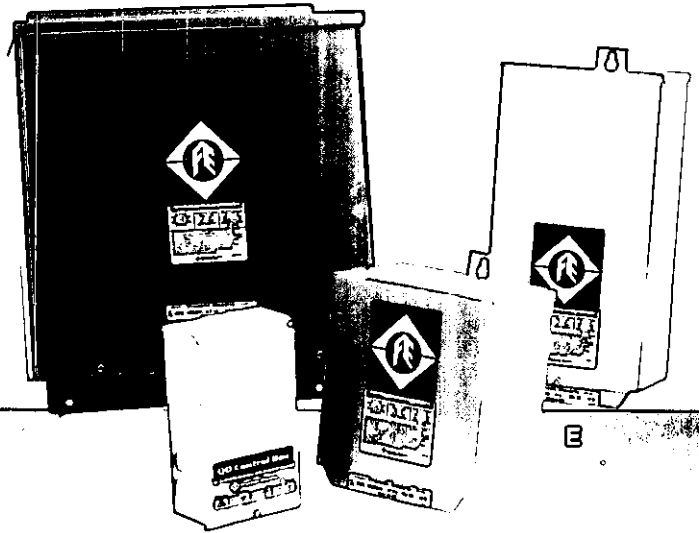
We define Franklin Electric as a process control company that is focused on expanding sales in two global distribution channels – water systems and petroleum equipment. These are attractive

segments for Franklin because: both are growing globally; both feature a more diversified customer base; installing contractors play a key role in both channels and they place a high

value on reliable submersible pumping; and in both channels Franklin has a strong reputation for high-quality products with installing contractors.

Our strategy for growing within these channels involves product line extensions and enhancements. Our core products, Franklin submersible motors, are present in over half of

the water well and filling station installations worldwide. Our strategic objective is to increase our revenue per installation by offering an expanded line of pumping system components that complement Franklin submersible motors.



- A. Franklin field service engineers are located throughout the world to provide hands-on support for water systems professionals.
- B. 4-inch submersible motor.
- C. 4-inch High Thrust submersible motor.
- D. 6-inch Hi-Temp submersible motor.
- E. A complete line of controls for any water well installation.

So, for example, in an installation that includes a Franklin motor, our revenue may be \$150; if that same installation includes a Franklin pump as well, our revenue may be \$300; if a Franklin drive package is included our revenue may be \$900. In both water and petroleum equipment we have expanded our high-quality product offerings into adjacent products that are also sold through these channels and this is increasing our revenue potential.

Water Systems Growth

In Water Systems, several years ago we chose to fundamentally change our business model. Prior to 2005 we sold Franklin motors to OEM pump manufacturers who in turn sold them to distributors. In late 2004 we expanded our water systems product line to include a broad range of pumps and began to sell all of our products directly to distributors in addition to supplying pump manufacturers. We pursued this strategy to become more efficient, and in response to changing competitive conditions in the water

additional layer in the distribution of our motors that led to inefficiencies. In light of these conditions we concluded that the time had come for us to diversify our customer base by selling directly to distributors and to expand our addressable market by adding clean water and water transfer pumping systems to our product line.

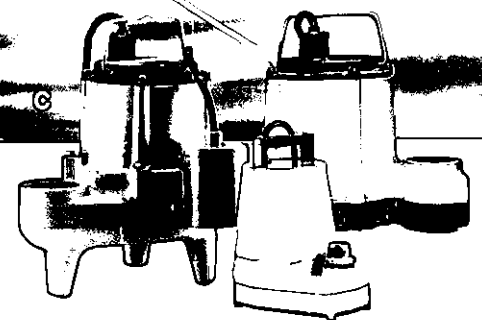
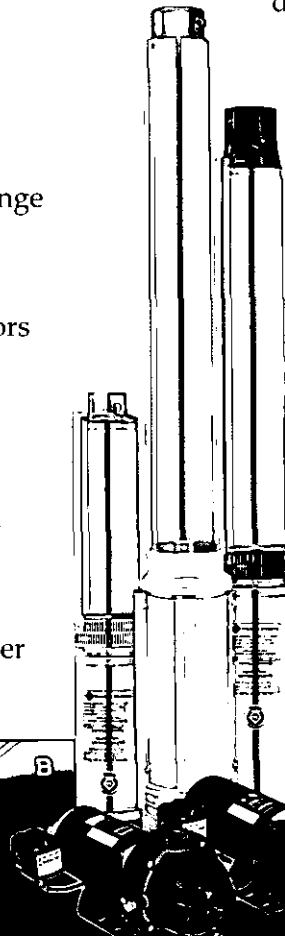
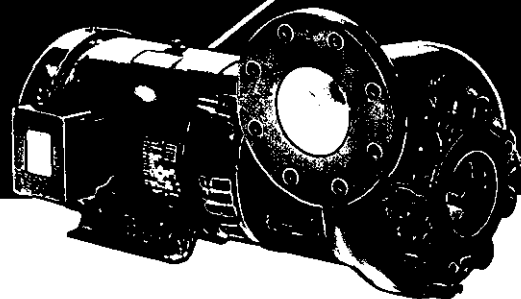
Pursuing this more efficient strategy has allowed us to build our global position as a supplier of groundwater pumping systems and components by offering a more competitive product package to our customers. While before the change we were limited to selling motors, we are now selling

A. End suction centrifugal pump launched in the 3rd quarter 2006.

B. Franklin Electric Submersible and above-ground pumps.

C. Little Giant wastewater pumps acquired in the 2nd quarter 2006.

D. 6" submersible turbine pump launched 4th quarter 2006.



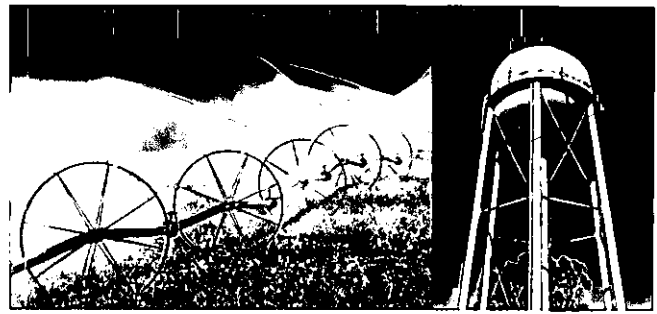
systems market. There has been a significant consolidation of industry players at both the submersible pump manufacturer and distributor level. In addition, sales of our motors exclusively through pump manufacturers meant an

all groundwater pumping system

components through a growing global distribution network. We believe we are already the worldwide sales leader in groundwater pumping systems, and that we continue to have

substantial headroom for both organic and acquisition growth.

While our core strategy is focused on expanding within the \$2 billion global business segment for groundwater pumping systems, we also see a major opportunity in adjacent



Franklin water systems provide a reliable source of water for agriculture and municipalities.

water pumping applications. These are residential, light-commercial, and agricultural pumping systems that are sold through the same channels as groundwater systems. The adjacent systems include sump pumps, sewage pumps, effluent pumps, condensate pumps, utility pumps, and other specialty pumps used in these applications. We believe these adjacent systems represent another \$2 billion global market opportunity.

We took an important step in pursuing this strategy during the second quarter of 2006 when we completed the acquisition of the Little Giant Pump Company. This acquisition increased our adjacent pumping system sales in 2006 by \$75 million. In addition to an extensive product catalog, Little Giant also has a large and highly regarded North American field sales network calling on plumbing, HVAC, and industrial wholesalers. This organization is complementary to the Franklin field sales network which sells to professional water systems distributors. With different customer bases, the two sales organizations have good cross-selling opportunities and together give us the best residential, light-commercial, and agricultural water systems selling and service network in North America.

The business dynamic that we are building involves complementing our strong position in groundwater to grow our position in adjacent pumping systems, and using our ability to supply adjacent systems to reinforce and build our sales in groundwater applications.

As a result of strong organic growth and the Little Giant pump acquisition, our water systems sales grew to \$459 million in 2006 – an increase of \$125 million or 37% versus 2005.

Going forward we have several important new product introductions which will enhance our water systems sales momentum. The most important is the ongoing rollout of our SubDrive QuickPAK constant pressure product line. QuickPAK is a prepackaged, plug-and-play constant-pressure system for water wells. The QuickPAK system uses a variable speed drive instead of a pressure tank to control water pressure in the home. With a QuickPAK installation, the homeowner can set the water pressure at the desired level and it will stay at a constant level regardless of how many showers, appliances or sprinklers may be in use. A system using a large pressure tank allows substantial and annoying variations in the water pressure to occur.

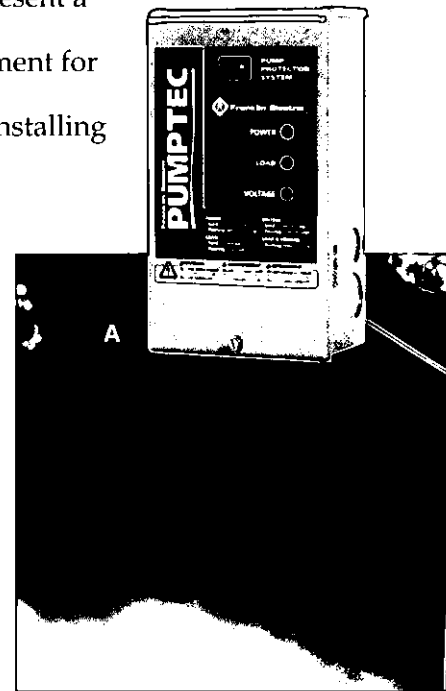
We introduced QuickPAK in 2006 and it has rapidly achieved an annual sales run-rate in excess of \$12 million – and yet this represents only an estimated 2 to 3% penetration of the potential market. The upside is significant for Franklin and

Homeowners enjoy a steady supply of water with Franklin's constant pressure system.



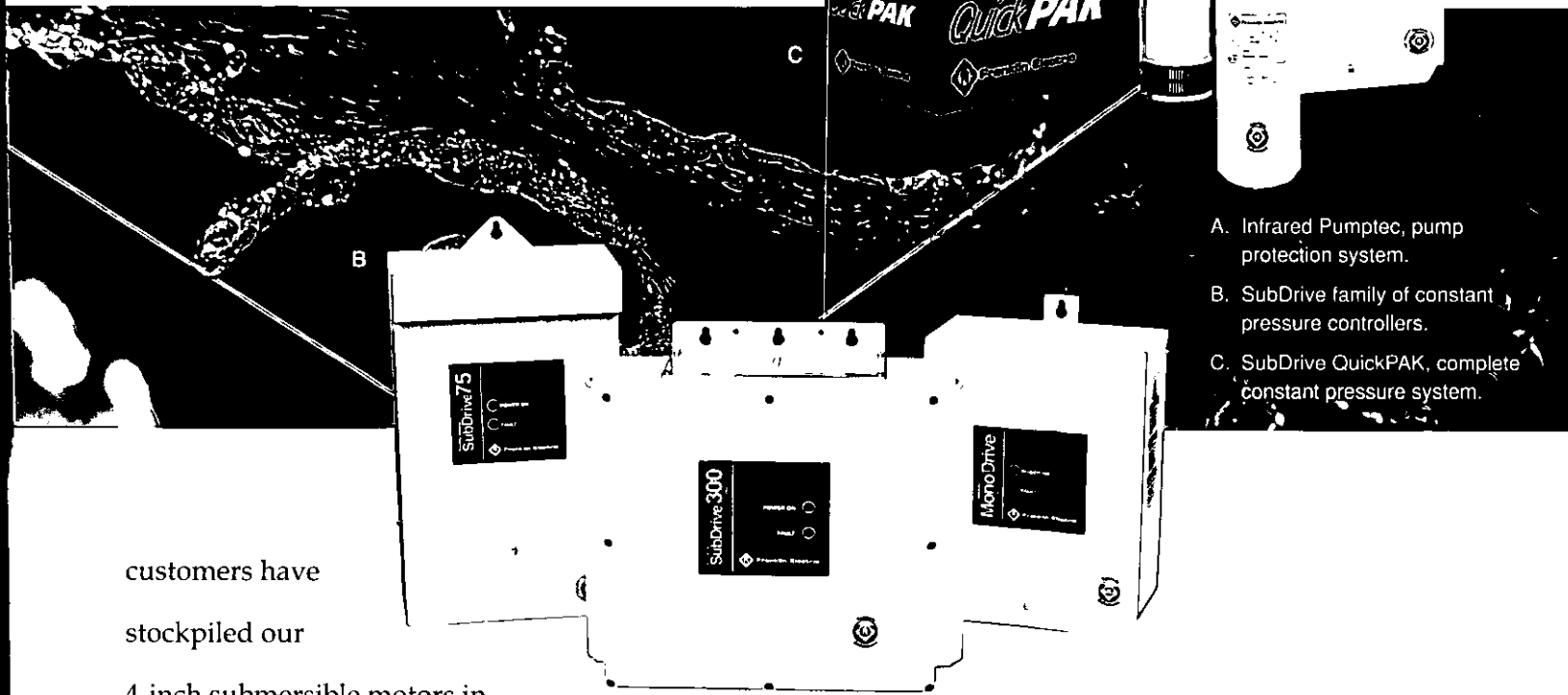
the product benefits represent a state-of-the-art improvement for homeowners as well as installing contractors.

As we enter 2007 we are also introducing our new TRI-SEAL and VersaJet pump product lines. These products, when fully introduced during the third quarter of 2007, will replace our existing submersible and jet pump lines. They will provide our customers with better efficiency, and value-added features while requiring less materials and labor to manufacture.



On the production side of our water systems business we are continuing to expand our manufacturing presence in low-cost regions. During 2006 we expanded our manufacturing facilities in Linares, Mexico, and Suzhou, China. We are now producing water systems pumps as well as submersible motors in Linares while increasing our component manufacturing capability in Suzhou. In addition, we started a pump manufacturing operation in our Wilburton, Oklahoma, facility to produce large sub-turbine and centrifugal pumps.

We are in a strong strategic position within the global Water Systems market. However, as I have previously informed investors, we believe that one or two of the large integrated pump OEM



- A. Infrared Pumptec, pump protection system.
- B. SubDrive family of constant pressure controllers.
- C. SubDrive QuickPAK, complete constant pressure system.

customers have stockpiled our 4-inch submersible motors in

response to the Company's announcement that we will principally sell directly to distributors in 2007 and beyond. We believe that these inventory stockpiles could represent up to a two month supply of 4-inch submersible motors in North America and could be sold off during the first half of 2007. This destocking, combined with the competitive response to our pump market share gains, may result in unusual marketplace volatility during the first part of 2007. Overall, despite these short-term market concerns, we are well positioned to continue our Water Systems growth in 2007 and beyond.

Fueling Systems Growth

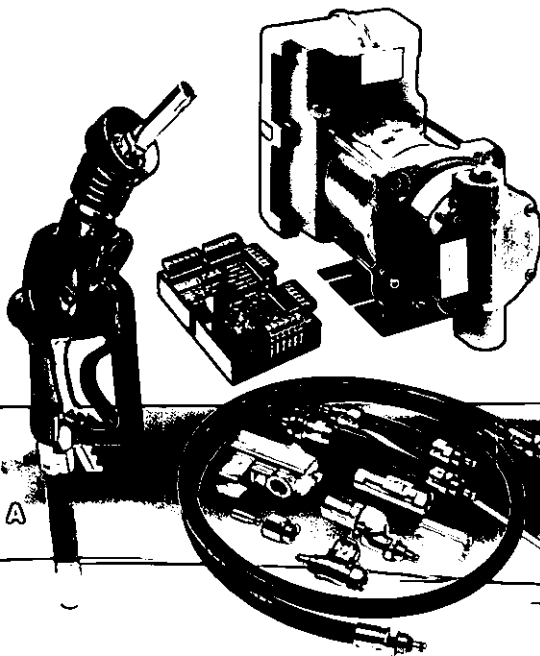
During the fourth quarter of 2006 we took an important step to enhance our product offering with the acquisition of Healy Systems. Healy manufactures a proprietary and patented system for controlling evaporative gasoline emissions from filling stations. The Healy product line is highly complementary to the Franklin Fuel Management System, which is a modular network of electronic sensors and controls that provide station owners with high speed pumping, automated inventory management, product quality monitoring, and leak detection.

With the Healy acquisition, the Fueling Systems business has become an increasingly significant part of our Company. Fueling Systems sales in 2006 were \$98.8 million, up 43% versus prior year.

We entered the fueling equipment business in the 1960s when Franklin engineers developed the first explosion-proof submersible electric

Our strategy for Fueling Systems growth has been to add components to our product line which complement the ubiquitous Franklin submersible motor. As a result, our product line now includes most of the underground components of a filling station — except the large fuel storage tanks — as well as the electronic systems that control and monitor the fuel delivery process.

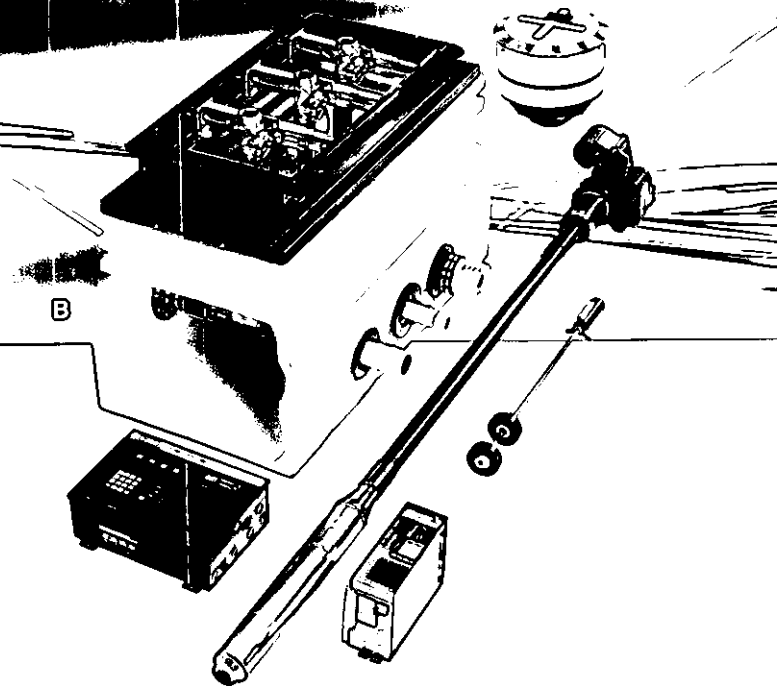
There are a number of growth drivers for the Franklin Fuel Management System including legislative mandate. For example, California has enacted vapor control regulations which mandate that the 10,000 stations in the state install vapor



A. Healy vapor recovery equipment.

B. Fueling Systems product offering has grown to include most of the underground components of a filling station.

C. Fuel management controls



motor for use in gasoline. To this day the Franklin motor is the only submersible motor listed by Underwriters Laboratories for use in explosion-proof applications. As a result, Franklin submersible motors currently power the pumping system in almost every gas station in North America and a high percentage in the world.

control and monitoring systems by mid 2009. As of now, the Franklin/Healy vapor control system

is the only one approved by the California Air Resources Board (CARB). Since each system sells for \$17,000 to \$25,000, this represents a major market opportunity for the Company. We believe that other states and municipalities worldwide may pass statutory vapor control regulations as well.



Franklin's variable speed fueling system maintains a constant flow of pressure regardless of demand at the pump.

Sale of the Engineered Motor Products Division (EMPD)

In December 2006 we sold the Company's Engineered Motor Products Division to Capital Works, a Cleveland-based private equity firm. EMPD manufactures custom motors for OEM customers in a wide variety of applications including ice cream makers, bowling pin setters, dental chairs, boat lifts, food processing equipment, and many others. EMPD represented less than 10% of our sales and generated earnings of about \$.01 per share in 2006. We were paid approximately \$16 million for the EMPD assets which included the Division's manufacturing facility and the Franklin Electric Headquarters building on the same site. Franklin has a lease to continue occupying the building and we have started to explore options for a new Headquarters and Tech Center location.

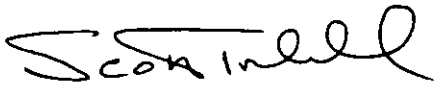
In addition, the advent of alternative fuels and the growing demand for automobiles in developing countries are also stimulating investment in filling station infrastructure. We foresee continued organic and acquisition growth for Franklin Fueling Systems in 2007 and beyond.

Summary Comments

During 2006 the people of Franklin Electric continued to make important progress on the

strategic transformation of the Company. We again achieved record financial performance, but of greater importance, we responded to changing market conditions with proactive initiatives to expand our customer base and product lines.

We foresee opportunities to continue growing in both the Global Water and Fueling markets. We will capitalize on these opportunities by maintaining our intense focus on the Key Factors for Success (Quality, Availability, Service, Innovation, and Value) which have been the basis of our progress over many years.

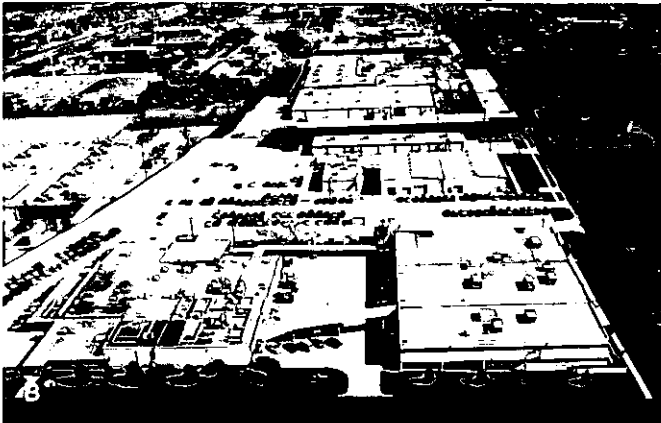


R. Scott Trumbull
Chairman and Chief Executive Officer





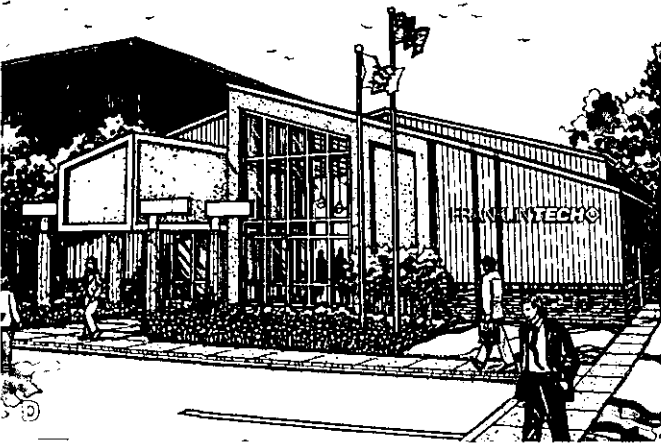
A



B



C



- A. Franklin acquired Healy Systems, a worldwide provider of Stage II Vapor Recovery Systems and Components used primarily at gasoline stations to reduce gasoline vapor emissions during vehicle refueling.
- B. The acquisition of the Little Giant Pump Company in 2006.
- C. In 2006 Franklin opened a 50,000-square-foot expansion for pump manufacturing in Linares, Mexico.
- D. April 2007 will mark the grand opening of Franklin Electric's state-of-the-art training facility in Wilburton, Oklahoma.

Management's Discussion and Analysis of Financial Condition and Results of Operations

2006 // 2005

Overview

Sales and earnings from continuing operations for 2006 were up from 2005. The increase in sales was primarily related to sales from acquisitions. Sales growth benefited from selling price realization gains and organic growth in Water Systems motor and pump unit shipments as well as organic growth in Fueling Systems product shipments, primarily flexible pipe. Earnings improved in 2006 primarily due to the increased sales as well as reduced manufacturing costs from the Company's growing production base in Mexico, The Czech Republic, and China. These improvements were partially offset by higher commodity costs and increased fixed costs incurred in connection with selling, general and administrative spending resulting from the Company's strategy of selling to a more diversified customer base by marketing its Water Systems products directly to distributors. Included in the results for 2006 are stock-based compensation expenses recorded under the new accounting guidelines of Statement of Financial Accounting Standards (SFAS) No. 123(R). The accounting pronouncement was adopted as of January 1, 2006.

During the fourth quarter of 2006, the Company divested its Engineered Motor Products Division (EMPD). For financial statement purposes, EMPD has been classified as a discontinued operation for all periods presented. As a discontinued operation, EMPD's sales and operational impact are excluded from the Company's continuing operations results and reported in the income statement

section as "discontinued operations." EMPD's sales for 2006 through the date of divestiture and for full years 2005 and 2004 represented less than 10 percent of the Company's total sales. EMPD's net earnings for 2006 through the date of divestiture and for full year 2005 were about \$0.01 per share in both years. EMPD had a net loss for full year 2004 of about \$0.02 per share. Unless otherwise indicated, the following discussion relates to continuing operations only.

Results of Operations

Net sales from continuing operations for fiscal year 2006 were a record \$557.9 million, an increase of \$154.5 million or 38 percent compared to 2005 sales of \$403.4 million. Incremental sales related to acquisitions for fiscal year 2006 were about \$86 million or 21 percent of prior year sales. The majority of the sales growth from acquisitions resulted from the Little Giant Pump Company. Sales growth benefited from price realization gains and organic growth in Water Systems motor and pumps. Sales increased by gains in price realization of approximately \$20.6 million or 5 percent in 2006 resulting from increases in product selling prices, changes in customer sales discount programs and greater direct sales to distribution customers. Water Systems product sales worldwide were up about 37 percent for fiscal year 2006 compared to 2005. Sales revenue increased in all of Water Systems' major product categories during the year (including submersible motors, pumps, and drives and controls). Fueling Systems worldwide sales increased approximately 43 percent in 2006 from fiscal year 2005.

Cost of sales from continuing operations as a percent of net sales for 2006 and 2005 was 65.7 percent and 64.6 percent, respectively. Cost of sales as a percent of net sales increased in 2006 from 2005 primarily as a result of product mix changes as Fueling Systems' products and complete Water Systems pumps (including Little Giant product lines) represented a higher percentage of overall sales and these product lines carry a higher cost of sales than submersible motor products.

Selling and administrative ("SG&A") expense as a percent of net sales for 2006 and 2005 was 18.4 percent and 17.6 percent, respectively. Incremental increases in SG&A expense were about \$31.7 million in 2006 over 2005 primarily due to acquisitions of \$15.5 million, stock-based compensation expense of \$2.7 million and increased fixed costs incurred in connection with selling, general and administrative spending resulting from the Company's strategy of selling to a more diversified customer base by marketing its Water Systems products directly to distributors.

Interest expense for 2006 and 2005 was \$3.4 million and \$0.8 million, respectively. Interest expense increased in 2006 due to the debt incurred for the acquisitions of the Little Giant Pump Company and Healy Systems.

Included in other income for 2006 and 2005 was interest income of \$1.9 million and \$1.4 million, respectively, primarily derived from the investment of cash balances in short-term U.S. treasury and agency securities. Also included in other income for 2006 and 2005 was income from equity investments of \$0.7 million and \$0.1 million, respectively.

Foreign currency-based transactions produced a loss for 2006 of about \$0.1 million primarily due to euro rate changes relative to other currencies in Europe and the U.S. dollar. Foreign currency-based transactions produced a gain for 2005 of \$0.2 million primarily due to fluctuations between the U.S. dollar and the Chinese Yuan and Mexican Peso.

The provision for income taxes for continuing operations in 2006 and 2005 was \$30.7 million and \$25.0 million, respectively. The effective tax rates were 35.1 and 35.3 percent for 2006 and 2005, respectively. The effective tax rate differs from the United States statutory rate of 35 percent, generally due to foreign income exclusion and R&D credits and due to the effects of state and foreign income taxes, net of federal tax benefits.

Income from continuing operations for 2006 was \$56.8 million, or \$2.43 per diluted share, compared to 2005 income from continuing operations of \$45.8 million or \$1.97 per diluted share.

Capital Resources and Liquidity

Cash flows from operations provide the principal source of current liquidity. Net cash flows provided by operating activities were \$55.4 million and \$74.2 million in 2006 and 2005, respectively. The primary source of cash from operations was earnings. Significant uses of operating cash flow in 2006 and 2005 were increases in inventory, \$11.0 million and \$10.6 million, respectively. Inventories increased significantly in 2006 and 2005 as the Company increased finished goods availability for pump products and distribution customers as a part of its new distribution channel strategy. Accounts receivable and accounts payable and other accrued expenses were significant

sources of operating cash flow in 2005. Accounts receivable increases were primarily attributable to the timing of payments received from customers and increased sales during 2005. Accounts payable increases were primarily attributable to the timing of payments made to vendors and increased inventories during 2005.

Net cash flows used in investing activities were \$131.6 million and \$63.5 million in 2006 and 2005, respectively. In 2006, the Company paid an aggregate of \$159.2 million for acquisitions in 2006, net of cash acquired. The acquisitions consisted of Little Giant Pump Company for \$123.9 million and Healy Systems for \$35.3 million. In 2005, the Company paid \$36.0 million for short-term investment securities, net of short-term investment securities sold. The Company paid an aggregate of \$8.5 million for acquisitions in 2005, net of cash acquired. The acquisitions consisted of \$5.6 million for Phil-Tite and \$2.9 million for an equity investment in Pioneer.

Cash flows from financing activities in 2006 were \$54.8 million primarily from long-term debt. Net cash flows used in financing activities were \$9.0 million in 2005. The Company paid \$9.8 million and \$8.5 million in dividends on the Company's common stock in 2006 and 2005, respectively. In 2005, another principal use of cash was purchases of Company common stock under the Company's repurchase program. During 2005, the Company repurchased 366,308 shares of its common stock for \$13.8 million.

Cash and cash equivalents at the end of 2006 were \$34.0 million compared to \$52.1 million at the end of 2005.

Working capital decreased \$15.2 million in 2006 and the current ratio of the Company was 2.3 for 2006 compared

to a current ratio of 3.2 at the end of 2005. The Company's working capital and current ratio decreased in 2006 as the Company invested its excess cash in acquisitions during the year.

Principal payments of \$1.0 million per year on the Company's \$20.0 million of unsecured long-term debt began in 1998 and will continue until 2008 when a balloon payment of \$10.0 million will fully retire the debt. In September 2004, the Company entered into an unsecured, 60-month \$80.0 million, amended and restated to \$120.0 million during December 2006, revolving credit agreement (the "Agreement"). The Agreement includes a facility fee of one-tenth of one percent on the committed amount. The Company had outstanding borrowings under the Agreement of \$50 million at December 30, 2006. The Company had no outstanding borrowings under the Agreement at December 31, 2005. The Company is subject to certain financial covenants with respect to borrowings, interest coverage, working capital, loans or advances, and investments. The Company was in compliance with all debt covenants at all times in 2006 and 2005.

At December 30, 2006, the Company had \$5.9 million of commitments primarily for the purchase of machinery and equipment, and building expansions. Management believes that internally generated funds and existing credit arrangements provide sufficient liquidity to meet these current commitments and existing debt, and finance business growth.

2005 // 2004

Overview

Sales and earnings for 2005 were up from 2004. The increase in sales was primarily related to sales from acquisitions. Sales growth was benefited by price realization gains and organic growth in Water Systems pump unit shipments. Earnings improved in 2005 primarily due to the increased sales as well as reduced manufacturing costs from the Company's growing production base in Mexico, The Czech Republic, and China. These improvements were partially offset by higher commodity costs and increased fixed costs incurred in connection with the Company's channel strategy change for Water Systems product distribution. Included in the results for 2005 are restructuring expenses of \$1.9 million pre-tax, down from \$5.5 million pre-tax in 2004.

Results of Operations

Net sales from continuing operations for fiscal year 2005 were \$403.4 million, an increase of \$33.3 million or 9 percent compared to 2004 sales of \$370.1 million. Incremental sales related to acquisitions for fiscal year 2005 were about \$17.5 million or 4 percent of sales. The majority of the sales growth from acquisitions resulted from the JBD, Inc. (the former Jacuzzi Brand) pump company. Sales growth was benefited by price realization gains and organic growth in Water Systems pump unit shipments. Water Systems product sales worldwide were up about 10 percent for fiscal year 2005 compared to 2004. Sales revenue increases in all of our Water Systems product categories during the year (including submersible motors, pumps, and drives and controls) were partially offset by slightly lower unit volumes of

motors and controls due to customers buying ahead of announced price increases in 2004. The sales increase in 2005 for water related products by customers principally in the North American market accounted for about \$33.6 million or 15 percent. The sales increase by European customers was about \$1.8 million for 2005 or 2 percent (when comparing both years at the current year exchange rate). Sales increased by gains in price realization of approximately \$25 million in 2005 resulting from increases in product selling prices, changes in customer sales discount programs and greater direct sales to distribution customers. Incremental sales for 2005 related to the acquisition of the assets of JBD, Inc. were about \$16.1 million. Fueling Systems product sales worldwide were up about 2 percent compared to the prior year, mostly related to an acquisition in the third quarter. Sales related to the acquisition of Phil-Tite Enterprises (Phil-Tite), a manufacturer of fuel containment systems, were about \$1.4 million in 2005.

Cost of sales from continuing operations as a percent of net sales for 2005 and 2004 was 64.6 percent and 65.9 percent, respectively. Cost of sales as a percent of net sales decreased in 2005 from 2004 primarily as a result of increased sales volume, leveraging fixed costs, and improving profit margin. The improvement in gross profit from sales volume was offset by increased costs for certain commodities used in the manufacture of the electric motors, primarily steel and copper, of \$5.2 million for 2005. Manufacturing costs in 2005 were reduced as approximately 23 percent of global Water Systems manufacturing man-hours were in relatively low-cost countries (Mexico, The Czech Republic, and China)

versus about 13 percent in 2004. Gross profit was further improved by increases in selling prices.

Selling and administrative ("SG&A") expense as a percent of net sales for 2005 and 2004 was 17.6 percent and 16.3 percent, respectively. SG&A costs increased about \$10.4 million in 2005 over 2004 partially due to increased selling and marketing expenses of about \$3.4 million related to the change in the Company's strategy of selling to a more diversified customer base by marketing its Water Systems products direct to distributors. The Company expanded its sales force and increased other selling expenses related to a broader customer base with the addition of the specialty Water Systems distributors as customers. Incremental SG&A expenses related to acquisitions were about \$2.7 million for 2005.

Restructuring expenses of \$1.9 million and \$5.5 million were incurred during 2005 and 2004, respectively. The expenses (included in "Restructure Expense" on the income statement) related to the Global Manufacturing Realignment Program. The costs were primarily for severance and other employee related expenses, as well as, equipment transfers and travel. The Company completed phase one of the ongoing program in 2005 and incurred pre-tax restructuring expense of about \$7.5 million over the two-year period.

Interest expense for 2005 and 2004 was \$0.8 million and \$0.5 million, respectively. Interest expense increased in 2005 due to increased interest rates.

Included in other income for 2005 and 2004 was interest income of \$1.4 million and \$0.5 million, respectively, primarily derived from the investment of cash balances in short-term U.S. treasury and agency securities. Also

included in other income for 2005 was income from equity investments of \$0.1 million.

Foreign currency-based transactions produced a gain for 2005 of \$0.2 million primarily due to fluctuations between the U.S. dollar and the Chinese Yuan and Mexican Peso. The foreign currency-based transaction loss, \$0.5 million, in 2004 was due primarily to the euro rate changes relative to other currencies in Europe.

The provision for income taxes from continuing operations in 2005 and 2004 was \$25.0 million and \$21.1 million, respectively. The effective tax rates were 35.3 and 35.5 percent for 2005 and 2004, respectively. The effective tax rate differs from the United States statutory rate of 35 percent, generally due to foreign income exclusion and R&D credits and due to the effects of state and foreign income taxes, net of federal tax benefits.

Income from continuing operations for 2005 was \$45.8 million, or \$1.97 per diluted share, compared to 2004 income from continuing operations of \$38.4 million, or \$1.67 per diluted share. Per share data for 2004 reflects the Company's two-for-one stock split effected in the form of a 100 percent stock distribution made on June 15, 2004.

Capital Resources and Liquidity

Cash flows from operations provide the principal source of current liquidity. Net cash flows provided by operating activities were \$74.2 million and \$57.5 million in 2005 and 2004, respectively. The primary source of cash from operations was earnings. Significant uses of operating cash flow in 2005 and 2004 were related to increases in inventory, \$10.6 million and \$1.2 million, respectively. Inventories increased significantly in 2005 as the Company increased finished goods availability for

distribution customers as a part of its new distribution channel strategy. Accounts receivable and accounts payable and other accrued expenses were significant sources of operating cash flow in 2005. Accounts receivable increases were primarily attributable to the timing of payments received from customers and increased sales during 2005. Accounts payable increases were primarily attributable to the timing of payments made to vendors and increased inventories during 2005. In 2004, a payment of \$4.0 million was made to qualified employee benefit plans.

Net cash flows used in investing activities were \$63.5 million and \$30.4 million in 2005 and 2004, respectively. The Company paid \$36.0 million for short-term investment securities, net of short-term investment securities sold in 2005. The Company paid an aggregate of \$8.5 million for acquisitions in 2005, net of cash acquired. The acquisitions consisted of \$5.6 million for Phil-Tite and \$2.9 million for an equity investment in Pioneer. The primary use of cash for investing activities in 2004 was additions to property, plant and equipment. Another use of cash in 2004 was for the acquisition of certain assets of JBD, Inc. for \$9.3 million.

Net cash flows used in financing activities were \$9.0 million and \$7.1 million in 2005 and 2004, respectively. The Company paid \$8.5 million and \$6.8 million in dividends on the Company's common stock in 2005 and 2004, respectively. Another principal use of cash was purchases of Company common stock under the Company's repurchase program. During 2005 and 2004, the Company repurchased 366,308 shares of its common stock for \$13.8 million and 102,800 for \$3.1 million, respectively.

Cash and cash equivalents at the end of 2005 were \$52.1 million compared to \$50.6 million at the end of 2004. Working capital increased \$27.3 million in 2005 and the current ratio of the Company was 3.2 for 2005 compared to a current ratio of 3.1 at the end of 2004.

Principal payments of \$1.0 million per year on the Company's \$20.0 million of unsecured long-term debt began in 1998 and will continue until 2008 when a balloon payment of \$10.0 million will fully retire the debt. In September 2004, the Company entered into an unsecured, 60-month \$80.0 million revolving credit agreement (the "Agreement"). The Agreement includes a facility fee of one-tenth of one percent on the committed amount. The Company had no outstanding borrowings under the Agreement at December 31, 2005. The Company is subject to certain financial covenants with respect to borrowings, interest coverage, working capital, loans or advances, and investments. The Company was in compliance with all debt covenants at all times in 2005 and 2004.

At December 31, 2005, the Company had \$3.6 million of commitments primarily for the purchase of machinery and equipment, and building expansions. Management believes that internally generated funds and existing credit arrangements provide sufficient liquidity to meet these current commitments and existing debt, and finance business growth.

2006

Aggregate Contractual Obligations

Most of the Company's contractual obligations to third parties are debt obligations. In addition, the Company

has certain contractual obligations for future lease payments, as well as purchase obligations. The payment schedule for these contractual obligations is as follows:

(In millions)

	Total	Less Than 1 Year	2-3 Years	4-5 Years	More Than 5 Years
Debt	\$61.3	\$11.0	\$50.3	\$—	\$—
Debt interest	5.7	3.3	2.4	—	—
Capital leases	1.1	0.3	0.8	—	—
Operating leases	22.4	5.3	7.1	3.1	6.9
Contingency from Healy acquisition	0.4	0.4	—	—	—
Purchase obligations	5.9	5.9	—	—	—
	<u>\$96.8</u>	<u>\$26.2</u>	<u>\$60.6</u>	<u>\$3.1</u>	<u>\$6.9</u>

Debt interest includes interest on the balance outstanding under the Company's fixed-to-variable interest rate swap. Per the swap contract, the Company receives interest at a fixed rate of 6.3 percent and pays interest at a variable rate based on the three month London Interbank Offered Rates (LIBOR) rate plus a spread. The average variable rate paid in 2006 was 7.9 percent. Debt interest also includes interest under the Company's current credit agreement. The average interest rate for 2006 was 5.5 percent based on the LIBOR plus an interest spread. The remaining interest is calculated based on the fixed rate of 6.3 percent for the Company's long-term insurance company debt.

The Healy Systems stock purchase agreement provided for additional contingent payments of 5 percent of certain Healy Systems product sales over the next five years, of which only one year could be estimated, therefore recognized and presented above.

The Company also has pension and other post-retirement benefit obligations not included in the table above which will result in future payments.

Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 "Accounting For Uncertain Tax Positions" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with Statements of Financial Accounting Standards (SFAS) No. 109 "Accounting for Income Taxes." It prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company reviewed the impact of FIN 48 on its financial statements and does not believe the adoption of this standard will have a significant impact on the Company's results of operations, financial position, or statement of cash flows.

In September 2006, the FASB issued SFAS No. 157 "Fair Value Measurements." SFAS No. 157 gives guidance for measuring assets and liabilities using fair value. Fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. The fair value measurements are disclosed by level within that hierarchy. While the Statement does not add any new fair value measurements, it does change current practice. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, although earlier application is encouraged. The Company is currently evaluating the impact

of adopting SFAS No. 157 on its financial statements, but does not believe the adoption of this standard will have a significant impact on the Company's results of operations, financial position, or statement of cash flows.

In September 2006, the SEC issued Staff Accounting Bulletin (SAB) No. 108, "Financial Statements — Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements." SAB No. 108 addresses how a registrant should quantify the effect of an error on the financial statements. The SEC concludes that a dual approach should be used to compute the amount of a misstatement. Specifically, the amount should be computed using both a "rollover" (current year income statement perspective) and "iron curtain" (year-end balance sheet perspective) methods. SAB 108 is effective for fiscal years ending after November 15, 2006. The adoption of SAB 108 did not have a material impact on the Company's results of operations, financial position, or statement of cash flows.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," which required recognition of the funded status of defined benefit pension and other postretirement plans, with a corresponding after-tax adjustment to accumulated other comprehensive loss. In 2006, the Company adopted SFAS No. 158. The adoption of SFAS No. 158, together with the annual remeasurement of our pension plans, resulted in a net of tax, \$1.3 million, decrease in Shareholders' equity. This decrease does not affect cash flows or the funded status of our benefit plans.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted provided the entity also elects to apply the provisions of SFAS No. 157. The Company is currently evaluating the impact of adopting SFAS No. 159 on its financial statements.

Critical Accounting Policies and Estimates

Management's discussion and analysis of its financial condition and results of operations are based upon the Company's consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these financial statements requires management to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and the related disclosure of contingent assets and liabilities. On an ongoing basis, management evaluates its estimates, including those related to revenue recognition, allowance for doubtful accounts, accounts receivable, inventories, recoverability of long-lived assets, intangible assets, income taxes, warranty obligations, stock-based compensation, pension and other employee benefit plan obligations, and contingencies. Management bases its estimates on historical experience and on other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments

about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

The Company's critical accounting policies are identified below:

Revenue Recognition:

Products are shipped utilizing common carriers direct to customers or, for consignment products, to customer-specified warehouse locations. Sales are recognized when the Company's products are shipped direct or, in the case of consignment products, transferred from the customer-specified warehouse location to the customer, at which time transfer of ownership and risk of loss pass to the customer. The Company records net sales revenues after discounts at the time of sale based on specific discount programs in effect, historical data and experience.

Warranty Obligations:

Warranty terms are generally two years from date of manufacture or one year from date of installation. Warranty liability is recorded when revenue is recognized and is based on actual historical return rates from the most recent warranty periods. While the Company's warranty costs have historically been within its calculated estimates, it is possible that future warranty costs could exceed those estimates.

Stock-Based Compensation:

Prior to January 1, 2006, the Company accounted for stock-based employee compensation plans under the measurement and recognition provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for

Stock Issued to Employees," and related Interpretations, as permitted by SFAS No. 123, "Accounting for Stock-Based Compensation." Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), using the modified prospective transition method. Under that transition method, compensation expense recognized includes: (a) compensation expense for all stock-based payments granted prior to, but not yet vested as of, January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123; and (b) compensation expense for all stock-based payments granted on or after January 1, 2006, based on the grant date fair value estimated in accordance with the provisions of SFAS No. 123(R).

The fair value of each option award, both before and after the adoption of SFAS No. 123(R), is estimated on the date of grant using the Black-Scholes option valuation model with a single approach and amortized using a straight-line attribution method over the option's vesting period. Options granted to retirement-eligible employees were immediately expensed. In 2005, this amount was disclosed in the pro-forma exhibit while in 2006 it was recognized as an expense. The Company uses historical data to estimate the expected volatility of its stock; the weighted average expected life, the period of time options granted are expected to be outstanding; and its dividend yield. The risk-free rates for periods within the contractual life of the option are based on the U.S. Treasury yield curve in effect at the time of the grant.

The assumptions used for the Black-Scholes model to

determine the fair value of options granted during 2006

is as follows:

Risk-free interest rate	4.54%
Dividend yield	.70-.74%
Weighted-average dividend yield	.707%
Volatility factor	.3553-.3768
Weighted-average volatility	.359
Expected term	4-5 years
Forfeiture rate	5.44%

In accordance with SFAS No. 123, for periods prior to January 1, 2006, the Company disclosed pro forma net income or loss and pro forma net income or loss per share as if the fair value-based method in measuring compensation expense for its stock-based incentive programs had been applied. For purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes option-pricing formula and amortized to expense over the options' vesting periods.

Accounts Receivable and Allowance for Uncollectible Accounts:

Accounts receivable is comprised of balances due from customers net of estimated allowances for uncollectible accounts. In determining allowances, historical trends are evaluated and economic conditions and specific customer issues are reviewed to arrive at appropriate allowances. Allowance levels change as customer-specific circumstances and the other analysis areas noted above change. Differences may result in the amount for allowances if actual experience differs significantly from management estimates; such differences have not historically been material.

Inventory Valuation:

The Company uses certain estimates and judgments to value inventory. Inventory is recorded at the lower of cost or market. The Company reviews its inventories for excess or obsolete products or components. Based on an

analysis of historical usage and management's evaluation of estimated future demand, market conditions and alternative uses for possible excess or obsolete parts, reserves are recorded or changed. Significant fluctuations in demand or changes in market conditions could impact management's estimates of necessary reserves. Excess and obsolete inventory is periodically disposed through sale to third parties, scrapping or other means, and the reserves are appropriately reduced. Differences may result in the amount for reserves if actual experience differs significantly from management estimates; such differences have not historically been material.

Business Combinations:

The Company follows the guidance under SFAS No. 141, "Business Combinations." The acquisition purchase price is allocated to the assets acquired and liabilities assumed based upon their respective fair values and subject to change during the twelve-month period subsequent to the acquisition date. The Company utilizes management estimates and independent third-party valuation firms to assist in determining the fair values of assets acquired and liabilities assumed. Such estimates and valuations require the Company to make significant assumptions, including projections of future events and operating performance.

Goodwill and Other Intangible Assets:

Goodwill is not amortized; however it is tested for impairment annually or more frequently whenever events or changes in circumstances indicate that the asset may be impaired. The Company performs impairment testing for its reporting units using future cash flows based on management's judgments and assumptions. An asset's value is impaired if the estimate of the aggregate future

cash flows, undiscounted and without interest charges, to be generated are less than the carrying amount of the reporting unit including goodwill. Such cash flows consider factors such as expected future operating income and historical trends, as well as the effects of demand and competition. To the extent impairment has occurred, the loss will be measured as the excess of the carrying amount of the reporting unit including goodwill over the fair value. Such estimates require the use of judgment and numerous subjective assumptions, which, if actual experience varies, could result in material differences in the requirements for impairment charges.

Income Taxes:

Under the requirements of SFAS No. 109, "Accounting for Income Taxes," the Company records deferred tax assets and liabilities for the future tax consequences attributable to differences between financial statement carrying amounts of existing assets and liabilities and their respective tax bases. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. Management judgment is required in determining the Company's provision for income taxes, deferred tax assets and liabilities, which, if actual experience varies, could result in material adjustments to deferred tax assets and liabilities. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Pension and Employee Benefit Obligations:

With the assistance of the Company's actuaries, the discount rate used to determine pension and post-retirement plan liabilities is selected using a yield-curve

approach. The yield-curve approach discounts each expected cash flow of the liability stream at an interest rate based on high quality corporate bonds. The present value of the discounted cash flows is summed and an equivalent weighted-average discount rate is calculated. A change in the discount rate selected by the Company of 25 basis points would result in a change of about \$0.1 million of employee benefit expense. The Company consults with actuaries, asset allocation consultants and investment advisors to determine the expected long-term rate of return on plan assets based on historical and projected rates of return on the types of assets in which the plans have invested. A change in the long-term rate of return selected by the Company of 25 basis points would result in a change of about \$0.4 million of employee benefit expense.

Contingencies:

The Company is subject to the possibility of various loss contingencies arising in the ordinary course of business resulting from litigation, claims and other commitments, and from a variety of environmental and pollution control laws and regulations. The Company considers the likelihood of loss or the incurrence of a liability, as well as the ability to reasonably estimate the amount of loss, in determining loss contingencies. The Company accrues an estimated loss contingency when it is probable that a liability has been incurred and the amount of loss can be reasonably estimated. The amount of the reserves is determined, if any, with the assistance of outside legal counsel or other governmental regulatory agencies. The Company regularly evaluates current information available to determine whether the accruals should be adjusted.

Factors That May Affect Future Results

Any forward-looking statements contained herein involve risks and uncertainties, including, but not limited to, general economic and currency conditions, various conditions specific to the Company's business and industry, market demand, competitive factors, changes in distribution channels, supply constraints, technology factors, litigation, government and regulatory actions, the Company's accounting policies, future trends, and other risks. These risks and uncertainties may cause actual results to differ materially from those indicated by the forward-looking statements. Any forward-looking statements included in this annual report are based upon information presently available. The Company does not assume any obligation to update any forward-looking information.

Quantitative and Qualitative Disclosures About Market Risk

The Company is subject to market risk associated with changes in foreign currency exchange rates and interest rates. Foreign currency exchange rate risk is mitigated through several means: maintenance of local production facilities in the markets served, invoicing of customers in the same currency as the source of the products, prompt settlement of inter-company balances utilizing a global netting system and limited use of foreign currency denominated debt.

The results of operations are exposed to changes in interest rates primarily with respect to borrowings under the Company's revolving credit agreement (credit facility), where interest rates are tied to the prime rate or LIBOR.

The average interest rate associated with borrowings against the credit facility paid by the Company in 2006 was 5.5 percent. As of December 30, 2006, the Company had \$50.0 million outstanding under the credit facility. The Company does not, as a matter of policy, enter into derivative contracts for speculative purposes. The interest rate swap agreement entered into by the Company on September 24, 2003, had a notional amount of \$10.0 million under which the Company receives a fixed rate of interest of 6.3 percent and pays interest at a variable rate based on a three month LIBOR rate plus a spread. The average rate associated with the swap agreement paid by the Company in 2006 was 7.9 percent. The fixed-to-variable interest rate swap is accounted for as a fair value hedge, per SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," with effectiveness assessed based on changes in the fair value of the underlying debt using incremental borrowing rates currently available on loans with similar terms and maturities. The effective gain or loss on the interest rate swap and that of the underlying debt are equal and offsetting resulting in no net effect to earnings. Based on the Company's variable rate debt at December 30, 2006, a hypothetical 1.0 percent increase in interest rates would result in an annual increase in interest expense of approximately \$0.6 million.

Selected Financial Data

The following selected financial data should be read in conjunction with our consolidated financial statements. The information set forth below is not necessarily indicative of future operations.

Ten Year Financial Summary (a)
Franklin Electric Co., Inc. and Consolidated Subsidiaries

(In thousands, except per share amounts and ratios)	2006 (b)	2005 (c)	2004 (d)
Operations:			
Net sales.....	\$557,948	\$403,413	\$370,070
Gross profit.....	191,557	142,821	126,191
Interest expense.....	3,373	766	488
Income taxes	30,671	24,953	21,126
Income from continuing operations (a)	56,762	45,796	38,368
Depreciation and amortization	17,989	14,971	15,143
Capital expenditures.....	23,190	17,845	21,110
Balance sheet:			
Working capital (h)	\$123,833	\$138,998	\$111,697
Property, plant and equipment, net.....	115,976	95,732	95,924
Total assets	526,925	379,762	333,473
Long-term debt.....	51,043	12,324	13,752
Shareowners' equity	345,831	267,562	234,333
Other data:			
Income, from continuing operations, to sales.....	10.2%	11.4%	10.4%
Income, from continuing operations, to average total assets	12.5%	12.8%	12.5%
Current ratio (i).....	2.3	3.2	3.1
Number of common shares outstanding.....	23,009	22,485	22,041
Per share:			
Market price range			
High	\$ 62.95	\$ 45.29	\$ 43.48
Low.....	38.70	34.54	29.01
Income, from continuing operations, per weighted-average common share.....	2.49	2.06	1.75
Income, from continuing operations, per weighted-average common share, assuming dilution	2.43	1.97	1.67
Book value (j)	14.84	11.54	10.17
Dividends per common share	0.43	0.38	0.31

(a) The 2006-2002 financial presentation excludes the sales and earnings of the Engineered Motor Products Division (EMPD) which was sold during the fourth quarter of 2006.

(b) Includes the results of operations of the Company's wholly-owned subsidiary, Little Giant Pump Company and Healy Systems, Inc., since their acquisition in the second and third quarter of 2006, respectively.

(c) Includes the results of operations of the Company's wholly-owned subsidiary, Phil-Tite Enterprises, and the effect of an equity investment in Pioneer Pump, Inc., both acquired in the third quarter of 2005.

(d) Includes the results of operations of the Company's wholly-owned subsidiary, Franklin Pump Systems, since the acquisition of certain assets of JBD, Inc. in the third quarter of 2004.

2003	2002 (e)	2001	2000 (f)	1999	1998	1997 (g)
\$325,529	\$319,025	\$322,908	\$325,731	\$293,236	\$272,533	\$303,298
106,670	99,707	92,871	85,186	84,171	79,955	85,533
1,107	1,317	1,193	1,111	1,317	1,364	1,435
16,950	17,730	16,235	13,683	15,591	15,237	15,004
34,649	31,318	27,150	22,226	26,805	24,784	25,505
13,748	12,878	12,660	10,839	7,460	6,687	7,628
15,261	15,568	6,709	14,108	13,691	24,601	8,598
\$ 82,640	\$ 62,762	\$ 69,158	\$ 54,897	\$ 56,886	\$ 61,878	\$ 87,973
83,916	76,033	58,839	64,604	57,047	51,461	32,357
281,971	258,583	195,643	197,179	176,101	167,590	163,110
14,960	25,946	14,465	15,874	17,057	18,089	19,163
192,938	153,138	123,269	115,998	96,293	91,597	92,841
10.6%	9.8%	8.4%	6.8%	9.1%	9.1%	8.4%
12.8%	13.8%	13.8%	11.9%	15.6%	15.0%	15.2%
2.8	2.2	2.7	2.2	2.2	2.4	3.2
21,828	21,648	21,336	22,016	21,652	22,296	23,388
\$ 32.80	\$ 30.27	\$ 21.32	\$ 18.25	\$ 18.72	\$ 18.13	\$ 16.07
23.00	19.95	16.00	13.06	14.75	10.00	10.32
1.60	1.45	1.25	1.02	1.22	1.08	1.08
1.53	1.38	1.19	0.98	1.15	1.01	1.00
8.53	6.74	5.42	5.10	4.14	3.71	3.65
0.27	0.26	0.24	0.22	0.20	0.17	0.15

(e) Includes the results of operations of the Company's wholly-owned subsidiaries, Coverco S.r.l. and Intelligent Controls, Inc., since their acquisition in the first and third quarters of 2002, respectively.

(f) Includes the results of operations of the Company's wholly-owned subsidiaries, EBW, Inc. and Advance Polymer Technology, Inc., since their acquisition in the third quarter of 2000.

(g) Includes 10 months of the results of operations of the Company's wholly-owned subsidiary, Oil Dynamics, Inc., until its sale in the fourth quarter of 1997.

(h) Working capital = Current assets minus Current liabilities

(i) Current ratio = Current assets divided by Current liabilities

(j) Book value = Shareowners' equity divided by weighted-average common shares, assuming full dilution

Management's Report on Internal Control over Financial Reporting

System of Internal Control over Financial Reporting:

Management is responsible for establishing and maintaining an adequate system of internal control over financial reporting of the Company. This system is designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with accounting principles generally accepted in the United States of America.

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

Because of its inherent limitations, internal control over financial reporting can provide only reasonable assurance with respect to financial statement preparation and may not prevent or detect misstatements. Further, because of changes in conditions, effectiveness of internal controls over financial reporting may vary over time.

Management conducted an evaluation of the effectiveness of the system of internal control over financial reporting based on the framework in *Internal Control-Integrated Framework* (the "Framework") issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Management did not include Little Giant Pump Company or Healy Systems in the scope of this evaluation and whose financial statements collectively constitute 45 percent and 33 percent of net and total assets, respectively, 15 percent of revenues, and 7 percent of net income of the consolidated financial statement amounts as of and for the year ended December 30, 2006. Based on its evaluation, management concluded that the Company's system of internal control over financial reporting was effective as of December 30, 2006.

Our independent registered accounting firm has issued an audit report on management's assessment of internal control over financial reporting.

Report of Independent Registered Public Accounting Firm

To the Shareowners and Directors, Franklin Electric Co., Inc.:

We have audited management's assessment, included in the accompanying Management's Report on Internal Control Over Financial Reporting, that Franklin Electric Co., Inc. and subsidiaries (the "Company") maintained effective internal control over financial reporting as of December 30, 2006, based on criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. As described in Management's Report on Internal Control Over Financial Reporting, management excluded from its assessment the internal control over financial reporting at Little Giant Pump Company, which was acquired on April 21, 2006 and Healy Systems, Inc., which was acquired on September 15, 2006, and whose financial statements collectively constitute 45 percent and 33 percent of net and total assets, respectively, 15 percent of revenues, and 7 percent of net income of the consolidated financial statement amounts as of and for the year ended December 30, 2006. Accordingly, our audit did not include the internal control over financial reporting at Little Giant Pump Company and Healy Systems, Inc. The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting. Our responsibility is to express an opinion on management's assessment and an opinion on the effectiveness of the Company's internal control over financial reporting based on our audit.

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

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

Because of the inherent limitations of internal control over financial reporting, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis. Also, projections of any evaluation of the effectiveness of the internal control over financial reporting to future periods are subject to the risk that the controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, management's assessment that the Company maintained effective internal control over financial reporting as of December 30, 2006, is fairly stated, in all material respects, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 30, 2006, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the consolidated financial statements as of and for the year ended December 30, 2006 of the Company and our report dated February 26, 2007 expressed an unqualified opinion on those financial statements and included an explanatory paragraph regarding the adoption of Statement of Financial Accounting Standards No. 123(R), *Share-Based Payment*, on January 1, 2006, and the adoption of Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, on December 31, 2006.

Debitte & Touche LLP

Chicago, Illinois, February 26, 2007

Report of Independent Registered Public Accounting Firm

To the Shareowners and Directors, Franklin Electric Co., Inc.:

We have audited the accompanying consolidated balance sheets of Franklin Electric Co., Inc. and subsidiaries (the "Company") as of December 30, 2006 and December 31, 2005, and the related consolidated statements of income, shareowners' equity and comprehensive income, and cash flows for each of the three years in the period ended December 30, 2006. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

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

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of Franklin Electric Co., Inc. and subsidiaries as of December 30, 2006 and December 31, 2005, and the results of their operations and their cash flows for each of the three years in the period ended December 30, 2006, in conformity with accounting principles generally accepted in the United States of America.

On January 1, 2006, the Company adopted the provisions of Statement of Financial Standards No. 123(R), *Share-Based Payment*, and on December 31, 2006, the Company adopted the provisions of Statement of Financial Accounting Standards No. 158, *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*.

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the effectiveness of the Company's internal control over financial reporting as of December 30, 2006, based on the criteria established in *Internal Control – Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission and our report dated February 26, 2007 expressed an unqualified opinion on management's assessment of the effectiveness of the Company's internal control over financial reporting and an unqualified opinion on the effectiveness of the Company's internal control over financial reporting.

Debitte & Touche LLP

Chicago, Illinois
February 26, 2007

Consolidated Statements of Income

Franklin Electric Co., Inc. and Consolidated Subsidiaries

(In thousands, except per share amounts)	2006	2005	2004
Net sales.....	\$557,948	\$403,413	\$370,070
Cost of sales.....	<u>366,391</u>	<u>260,592</u>	<u>243,879</u>
Gross profit.....	191,557	142,821	126,191
Selling and administrative expenses.....	102,478	70,799	60,413
Restructure expense	<u>—</u>	<u>1,920</u>	<u>5,536</u>
Operating income.....	89,079	70,102	60,242
Interest expense.....	(3,373)	(766)	(488)
Other income	1,791	1,200	219
Foreign exchange income/(loss).....	<u>(64)</u>	<u>213</u>	<u>(479)</u>
Income before income taxes.....	87,433	70,749	59,494
Income taxes	<u>30,671</u>	<u>24,953</u>	<u>21,126</u>
Income from continuing operations.....	56,762	45,796	38,368
Discontinued operations.....	381	344	(460)
Income taxes	<u>145</u>	<u>131</u>	<u>(175)</u>
Income/(loss) from discontinued operations.....	<u>236</u>	<u>213</u>	<u>(285)</u>
Net income	<u>\$ 56,998</u>	<u>\$ 46,009</u>	<u>\$ 38,083</u>
Income per share			
Basic continuing operations.....	\$ 2.49	\$ 2.06	\$ 1.75
Basic discontinued operations.....	<u>0.01</u>	<u>0.01</u>	<u>(0.02)</u>
	<u>\$ 2.50</u>	<u>\$ 2.07</u>	<u>\$ 1.73</u>
Diluted continuing operations.....	\$ 2.43	\$ 1.97	\$ 1.67
Diluted discontinued operations.....	<u>0.01</u>	<u>0.01</u>	<u>(0.02)</u>
	<u>\$ 2.44</u>	<u>\$ 1.98</u>	<u>\$ 1.65</u>
Dividends per common share.....	\$ 0.43	\$ 0.38	\$ 0.31

See Notes to Consolidated Financial Statements.

Consolidated Balance Sheets
Franklin Electric Co., Inc. and Consolidated Subsidiaries

Assets

(In thousands, except per share amounts)

	2006	2005
Current assets:		
Cash and equivalents	\$ 33,956	\$ 52,136
Investments.....	—	35,988
Receivables (less allowances of \$2,786 and \$2,204, respectively)	52,679	30,165
Inventories:		
Raw materials.....	39,195	25,267
Work-in-process	14,414	10,647
Finished goods	76,661	51,754
LIFO reserve	<u>(18,707)</u>	<u>(17,287)</u>
	111,563	70,381
Other current assets (including deferred income taxes of \$14,914 and \$10,744, respectively)	<u>19,592</u>	<u>14,350</u>
Total current assets.....	217,790	203,020
Property, plant and equipment, at cost:		
Land and buildings	56,352	53,106
Machinery and equipment	<u>169,119</u>	<u>164,926</u>
	225,471	218,032
Less allowance for depreciation.....	<u>(109,495)</u>	<u>(122,300)</u>
	115,976	95,732
Other assets (including deferred income taxes of \$1,269 and \$0, respectively)	14,375	13,064
Intangible assets	45,257	9,964
Goodwill.....	<u>133,527</u>	<u>57,982</u>
Total assets	<u>\$ 526,925</u>	<u>\$379,762</u>

See Notes to Consolidated Financial Statements.

Liabilities and Shareowners' Equity

(In thousands, except per share amounts)

	2006	2005
Current liabilities:		
Accounts payable.....	\$ 30,832	\$ 26,409
Accrued liabilities	40,166	34,223
Income taxes	11,649	2,087
Current maturities of long-term debt and short-term borrowings.....	<u>11,310</u>	<u>1,303</u>
Total current liabilities	93,957	64,022
Long-term debt.....	51,043	12,324
Deferred income taxes	4,597	4,296
Employee benefit plan obligations.....	25,969	25,830
Other long-term liabilities.....	5,528	5,728
Contingencies and commitments (note 16)		
Shareowners' equity:		
Common shares (45,000 shares authorized, \$.10 par value) outstanding (23,009 and 22,485, respectively).....	2,301	2,249
Additional capital	94,356	74,717
Retained earnings	236,780	190,381
Loan to ESOP trust.....	(200)	(432)
Accumulated other comprehensive income	<u>12,594</u>	<u>647</u>
Total shareowners' equity	<u>345,831</u>	<u>267,562</u>
Total liabilities and shareowners' equity	<u>\$526,925</u>	<u>\$379,762</u>

See Notes to Consolidated Financial Statements.

Consolidated Statements of Cash Flows

Franklin Electric Co., Inc. and Consolidated Subsidiaries

(In thousands)	2006	2005	2004
Cash flows from operating activities:			
Net income	\$ 56,998	\$ 46,009	\$ 38,083
Adjustments to reconcile net income to net cash flows from operating activities:			
Depreciation and amortization	17,989	14,971	15,143
Stock based compensation	3,206	147	—
Deferred income taxes	(9,933)	284	1,219
Gain/loss on divestiture and disposals of plant and equipment	(4,637)	174	187
Changes in assets and liabilities, before the effect of acquisitions			
Receivables	(5,380)	7,354	(1,243)
Inventories	(10,978)	(10,642)	(1,167)
Accounts payable and other accrued expenses ..	(4,540)	5,930	2,276
Accrued income taxes	15,012	8,076	5,029
Excess tax from share-based compensation arrangements	(5,743)	—	—
Employee benefit plans	4,956	2,420	(3,491)
Other, net	(1,561)	(559)	1,471
Net cash flows from operating activities	<u>55,389</u>	<u>74,164</u>	<u>57,507</u>
Cash flows from investing activities:			
Additions to plant and equipment	(23,190)	(17,845)	(21,110)
Proceeds from sale of plant and equipment	343	1,073	29
Additions to other assets	—	(2,184)	(10)
Purchase of securities	(63,500)	(236,773)	—
Proceeds from sale of securities	99,488	200,785	—
Cash paid for acquisitions, net of cash acquired	(159,205)	(8,509)	(9,307)
Proceeds from sale of business	14,470	—	—
Net cash flows from investing activities	<u>(131,594)</u>	<u>(63,453)</u>	<u>(30,398)</u>
Cash flows from financing activities:			
Proceeds from long-term debt	130,000	—	—
Repayment of long-term debt	(81,296)	(1,280)	(1,553)
Proceeds from issuance of common stock	10,120	14,298	4,110
Excess tax from share-based compensation arrangements	5,743	—	—
Purchases of common stock	(198)	(13,775)	(3,091)
Reduction of loan to ESOP Trust	232	233	232
Dividends paid	(9,833)	(8,447)	(6,815)
Net cash flows from financing activities	<u>54,768</u>	<u>(8,971)</u>	<u>(7,117)</u>
Effect of exchange rate changes on cash	3,257	(208)	650
Net change in cash and equivalents	(18,180)	1,532	20,642
Cash and equivalents at beginning of year	52,136	50,604	29,962
Cash and equivalents at end of year	<u>\$ 33,956</u>	<u>\$ 52,136</u>	<u>\$ 50,604</u>
(In millions)			
Cash paid for income taxes	\$ 24.4	\$ 19.3	\$ 19.0
Cash paid for interest	\$ 3.1	\$ 0.7	\$ 0.6
Non-cash items:			
Payable to seller of Healy Systems, Inc.	\$ 3.0	\$ —	\$ —
Additions to property, plant, and equipment, not yet paid	\$ 0.5	\$ 0.5	\$ 0.1
Receivable from sale of EMPD	\$ 2.2	\$ —	\$ —

See Notes to Consolidated Financial Statements.

Consolidated Statements of Shareowners' Equity and Comprehensive Income

Franklin Electric Co., Inc. and Consolidated Subsidiaries

(In thousands)	Common Shares Outstanding	Common Stock	Additional Capital	Retained Earnings	Loan to ESOP Trust	Accumulated Other Comprehensive Income (Loss)	Comprehensive Income
Balance year end 2003	21,828	\$2,182	\$45,826	\$139,057	\$(897)	\$ 6,770	
Net income				38,083			\$38,083
Currency translation adjustment						6,935	6,935
Minimum pension liability adjustment, net of tax \$141						(211)	(211)
Comprehensive income							<u>\$44,807</u>
Dividends on common stock				(6,815)			
Common stock issued	337	35	4,495				
Common stock repurchased or received for stock options exercised	(124)	(13)		(3,768)			
Tax benefit of stock options exercised			2,422				
Loan payment from ESOP					232		
Balance year end 2004	<u>22,041</u>	<u>\$2,204</u>	<u>\$52,743</u>	<u>\$166,557</u>	<u>\$(665)</u>	<u>\$13,494</u>	
Net income				46,009			\$46,009
Currency translation adjustment						(9,405)	(9,405)
Minimum pension liability adjustment, net of tax \$2,295						(3,442)	(3,442)
Comprehensive income							<u>\$33,162</u>
Dividends on common stock				(8,447)			
Common stock issued	795	81	14,855				
Stock-based compensation	15	1	147				
Common stock repurchased or received for stock options exercised	(366)	(37)		(13,738)			
Tax benefit of stock options exercised			6,972				
Loan payment from ESOP					233		
Balance year end 2005	<u>22,485</u>	<u>\$2,249</u>	<u>\$74,717</u>	<u>\$190,381</u>	<u>\$(432)</u>	<u>\$ 647</u>	
Net income				56,998			\$56,998
Currency translation adjustment						8,306	8,306
Minimum pension liability adjustment, net of tax \$(3,278)						4,917	4,917
Comprehensive income							<u>\$70,221</u>
SFAS 158 transition amount, net of tax \$851						(1,276)	
Dividends on common stock				(9,833)			
Common stock issued	513	50	10,690				
Stock-based compensation	26	3	3,206				
Common stock repurchased or received for stock options exercised	(15)	(1)		(766)			
Tax benefit of stock options exercised			5,743				
Loan payment from ESOP					232		
Balance year end 2006	<u>23,009</u>	<u>\$2,301</u>	<u>\$94,356</u>	<u>\$236,780</u>	<u>\$(200)</u>	<u>\$12,594</u>	

See Notes to Consolidated Financial Statements.

Notes to Consolidated Financial Statements

Franklin Electric Co., Inc. and Consolidated Subsidiaries

1. Summary of Significant Accounting Policies

Company – “Franklin Electric” or the “Company” shall refer to Franklin Electric Co., Inc. and its consolidated subsidiaries.

Fiscal Year – The Company’s fiscal year ends on the Saturday nearest December 31. The financial statements and accompanying notes are as of and for the years ended December 30, 2006 (52 weeks), December 31, 2005 (52 weeks), and January 1, 2005 (52 weeks) and referred to as 2006, 2005, and 2004, respectively.

Principles of Consolidation – The consolidated financial statements include the accounts of the Company and its subsidiaries. All significant inter-company balances and transactions are eliminated.

Revenue Recognition – Products are shipped utilizing common carriers direct to customers or, for consignment products, to customer specified warehouse locations. Sales are recognized when the Company’s products are shipped direct or, in the case of consignment products, transferred from the customer specified warehouse location to the customer, at which time transfer of ownership and risk of loss pass to the customer. The Company records net sales revenues after discounts at the time of sale based on specific discount programs in effect, historical data, and experience.

Research and Development Expense – The Company’s research and development activities are charged to expense in the period incurred. The Company spent approximately \$8.1 million in 2006, \$5.6 million in 2005, and \$4.2 million in 2004 on research and development.

Cash Equivalents – Cash equivalents consist of highly liquid investments which are readily convertible to cash, present insignificant risk of changes in value due to interest rate fluctuations, and have original or purchased maturities of three months or less.

Fair Value of Financial Instruments – The carrying amounts for cash and equivalents, and short-term debt approximate fair value. The fair value of long-term debt is estimated based on current borrowing rates for similar issues and current exchange rates for foreign currency denominated amounts, which is not materially different from the recorded value. The Company’s off-balance sheet instruments consist of operating leases and an interest rate swap, which are not significant.

Accounts Receivable and Allowance for Uncollectible Accounts – Accounts receivable are stated at estimated net realizable value. Accounts receivable is comprised of balances due from customers, net of earned discounts and estimated allowances for uncollectible accounts.

Earned discounts are based on specific customer agreement terms. In determining allowances, historical trends are evaluated and economic conditions and specific customer issues are reviewed to arrive at appropriate allowances. Allowance levels change as customer-specific circumstances and the other analysis areas noted above change. Differences may result in the amount for allowances if actual experience differs significantly from management estimates; such differences have not historically been material.

Inventories – Inventories are stated at the lower of cost or market. The majority of the cost of domestic and foreign inventories is determined using the first-in, first-out (FIFO) method; a portion of domestic inventory costs are determined using the last-in, first-out (LIFO) method. Inventories stated on the LIFO method were approximately 15.7 percent and 31.5 percent of total inventories in 2006 and 2005, respectively. The Company reviews its inventories for excess or obsolete products or components. Based on an analysis of historical usage and management’s evaluation of estimated future demand, market conditions and alternative uses for possible excess or obsolete parts, reserves are recorded or changed.

Property, Plant and Equipment – Property, plant and equipment are stated at cost. Depreciation of plant and equipment is provided principally on a straight line basis over the estimated useful lives of 5 to 20 years for land improvements and buildings, 2 to 10 years for machinery and equipment. Maintenance, repairs, and renewals of a minor nature are expensed as incurred. Betterments and major renewals which extend the useful lives of buildings, improvements, and equipment are capitalized. Accelerated methods are used for income tax purposes. The Company reviews its property, plant and equipment for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. The Company’s depreciation expense was \$15.8, \$13.5, and \$13.0 million in 2006, 2005, and 2004, respectively.

Asset Retirement Obligations – The Company recognizes and reports obligations associated with tangible asset retirements that result from the acquisition, disposal, or normal operation of a long-lived asset. Obligations are recognized and recorded at fair value in the period in which the obligation is incurred and a reasonable estimate made, or recognized when a reasonable estimate can be made.

Goodwill and Other Intangible Assets – The Company performs goodwill impairment testing for its reporting units, annually or more frequently whenever events or a change in circumstances indicate that the asset may

be impaired. Goodwill is then adjusted in the event of impairment. Amortization is recorded for other intangible assets with definite lives.

Derivatives and Hedging—On September 24, 2003, the Company entered into a fixed-to-variable interest rate swap to achieve a desired proportion of variable vs. fixed rate debt. The fixed-to-variable interest rate swap is accounted for as a fair value hedge, per SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," with effectiveness assessed based on changes in the fair value of the underlying debt using incremental borrowing rates currently available on loans with similar terms and maturities. The effective gain or loss on the interest rate swap and that of the underlying debt are equal and offsetting resulting in no net effect to earnings.

Warranty Obligations—Warranty terms are generally two years from date of manufacture or one year from date of installation. Warranty liability is recorded when revenue is recognized and is based on actual historical return rates from the most recent warranty periods.

Income Taxes—Income taxes are accounted for in accordance with SFAS No. 109, "Accounting for Income Taxes." Under this method, deferred tax assets and liabilities are determined based on the difference between the financial statement and tax basis of assets and liabilities and net operating loss and credit carryforwards using enacted tax rates in effect for the year in which the differences are expected to reverse. Valuation allowances are established when necessary to reduce deferred tax assets to the amounts expected to be realized.

Stock-Based Compensation—Prior to January 1, 2006, the Company accounted for stock-based employee compensation plans under the recognition and measurement provisions of Accounting Principles Board (APB) Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations, as permitted by SFAS No. 123, "Accounting for Stock-Based Compensation." Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), "Share-Based Payment," using the modified-prospective-transition method. Under that transition method, compensation cost recognized in 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). Results for prior periods have not been restated.

For pro forma information regarding net income and earnings per share, the fair value for the options awarded in 2005 and 2004, for all fixed stock option plans was estimated as of the date of the grant using a Black-Scholes option valuation model. The Black-Scholes option valuation model used by the Company was developed for use in estimating the fair value of fully tradable options which have no vesting restrictions and are fully transferable. In addition, option valuation models require the input of highly subjective assumptions including the expected stock price volatility.

Earnings Per Common Share—Basic and diluted earnings per share are computed and disclosed under SFAS No. 128, "Earnings Per Share." Earnings per share are based on the weighted-average number of common shares outstanding. Diluted earnings per share is computed based upon earnings applicable to common shares divided by the weighted-average number of common shares outstanding during the period adjusted for the effect of other dilutive securities.

Translation of Foreign Currencies—All assets and liabilities of foreign subsidiaries whose functional currency is other than the U.S. dollar are translated at year end exchange rates. All revenue and expense accounts are translated at average rates in effect during the respective period. Adjustments for translating foreign currency assets and liabilities in U.S. dollars are included as a component of other comprehensive income. Transaction gains and losses that arise from exchange rate fluctuations are included in the results of operations in "Other income," as incurred.

Significant Estimates and Assumptions—The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make significant estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting periods. Significant estimates and assumptions by management affect accrued expenses, stock-based compensation, pension, goodwill impairment, long-lived assets and inventory valuation.

Although the Company regularly assesses these estimates, actual results could differ materially from these estimates. The Company bases its estimates on historical experience and various other assumptions that it believes to be reasonable under the circumstances.

Reclassifications—All share and per share data included in these financial statements reflect the Company's two-for-one stock splits effected in the form of a 100 percent stock distribution made on June 15, 2004.

Notes to Consolidated Financial Statements (continued)

2. Accounting Pronouncements

In July 2006, the Financial Accounting Standards Board (FASB) issued FASB Interpretation No. 48 "Accounting For Uncertain Tax Positions" ("FIN 48"). FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with SFAS No. 109 "Accounting for Income Taxes." It prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. FIN 48 also provides guidance on de-recognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company reviewed the impact of FIN 48 on its financial statements and does not believe the adoption of this standard will have a significant impact on the Company's results of operations, financial position, or statement of cash flows.

In September 2006, the FASB issued SFAS No. 157 "Fair Value Measurements." SFAS No. 157 gives guidance for measuring assets and liabilities using fair value. Fair value is a market-based measurement, not an entity-specific measurement, and sets out a fair value hierarchy with the highest priority being quoted prices in active markets. The fair value measurements are disclosed by level within that hierarchy. While the Statement does not add any new fair value measurements, it does change current practice. This statement is effective for financial statements issued for fiscal years beginning after November 15, 2007, although earlier application is encouraged. The Company is currently evaluating the impact of adopting SFAS No. 157 on its financial statements, but does not believe the adoption of this standard will have a significant impact on the Company's results of operations, financial position, or statement of cash flows.

In September 2006, the SEC issued Staff Accounting Bulletin No. 108, "Financial Statements – Considering the Effects of Prior Year Misstatements When Quantifying Misstatements in Current Year Financial Statements" ("SAB 108"). SAB 108 addresses how a registrant should quantify the effect of an error on the financial statements. The SEC concludes that a dual approach should be used to compute the amount of a misstatement. Specifically, the amount should be computed using both a "rollover" (current year income statement perspective) and "iron curtain" (year-end balance sheet perspective) methods. SAB 108 is effective for fiscal years ending after November 15, 2006. The adoption of SAB 108 did not have a material impact on the Company's results of operations, financial position, or statement of cash flows.

In September 2006, the FASB issued SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans," which required recognition of the funded status of defined benefit pension and other postretirement plans, with a corresponding after-tax adjustment to accumulated other comprehensive loss. In 2006, the Company adopted SFAS No. 158. The adoption of SFAS No. 158, together with the annual remeasurement of our pension plans, resulted in a net of tax, \$1.3 million, decrease in Shareholders' equity. This decrease does not affect cash flows or the funded status of our benefit plans.

In February 2007, the FASB issued SFAS No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities." SFAS No. 159 permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007, with early adoption permitted provided the entity also elects to apply the provisions of SFAS No. 157. The Company is currently evaluating the impact of adopting SFAS No. 159 on its financial statements.

3. Acquisitions

During April 2006, the Company completed its acquisition of all of the outstanding shares of capital stock of Little Giant Pump Company ("Little Giant") from Tecumseh Products Company for a cash purchase price of \$120.8 million, excluding direct transaction costs and subject to a final post-closing working capital adjustment. Transaction costs, approximately \$2.4 million, and the final post-closing working capital adjustment, approximately \$0.7 million, are included in the purchase accounting calculations under the guidance of SFAS No. 141 "Business Combinations." Accordingly, a portion of the aggregate purchase price has been allocated to net assets acquired based on a fair market valuation. The initial excess purchase price over fair value of the net assets acquired, \$82.6 million originally recorded as goodwill, has been adjusted to \$47.3 million for the fair market values assigned to fixed assets, customer relationships, technology and other intangible assets. Certain due to values assigned, within property, plant and equipment, are considered preliminary estimates and will be adjusted as additional information is received and valuation assessments are completed. The \$47.3 million recorded as goodwill, will be deductible for tax purposes.

The purchase price assigned to each major asset and liability of Little Giant Pump Company is as follows:

(In millions)	
Assets:	
Current assets	\$ 45.6
Property, plant and equipment	13.4
Intangible assets	31.2
Goodwill	47.3
Other assets	0.2
Total assets	137.7
Less liabilities	(13.8)
Total purchase price	\$123.9

Little Giant's results of operations were included in the Company's consolidated statement of income, from the acquisition date through the year ended December 30, 2006.

During September 2006, the Company acquired Healy Systems, Inc. ("Healy Systems") in a stock purchase transaction for a cash purchase price of \$35.1 million, excluding direct transaction costs and a post-closing working capital adjustment. The purchase agreement provides for additional payments of 5 percent of certain Healy Systems product sales over the next five years. The transaction costs, approximately \$0.3 million, and the preliminary post closing working capital adjustment, approximately \$2.6 million are included in the total purchase accounting calculations under the guidance of SFAS No. 141 "Business Combinations." The purchase price has been allocated to net assets based on preliminary estimated fair values. The Company will complete an independent fair market valuation in 2007. The excess of purchase price over preliminary estimated fair value of the net assets acquired, \$26.4 million, has been recorded as goodwill. No portion of the \$26.4 million, recorded as goodwill, will be deductible for tax purposes.

The purchase price assigned to each major asset and liability of Healy Systems, Inc. is as follows:

(In millions)	
Assets:	
Current assets	\$ 8.1
Property, plant and equipment	2.0
Intangible assets	6.0
Goodwill	26.4
Total assets	42.5
Less liabilities:	
Current liabilities	(1.7)
Deferred income taxes	(2.4)
Total purchase price	\$38.4

Healy Systems results of operations were included in the Company's consolidated statement of income, from the acquisition date through the year ended December 30, 2006.

Pro forma Results of Operations

The following unaudited pro forma statements give effect to the acquisition of Little Giant Pump Company and Healy Systems, by the Company. The unaudited pro forma combined condensed statements of income for 2006 and 2005 give effect to the acquisition of

Little Giant Pump Company and Healy Systems as if the acquisitions had occurred at the beginning of the periods reported. These unaudited pro forma combined condensed financial statements are prepared for informational purposes only and are not necessarily indicative of actual results or financial position that would have been achieved had the acquisitions of Little Giant and Healy Systems been consummated on the dates indicated and are not necessarily indicative of future operating results or financial position of the consolidated companies. The unaudited pro forma combined condensed financial statements do not give effect to any cost savings or incremental costs that may result from the integration of Little Giant Pump Company and Healy Systems with the Company.

Franklin Electric Co., Inc.

Pro Forma Condensed Consolidated Statements of Income

(In millions, except per share amounts)	2006	2005
Net sales	\$615.7	\$529.6
Net income	\$ 59.3	\$ 52.8
Per share data:		
Basic earnings per share	\$2.60	\$2.38
Diluted earnings per share	\$2.55	\$2.28

4. Discontinued Operations

During December 2006, the Company sold its Engineered Motor Products Division, ("EMPD") for an approximate \$16.6 million selling price. Representing less than 10 percent of the Company's consolidated sales, the Company no longer considered EMPD to be a part of its core operations. Thus future growth potential would be limited. This transaction was recognized in accordance to the guidance within SFAS No. 144 "Accounting for the Impairment and/or Disposal of Long-Lived Assets."

The selling price included an initial sales price of \$16.0 million and a preliminary working capital adjustment of \$0.6 million. Net book value of the disposed assets was \$11.9 million, including \$14.5 million in total assets offset by \$2.5 million in assumed liabilities. The Company realized a net book gain of \$4.7 million. Divestiture expenses, incurred by the Company, of \$0.8 million and \$4.6 million for a one-time pension cost adjustment were recognized, offsetting the \$4.7 million gain, resulting in a net pre-tax loss of \$0.8 million. The net pre-tax loss is included in the statement of income, as part of discontinued operations.

Net sales for discontinued operations, were \$36.8 million, \$36.1 million, and \$34.2 million, for 2006, 2005, and 2004, respectively. The income/loss before tax, related to discontinued operations, was \$0.4 million, \$0.3 million, and (\$0.5) million, for 2006, 2005, and 2004 respectively.

Notes to Consolidated Financial Statements (continued)

5. Investments

As of December 30, 2006, the Company held no investments in financial securities. As of December 31, 2005, the Company held \$36.0 million of investments in financial securities. Income generated from investments was recorded as "Other income," in the Company's statement of income. Cash paid for these securities and proceeds from the sale of these securities was included as part of the "Cash flows from investing activities" section in the Company's statement of cash flows.

The Company holds a 35 percent equity interest, in Pioneer Pump, Inc., which is accounted for using the equity method and is included as part of "Other assets" in the balance sheet. The carrying amount of the investment is adjusted for the Company's proportionate share of earnings, losses, and dividends. At December 30, 2006, the carrying value of the investment was \$6.1 million. At December 31, 2005, the carrying value of the investment was \$6.0 million. The Company's proportionate share of Pioneer Pump, Inc. earnings, included in "Other income" in the Company's results of operations, was \$0.7 million for 2006 and \$0.1 for 2005.

6. Goodwill and Other Intangible Assets

The Company uses the purchase method of accounting for business combinations, in accordance with SFAS Nos. 141 and 142, "Business Combinations" and "Goodwill and Other Intangible Assets," respectively. During the fourth quarter of each year, the Company performs its annual impairment testing required by SFAS No. 142, unless events or circumstances indicate earlier impairment testing. No impairment loss was recognized for 2006, 2005, or 2004.

The carrying amount of the Company's intangible assets and goodwill include:

(In millions)	2006	2005
Amortized intangibles		
Patents	\$ 6.3	\$ 5.9
Accumulated amortization	(2.8)	(2.0)
Supply agreements	7.2	10.0
Accumulated amortization	(4.3)	(6.6)
Technology	3.8	2.7
Accumulated amortization	(0.3)	(0.1)
Customer relationships	26.8	0.0
Accumulated amortization	(0.8)	0.0
Other	1.7	1.5
Accumulated amortization	(1.6)	(1.4)
	<u>36.0</u>	<u>10.0</u>
Unamortized intangibles		
Trade names	9.3	0.0
Total intangibles	<u>\$ 45.3</u>	<u>\$10.0</u>
Goodwill	<u>\$133.5</u>	<u>\$58.0</u>

The weighted average years over which each intangible class is amortized is as follows:

Class	Years
Patents	17
Supply Agreements	6
Technology	15
Customer Relationships	20
Other	8

Amortization expense related to intangible assets for the twelve months ended December 30, 2006, December 31, 2005, and January 1, 2005 was \$2.2, \$1.4, and \$2.1 million, respectively. Amortization expense for each of the five succeeding years is projected as \$2.7 million, \$2.7 million, \$2.6 million, \$2.5 million and \$2.4 million for fiscal 2007, 2008, 2009, 2010, and 2011, respectively.

In the second quarter 2006 acquisition of Little Giant Pump Company, \$31.2 million was recorded as intangibles (\$1.1 million technology, \$9.3 million trade name, and \$20.8 million customer relationships) and \$47.3 million as goodwill. In the third quarter 2006 acquisition of Healy Systems, Inc., \$6.0 million was recorded as intangibles, classified as customer relationships and subject to an independent fair market valuation, and \$26.4 million as goodwill.

Other changes in the carrying amount of intangibles and goodwill reflect foreign currency fluctuations.

7. Employee Benefit Plans

Defined Benefit Plans – As of December 30, 2006, the Company maintained three domestic pension plans and one German pension plan. The Company uses a December 31 measurement date for its plans. In 2006, the Company adopted SFAS No. 158, "Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans."

The following table sets forth aggregated information related to the Company's pension benefits and other postretirement benefits, including changes in the benefit obligations, changes in plan assets, funded status, and amounts recognized in the consolidated balance sheet, amounts recognized in Other Comprehensive Income, and actuarial assumptions:

(In millions)	Pension Benefits		Other Benefits	
	2006	2005	2006	2005
Accumulated benefit obligation, end of year	\$150.0	\$145.1	\$ 13.0	\$ 14.3
Change in benefit obligation:				
Projected benefit obligation, beginning of year	\$149.0	\$141.3	\$ 14.3	\$ 16.0
Service cost	4.7	3.9	0.3	0.4
Interest cost	8.1	7.7	0.8	0.8
Plan amendments	—	—	—	—
Actuarial gain (loss)	(2.7)	5.6	(0.1)	(1.4)
Settlements paid	(0.2)	(1.0)	—	—
Benefits paid	(9.2)	(7.4)	(1.3)	(1.5)
Liability (gain)/loss due to curtailment*	0.5	—	(1.2)	—
Special termination benefits*	1.4	—	0.2	—
Exchange	1.2	(1.1)	—	—
Projected benefit obligation, end of year	\$152.8	\$149.0	\$ 13.0	\$ 14.3
Change in plan assets:				
Fair value of assets, beginning of year	\$131.7	\$133.9	\$ —	\$ —
Actual return on plan assets	19.9	6.2	—	—
Company contributions	1.7	1.6	1.3	1.5
Settlements paid	(0.2)	(1.0)	—	—
Benefits paid	(9.2)	(8.4)	(1.3)	(1.5)
Exchange	0.4	(0.6)	—	—
Fair value of assets, end of year	\$144.3	\$131.7	\$ —	\$ —
Funded status	\$ (8.5)	\$ (17.3)	\$ (13.0)	\$ (14.3)
Amounts recognized in statement of financial position:				
Noncurrent assets	\$ 6.0	N/A**	\$ —	N/A**
Deferred tax asset	—	N/A**	1.4	N/A**
Current liabilities	(0.3)	N/A**	(1.2)	N/A**
Noncurrent liabilities	(14.2)	N/A**	(11.8)	N/A**
Net pension asset/(liability) at end of year	\$ (8.5)	N/A**	\$ (11.6)	N/A**
Amount recognized in other comprehensive income:				
Net transition (asset)/obligation	—	N/A**	1.1	N/A**
Prior service cost (credit)	1.5	N/A**	0.6	N/A**
Net actuarial (gain)/loss	(1.5)	N/A**	0.4	N/A**
Total recognized in other comprehensive income	\$ —	N/A**	\$ 2.1	N/A**

* These items are primarily related to the divestiture of the Engineered Motor Products Division in 2006.

** The requirements of SFAS No. 158 are not applied retrospectively and do not apply to disclosures for fiscal 2005.

Plans with accumulated benefit obligation in excess of plan assets as of December 31:

(In millions)	Pension Benefits		Other Benefits	
	2006	2005	2006	2005
Projected benefit obligation	\$115.2	\$112.5	\$13.0	\$14.3
Accumulated benefit obligation	113.8	110.5	13.0	14.3
Fair value of plan assets	100.8	91.7	—	—

Actuarial assumptions used to determine benefit obligations:

	Pension Benefits		Other Benefits	
	2006	2005	2006	2005
Discount rate	5.85%	5.65%	5.85%	5.65%
Rate of increase in future compensation	3-8.00% (Graded)	3-8.00% (Graded)	3-8.00% (Graded)	3-8.00% (Graded)

Actuarial assumptions used to determine periodic benefit cost:

	Pension Benefits		Other Benefits	
	2006	2005	2006	2005
Discount rate	5.65%	5.75%	5.65%	5.75%
Rate of increase in future compensation	3-8.00% (Graded)	3-8.00% (Graded)	3-8.00% (Graded)	3-8.00% (Graded)
Expected long-term rate of return on plan assets	8.50%	8.50%	—	—

The accumulated benefit obligation for the Company's qualified defined benefit pension plans was \$135.1 million and \$131.1 million at December 31, 2006 and 2005.

The following table sets forth aggregated net periodic benefit cost for 2006, 2005, and 2004:

(In millions)	Pension Benefits			Other Benefits		
	2006	2005	2004	2006	2005	2004
Service cost	\$4.7	\$3.9	\$4.3	\$0.3	\$0.4	\$0.4
Interest cost	8.1	7.7	7.5	0.8	0.8	0.9
Expected return on assets	(10.5)	(10.3)	(10.9)	—	—	—
Amortization of transition (asset) obligation	—	—	—	0.5	0.5	0.5
Prior service cost	1.4	1.7	1.4	0.2	0.2	0.2
Loss/(Gain)	0.3	0.2	—	0.1	0.1	0.2
Net periodic benefit cost	\$4.0	\$3.2	\$2.3	\$1.9	\$2.0	\$2.2
Curtailment expense*	1.1	—	—	1.9	—	—
Special termination benefits*	1.4	—	—	0.2	—	—
Settlement cost	0.3	0.3	0.3	—	—	—
Total net periodic benefit cost	\$6.8	\$3.5	\$2.6	\$4.0	\$2.0	\$2.2

* These items relate to the divestiture of the Engineered Motor Products Division in 2006.

The estimated net actuarial loss, prior service cost, and transition obligation for the defined benefit pension plans that will be amortized from accumulated other comprehensive income into net periodic benefit cost during the 2007 fiscal year are \$0.2, \$1.2 and \$0.0, respectively and for other benefits will be \$0.0, \$0.1 and \$0.3, respectively.

The Company consults with actuaries, asset allocation consultants and investment advisors to determine the expected long-term rate of return on plan assets. Plan assets are invested in a diversified portfolio of equity and fixed-income securities in order to maximize the long-term return for a prudent level of risk. Furthermore, equity investments are diversified

Notes to Consolidated Financial Statements (continued)

across growth, value, small and large capitalizations. Investment risk is measured and monitored on an ongoing basis through investment portfolio reviews, annual liability measurements, and periodic asset/liability studies.

Risk tolerance is established through careful consideration of plan liabilities, plan funded status, plan liquidity needs and corporate financial condition. Based on these analyses the Company has assumed the expected long-term rate of return on plan assets will be 8.5 percent.

The qualified plans asset allocations at December 31, 2006, and 2005, by asset category are as follows:

(Percentages)	Plan Assets at December 31	
	2006	2005
Equity securities	74	74
Fixed income securities	26	26
Total	100	100

Equity securities include Company stock of \$18.9 million (13.0 percent of total plan assets) and \$18.5 million (14.0 percent of total plan assets) at December 31, 2006 and 2005, respectively.

The Company's German pension plan is partially funded with insurance contracts up to maximums established by German tax legislation. Benefits above the statutory maximums are recorded in the Company's balance sheet.

One of the Company's four pension plans covers certain management employees. The Company does not fund this plan, and its assets were zero in 2006 and 2005. The plan's projected benefit obligation and accumulated benefit obligation were \$5.6 million and \$4.4 million, respectively, at December 31, 2006, and \$6.1 million and \$4.8 million, respectively, at December 31, 2005.

The Company estimates total contributions to the plans of \$2.6 million in 2007.

The following benefit payments, which reflect expected future service, as appropriate, are expected to be paid:

(In millions)	Pension	Other
	Benefits	Benefits
2007	\$13.0	\$ 1.2
2008	8.6	1.2
2009	9.9	1.2
2010	9.3	1.1
2011	9.5	1.1
Years 2012 through 2016	53.5	5.0

The Company's other postretirement benefit plans provide health and life insurance benefits to domestic employees hired prior to 1992. The Company effectively capped its cost for those benefits through plan amendments made in 1992, freezing Company contributions for insurance benefits at 1991 levels for

current and future beneficiaries with actuarially reduced benefits for employees who retire before age 65.

The following table illustrates the effects of the application of SFAS No. 158 on individual line items in the consolidated balance sheets as of December 30, 2006 for the Company.

(In millions)	Incremental Effect of Applying SFAS No. 158 on Individual Line Items in the Statement of Financial Position December 30, 2006		
	Before	Adjust-	After
	Application of SFAS No. 158	ments	Application of SFAS No. 158
Other assets	\$ 8.7	\$5.7	\$14.4
Accrued liabilities	38.8	1.4	40.2
Deferred income taxes	4.1	0.5	4.6
Employee benefit plan obligation	20.9	5.1	26.0
Accumulated other comprehensive income	13.9	(1.3)	12.6

Defined Contribution Plans—The Company maintains an integrated 401(k) and Employee Stock Ownership Plan (ESOP). In 1992, the ESOP Trustee acquired shares of Company common stock on the open market using the proceeds of a fifteen-year, \$3.0 million loan from the Company. Under the terms of the variable rate loan (6.31 percent at December 31, 2006), principal plus interest is payable in equal annual installments. The shares of stock purchased with the loan proceeds are collateral for the loan and are considered outstanding for purposes of calculating earnings per share.

The Company contributes a portion of its 401(k) matching contribution as well as an additional annual contribution, both subject to the Company's annual financial results, to the ESOP Trust. The ESOP Trustee uses a portion of the Company's contributions to make principal and interest payments on the loan. As loan payments are made, shares of common stock are released as collateral and are allocated to participants' accounts. The balance of the Company's contributions in cash or common stock is made to the Company stock fund of the 401(k) and ESOP Trusts, and allocated to participants' accounts to satisfy the balance of the Company's 401(k) matching contribution.

At December 30, 2006, 382,693 shares were allocated to the accounts of participants, 24,783 shares were committed to be released and allocated to the accounts of participants for service rendered during 2006, and 24,783 shares were held by the ESOP Trust in suspense. The following table sets forth Company contributions to the integrated ESOP and 401(k) Plan.

(In millions)	2006	2005	2004
Company contributions to integrated plan	\$1.1	\$0.6	\$0.9

8. Accrued Liabilities

Accrued liabilities consist of:

(In millions)	2006	2005
Salaries, wages, and commissions	\$14.6	\$13.5
Product warranty costs	10.0	7.0
Insurance	6.3	5.2
Employee benefits	4.0	2.2
Other	5.3	6.3
	<u>\$40.2</u>	<u>\$34.2</u>

9. Income Taxes

Income before income taxes consisted of:

(In millions)	2006	2005	2004
Domestic	\$70.9	\$54.9	\$48.6
Foreign	16.5	15.9	10.9
Continuing operations	87.4	70.8	59.5
Discontinued operations	0.4	0.3	(0.5)
	<u>\$87.8</u>	<u>\$71.1</u>	<u>\$59.0</u>

The income tax provision consisted of:

(In millions)	2006	2005	2004
Current payable:			
Federal	\$28.6	\$15.8	\$13.1
Foreign	7.0	6.6	5.0
State	5.0	2.3	1.8
Deferred:			
Federal	(7.1)	0.6	1.8
Foreign	(0.7)	(0.8)	(0.7)
State	(2.1)	0.5	0.1
Continuing operations	30.7	25.0	21.1
Discontinued operations	0.1	0.1	(0.2)
	<u>\$30.8</u>	<u>\$25.1</u>	<u>\$20.9</u>

Significant components of the Company's deferred tax assets and liabilities were as follows:

(In millions)	2006	2005
Deferred tax assets:		
Accrued expenses and reserves	\$ 9.9	\$ 5.7
Compensation and employee benefits	12.8	10.1
Other items	4.8	3.4
Total deferred tax assets	<u>27.5</u>	<u>19.2</u>
Deferred tax liabilities:		
Accelerated depreciation on fixed assets	8.6	10.4
Amortization of intangibles	5.9	1.8
Other items	1.4	0.6
Total deferred tax liabilities	<u>15.9</u>	<u>12.8</u>
Net deferred tax assets	<u>\$11.6</u>	<u>\$ 6.4</u>

The portions of current and non-current deferred tax assets and liabilities were as follows:

(In millions)	2006		2005	
	Deferred Tax Assets	Deferred Tax Liabilities	Deferred Tax Assets	Deferred Tax Liabilities
Current	\$15.3	\$ 0.4	\$11.0	\$ 0.3
Non-current	12.2	15.5	6.4	10.7
	<u>\$27.5</u>	<u>\$15.9</u>	<u>\$17.4</u>	<u>\$11.0</u>

The valuation allowance for deferred tax assets was not significant in 2005.

The differences between the statutory and effective tax rates were as follows:

(Percentages)	2006	2005	2004
U.S. Federal statutory rate	35.0%	35.0%	35.0%
State income taxes, net of federal benefit	2.1	2.5	2.1
Extraterritorial income exclusion	(0.6)	(1.0)	(1.8)
R&D tax credits	(0.7)	(0.5)	(0.7)
Other items	(0.7)	(0.7)	0.9
Effective tax rate	<u>35.1%</u>	<u>35.3%</u>	<u>35.5%</u>

10. Debt

Long-term debt consisted of:

(In millions)	2006	2005
Insurance Company—6.31 percent, principal payments of \$1.0 million due in annual installments, with a balloon payment of \$10.0 in 2008 (\$1.9 denominated in JPY at 12/30/06)	\$11.3	\$12.3
Capital Leases	1.1	1.3
Credit Agreement—the average interest rate for 2006 was 5.5 percent based on the London Interbank Offered Rates (LIBOR) plus an interest spread.	50.0	—
	<u>62.4</u>	<u>13.6</u>
Less Current Maturities	<u>(11.3)</u>	<u>(1.3)</u>
	<u>\$51.1</u>	<u>\$12.3</u>

The following debt payments are expected to be paid:

(In millions)	Total	2007	2008	2009
Debt	\$61.3	\$11.0	\$50.3	\$—
Capital leases	1.1	0.3	0.4	0.4
	<u>\$62.4</u>	<u>\$11.3</u>	<u>\$50.7</u>	<u>\$0.4</u>

On September 9, 2004, the Company entered into an unsecured, 60-month, \$80.0 million revolving credit agreement. This agreement was amended and restated on December 14, 2006 to be an unsecured, 60-month \$120.0 million revolving credit agreement (the "Agreement"). The Agreement provides for various borrowing rate options including interest rates based on the London Interbank Offered Rates (*LIBOR*) plus interest spreads keyed to the Company's ratio of debt to earnings before interest, taxes, depreciation, and amortization ("*EBITDA*"). The Agreement contains certain financial covenants with respect to borrowings, interest coverage, loans or advances and investments. The Company had outstanding borrowings of \$50.0 million under the Agreement at December 30, 2006. The Company also has certain overdraft facilities at its foreign subsidiaries, of which none were outstanding at December 30, 2006.

The Company was in compliance with all debt covenants, at all times, in 2006 and 2005.

Notes to Consolidated Financial Statements (continued)

11. Interest Rate Risk

On September 24, 2003 the Company entered into a fixed-to-variable interest rate swap to achieve a desired proportion of variable vs. fixed rate debt. The fixed-to-variable interest rate swap is accounted for as a fair value hedge, per SFAS No. 133, "Accounting for Derivative Instruments and Hedging Activities," with effectiveness assessed based on changes in the fair value of the underlying debt using incremental borrowing rates currently available on loans with similar terms and maturities. The effective gain or loss on the interest rate swap and that of the underlying debt are equal and offsetting resulting in no net effect to earnings. The fair value of this hedge instrument was \$(0.3) million at December 30, 2006 and December 31, 2005, and is recorded in other assets and other long-term liabilities.

The swap contract has a notional amount of \$10 million and matures on November 10, 2008. Per the terms of the swap contract the Company receives interest at a fixed rate of 6.3 percent and pays interest at a variable rate based on the three month LIBOR rate plus a spread. The average variable rate paid by the Company in 2006 was 7.9 percent. The differential in interest rates on the swap is recognized as an adjustment of interest expense over the term of the agreement.

12. Shareowners' Equity

The Company had 23,009,513 shares of common stock (45,000,000 shares authorized, \$1.0 par value) outstanding at the end of 2006.

During 2006, 2005, and 2004, pursuant to a stock repurchase program authorized by the Company's Board of Directors, the Company repurchased a total of 5,000 shares for \$0.2 million, 366,308 shares for \$13.8 million and 102,800 shares for \$3.1 million, respectively. All repurchased shares were retired.

During 2006 and 2004, under terms of a Company stock option plan, participants delivered 9,619 shares for \$0.6 million and 21,312 shares for \$0.7 million, respectively, of Company common stock as consideration for stock issued upon the exercise of stock options. There were no such transactions in 2005. All of the shares received were from officers of the Company.

In 2006, 2005, and 2004, the Company recorded a \$5.7 million, \$7.0 million and \$2.4 million, respectively, as a reduction in tax liability and an increase to shareowners' equity as a result of stock option exercises.

Accumulated other comprehensive income (loss), consisting of the currency translation adjustment and the pension liability adjustment, was \$14.5 million and \$(2.1) million, respectively, at December 30, 2006, and \$6.2 million and \$(5.6) million, respectively, at December 31, 2005.

13. Earnings Per Share

The following table sets forth the computation of basic and diluted earnings per share:

(In millions, except per share amounts)	2006	2005	2004
Numerator:			
Income from continuing operations	\$56.8	\$45.8	\$38.4
Income from discontinued operations	0.2	0.2	(0.3)
Net income	<u>\$57.0</u>	<u>\$46.0</u>	<u>\$38.1</u>
Denominator:			
Basic			
Weighted-average common shares	22.8	22.2	22.0
Diluted			
Effect of dilutive securities:			
Employee and director incentive stock options and awards	0.5	1.0	1.1
Adjusted weighted-average common shares	<u>23.3</u>	<u>23.2</u>	<u>23.1</u>
Basic earnings per share			
Basic from continuing operations	\$2.49	\$2.06	\$1.75
Basic from discontinuing operations	0.01	0.01	(0.02)
Total basic earnings per share	<u>\$2.50</u>	<u>\$2.07</u>	<u>\$1.73</u>
Diluted earnings per share			
Diluted from continuing operations	\$2.43	\$1.97	\$1.67
Diluted from discontinuing operations	0.01	0.01	(0.02)
Total diluted earnings per share	<u>\$2.44</u>	<u>\$1.98</u>	<u>\$1.65</u>
Anti-dilutive stock options excluded	0.3	0.2	0.2
Anti-dilutive stock options price range—low	\$36.97	\$36.97	\$29.95
Anti-dilutive stock options price range—high	\$45.90	\$44.51	\$32.51

14. Stock-based Compensation

Prior to January 1, 2006, the Company accounted for stock-based employee compensation plans under the recognition and measurement provisions of APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related Interpretations, as permitted by SFAS No. 123, "Accounting for Stock-Based Compensation." Effective January 1, 2006, the Company adopted the fair value recognition provisions of SFAS No. 123(R), "Share-Based Payment," using the modified-prospective-transition method. Under that transition method, compensation cost recognized in 2006 includes: (a) compensation cost for all share-based payments granted prior to, but not yet vested as of January 1, 2006, based on the grant date fair value estimated in accordance with the original provisions of SFAS No. 123, and (b) compensation cost for all share-based payments granted subsequent to January 1, 2006, based on the grant-date fair value estimated in accordance with the provisions of SFAS No. 123(R). The total stock-based compensation recognized in 2006 and 2005 was \$3.2 million and \$0.1 million, respectively. Results for prior periods have not been restated.

Prior to the adoption of SFAS No. 123(R), the Company presented all tax benefits of deductions resulting from the exercise of stock options as operating cash flows in the Statement of Cash Flows. SFAS No. 123(R) requires the cash flows resulting from the tax benefits resulting from tax deductions in excess of the compensation cost recognized for those options (excess tax benefits) to be classified as financing cash flows. The \$5.7 million excess tax benefit classified as a financing cash inflow would have been classified as an operating cash inflow if the Company had not adopted SFAS No. 123(R), and is included in "Income taxes" in the Company's statement of financial position.

The following table illustrates the effect on net income and earnings per share if the Company had applied the fair value recognition provisions of SFAS No. 123 to options granted under the Company's stock option plans in all periods presented. For purposes of this pro forma disclosure, the value of the options is estimated using a Black-Scholes option-pricing formula and amortized to expense over the options' vesting periods.

(In millions, except per share amounts)	2005	2004
Reported net income	\$46.0	\$38.1
Add: Total fair value computed stock-based compensation, net of tax*	0.1	—
Deduct: Total fair value computed stock-based compensation, net of tax*	(1.6)	(1.5)
Pro forma net income	\$44.5	\$36.6
Earnings per share:		
Basic—as reported	\$2.07	\$1.73
Basic—pro forma	\$2.00	\$1.67
Diluted—as reported	\$1.98	\$1.65
Diluted—pro forma	\$1.92	\$1.59
Assumptions used for the Black-Scholes Model		
Risk-free interest rate	3.75%	3.60%
Dividend yield	.77%	.63%
Volatility factor	.194	.181
Weighted average expected term	5.3 years	6 years

*Includes expense related to restricted stock reported in net income.

The Company has authorized the grant of options to purchase common stock and award shares of common stock of the Company to employees and non-employee directors of the Company and its subsidiaries under two stock plans. The plans and the original number of authorized shares available for grants are as follows:

	Authorized Shares
Franklin Electric Co., Inc. Stock Option Plan	3,600,000
Franklin Electric Co., Inc. Stock Plan—options	1,150,000
Franklin Electric Co., Inc. Stock Plan—stock awards	150,000

During 2005, all remaining authorized shares available for grant under the Franklin Electric Co., Inc. Stock Option Plan were awarded. On April 29, 2005, the Franklin Electric Co., Inc. Stock Plan (the "Stock Plan") was approved by the Company's shareholders. Under the Stock Plan, employees and non-employee directors

may be granted stock options or stock awards. The Company currently issues new shares from its common stock outstanding balance to satisfy share option exercises and stock awards.

Stock Options:

Under each of the above plans, the exercise price of each option equals the market price of the Company's common stock on the date of grant and the options expire ten years after the date of the grant. Generally, options granted to nonemployee directors vest 33 percent a year and become fully vested and exercisable after three years. Options granted to employees vest at 20 or 25 percent a year and become fully vested and exercisable after five years or four years, respectively. Subject to the terms of the plans, in general, the aggregate option price and any applicable tax withholdings may be satisfied in cash or its equivalent, or by the plan participant's delivery of shares of the Company's common stock owned more than six months, having a fair market value at the time of exercise equal to the aggregate option price and/or the applicable tax withholdings.

The fair value of each option award, both before and after the adoption of SFAS No. 123(R), is estimated on the date of grant using the Black-Scholes option valuation model with a single approach and amortized using a straight-line attribution method over the option's vesting period. Options granted to retirement eligible employees were immediately expensed. In 2005, this amount was disclosed in the pro-forma exhibit while in 2006 it is recognized as an expense. The Company uses historical data to estimate the expected volatility of its stock; the weighted average expected life, the period of time options granted are expected to be outstanding; and its dividend yield. The risk-free rates for periods within the contractual life of the option are based on the U.S. Treasury yield curve in effect at the time of the grant.

The assumptions used for the Black-Scholes model to determine the fair value of options granted during 2006 is as follows:

Risk-free interest rate	4.54%
Dividend yield	.70–.74%
Weighted-average dividend yield	.707%
Volatility factor	.3553–.3768
Weighted-average volatility	.359
Expected term	4–5 years
Forfeiture rate	5.44%

Notes to Consolidated Financial Statements (continued)

A summary of the Company's stock option plans activity and related information is as follows:

(Shares in thousands)		Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (000s)
Stock Options	Shares			
Outstanding at beginning of 2004	2,534	\$18.93		
Granted	199	30.57		
Exercised	(331)	13.66		
Forfeited	—	—		
Outstanding at beginning of 2005	2,401	\$20.61		
Granted	183	40.93		
Exercised	(777)	18.39		
Forfeited	(14)	27.52		
Outstanding at beginning of 2006	1,793	\$23.60		
Granted	125	45.90		
Exercised	(509)	20.69		
Forfeited	(11)	25.22		
Outstanding at end of period	<u>1,398</u>	<u>\$26.65</u>	<u>5.58</u>	<u>\$34,602</u>
Expected to vest after applying forfeiture rate	<u>1,344</u>	<u>\$26.32</u>	<u>5.50</u>	<u>\$33,687</u>
Vested and exercisable at end of period	<u>842</u>	<u>\$21.82</u>	<u>4.37</u>	<u>\$24,905</u>
		2006	2005	2004
Weighted average grant-date fair value of options		\$16.43	\$9.60	\$7.47
(In millions)				
Intrinsic value of options exercised	\$ 2.7		\$ 4.3	\$ 1.3
Cash received from the exercise of options	\$ 10.1		\$14.3	\$ 4.0
Fair value of shares vested	\$ 2.7		\$ 3.1	\$ 3.3
Tax benefit realized from tax deductions	\$ 5.7		\$ 7.0	\$ 2.4

There were no options granted during the fourth quarter. The total intrinsic value of options exercised during the fourth quarter of 2006 was \$0.2 million. There were no share-based liabilities paid during the 2006 fiscal year. As a result of the Company's policy for issuing shares upon share option exercise, during the 2007 fiscal year, the Company expects to repurchase up to 400,000 shares.

A summary of the Company's nonvested shares activity and related information, for fiscal year ended December 30, 2006 follows:

(Shares in thousands)		Weighted-Average Grant-Date Fair Value
Nonvested Shares	Shares	
Nonvested at beginning of period	736	\$ 7.03
Granted	125	16.43
Vested	(294)	6.50
Forfeited	(11)	5.84
Nonvested at end of period	<u>556</u>	<u>\$ 9.47</u>

As of December 30, 2006 there was \$3.2 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plans. That cost is expected to be recognized over a weighted-average period of 1.7 years.

Stock Awards:

Under the Stock Plan, nonemployee directors and employees may be granted stock awards or grants of restricted shares of the Company's common stock, vesting subject to the employees' performance of certain goals. The Stock Plan is an amendment and restatement of the Franklin Electric Co., Inc. Key Employee Performance Incentive Stock Plan (the "Incentive Plan"), established in 2000. Prior to April 29, 2005, 16,300 shares had been awarded under the Incentive Plan and an additional 150,000 shares were authorized for stock awards under the Stock Plan.

The stock awards are granted at the market value on the date of grant and the stock awards cliff vest over either 4 or 5 years and the attainment of certain performance goals. Dividends are paid to the recipient prior to vesting. Stock awards granted to retirement eligible employees were immediately expensed in 2006. There were no grants made to retirement eligible employees in 2005.

A summary of the Company's restricted stock award activity and related information, for the fiscal year ended December 30, 2006 follows:

(Shares in thousands)		Weighted-Average Grant-Date Fair Value
Nonvested Shares	Shares	
Nonvested at beginning of period	21	\$40.82
Awarded	26	49.25
Vested	(6)	58.33
Forfeited	(1)	40.72
Nonvested at end of period	<u>40</u>	<u>\$43.39</u>

As of December 30, 2006 there was \$1.1 million of total unrecognized compensation cost related to nonvested share-based compensation arrangements granted under the Plan. That cost is expected to be recognized over a weighted-average period of 3.1 years.

15. Segment and Geographic Information

Based on the management approach established by SFAS No. 131, "Disclosure About Segments of an Enterprise and Related Information," the Company's business consists of two operating segments based on the principal end market served: the Water Systems segment and the Fueling Systems segment.

The Water Systems segment designs, manufactures and sells motors, pumps, electronic controls and related parts and equipment primarily for use in submersible water and other fluid system applications. The Fueling Systems segment designs, manufactures and sells pumps, electronic controls and related parts and equipment primarily for use in submersible fueling system applications. The Fueling Systems segment integrates and sells motors and electronic controls produced by the Water Systems segment.

Under SFAS No. 131's aggregation criteria, the Company's operating segments have been combined into a single reportable segment. As a result, there are no significant differences between reportable segment financial information and the Company's consolidated results.

Net sales by product category, net of inter-company activity, are as follows:

	2006	2005	2004
Water Systems	\$459.1	\$334.5	\$304.2
Fueling Systems	98.8	68.9	65.9
Total	\$557.9	\$403.4	\$370.1

Geographical information

	Net Sales			Long-lived assets		
	2006	2005	2004	2006	2005	2004
United States	\$364.7	\$240.9	\$221.6	\$241.8	\$116.5	\$101.7
Foreign	193.2	162.5	148.5	66.1	60.2	65.6
Total	\$557.9	\$403.4	\$370.1	\$307.9	\$176.7	\$167.3

ITT Industries, Inc., and its various subsidiaries and affiliates, accounted for 11 percent, 16 percent and 20 percent of the Company's consolidated sales in 2006, 2005, and 2004, respectively. Pentair Corporation and its various subsidiaries and affiliates, accounted for 12 and 14 percent, of the Company's consolidated sales in 2006 and 2005, respectively. Sta-Rite Industries, Inc., formerly a part of the manufacturing subsidiary of Wisconsin Energy Corporation, accounted for 22 percent of the Company's consolidated sales in 2004. Sta-Rite Industries, Inc. was acquired by Pentair Corporation during 2004 and its sales have been included with Pentair's sales for 2005 and 2006.

16. Contingencies and Commitments

The Company is defending various claims and legal actions, including environmental matters, which have arisen in the ordinary course of business. In the opinion of management, based on current knowledge of the facts and after discussion with counsel, these claims and legal actions can be successfully defended or resolved without a material adverse effect on the Company's financial position, results of operations, and net cash flows.

Total rent expense charged to operations for operating leases including contingent rentals was \$5.8 million, \$4.3 million and \$3.4 million for 2006, 2005 and 2004, respectively.

The future minimum rental payments for non-cancelable operating leases as of December 30, 2006, are as follows: 2007, \$5.3 million; 2008, \$4.3 million; 2009, \$2.8 million; 2010, \$1.8 million; and 2011, \$1.3 million. Rental commitments subsequent to 2011 are not significant by year, but aggregated are \$6.9 million in total.

At December 30, 2006, the Company had \$5.9 million of commitments primarily for the purchase of machinery and equipment, and building expansions.

Below is a table that shows the activity in the warranty accrual accounts:

(in millions)	2006	2005
Beginning balance	\$ 7.0	\$7.1
Accruals related to product warranties	7.9	5.4
Additions related to acquisitions	2.8	—
Reductions for payments made	(7.7)	(5.5)
Ending balance	\$10.0	\$7.0

17. Selected Quarterly Financial Data (Unaudited)

Unaudited quarterly financial information for 2006 and 2005 from continuing operations is as follows:

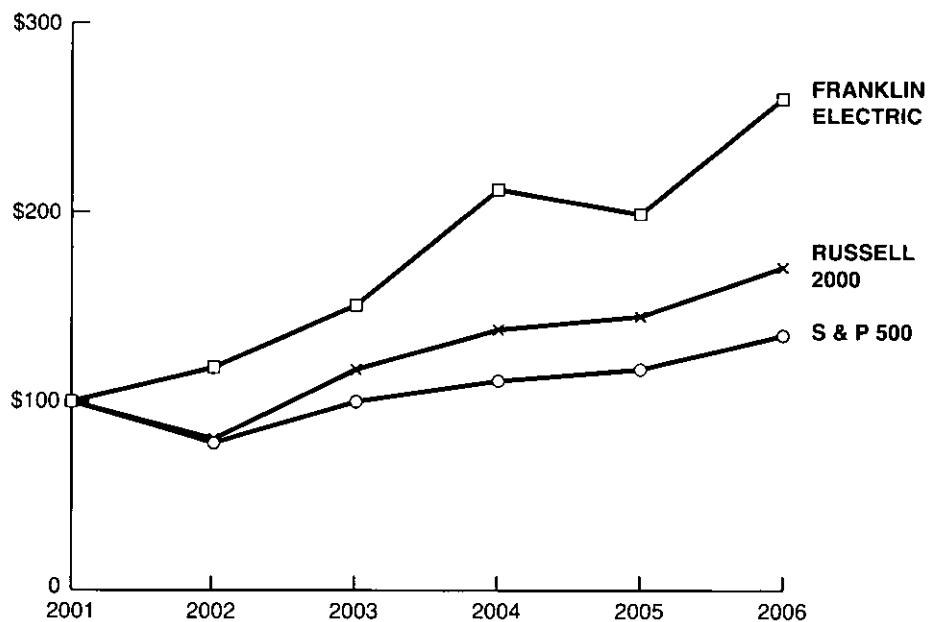
	(in millions, except per share amounts)				
	Net Sales	Gross Profit	Income Cont. Ops.	Basic Earnings Per Share(a)	Diluted Earnings Per Share
2006					
1st Quarter	\$101.7	\$ 35.4	\$ 9.7	\$0.43	\$0.42
2nd Quarter	152.2	52.6	16.5	0.72	0.70
3rd Quarter	156.1	53.6	16.3	0.71	0.70
4th Quarter	147.9	50.0	14.3	0.62	0.61
	\$557.9	\$191.6	\$56.8	\$2.48	\$2.43
2005					
1st Quarter	\$ 73.5	\$ 24.3	\$ 5.9	\$0.27	\$0.25
2nd Quarter	114.3	40.2	13.5	0.61	0.59
3rd Quarter	109.9	39.1	13.2	0.59	0.56
4th Quarter	105.7	39.2	13.2	0.59	0.57
	\$403.4	\$142.8	\$45.8	\$2.06	\$1.97

(a) Earnings per common share amounts are computed independently for each of the quarters presented. Therefore, the sum of the quarterly earnings per share may not equal the annual earnings per share.

18. Subsequent Event

In an agreement dated February 21, 2007, between Franklin Electric and Howden Africa Holdings Limited, Franklin will acquire Howden's 42 percent shareholding in Pump Brands (Pty) Limited, Johannesburg, South Africa ("Pumps") for an estimated \$4.5 million, subject to certain terms and conditions, including the requirement of obtaining approval from the South African Competition Authority. Pumps is involved in the design, manufacture, marketing and selling of pumps and related products in South Africa and other African markets. Pumps offers a broad range of products for the agricultural sector, water and effluent treatment industries as well as for processing, pharmaceutical, food and beverage, petrochemical, and construction.

Stock Performance Graph



■	2001	2002	2003	2004	2005	2006
□ FRANKLIN ELECTRIC	\$100	\$118	\$151	\$212	\$199	\$260
○ S & P 500	\$100	\$ 78	\$100	\$111	\$117	\$135
× RUSSELL 2000	\$100	\$ 80	\$117	\$138	\$145	\$171

Dividend Payments

The number of shareowners of record as of January 12, 2007 was 935. The Company's stock is traded on Nasdaq National Market: Symbol FELE.

All share and per share data included in this annual report reflects the Company's two-for-one stock split effected in the form of a 100 percent stock distribution made on June 15, 2004. Dividends paid and the price range per common share as quoted by the Nasdaq National Market for 2006 and 2005 were as follows:

	DIVIDENDS PER SHARE		PRICE PER SHARE			
	2006	2005	2006		2005	
			Low	High	Low	High
1st Quarter.....	\$.10	\$.08	\$38.70	\$55.72	\$37.36	\$44.31
2nd Quarter.....	\$.11	\$.10	\$46.37	\$62.95	\$34.54	\$40.82
3rd Quarter.....	\$.11	\$.10	\$45.70	\$54.19	\$37.01	\$45.29
4th Quarter.....	\$.11	\$.10	\$49.50	\$57.35	\$39.20	\$44.75

Company Information

Directors

Jerome D. Brady,
Retired President and Chief Executive Officer,
C & K Components, Inc. (A)

Diana S. Ferguson,
Senior Vice President and Chief Financial Officer
Sara Lee Food Service (A, C)

David A. Roberts,
Chairman, President and Chief Executive Officer,
Graco, Inc. (B, C)

R. Scott Trumbull,
Chairman of the Board and Chief Executive Officer,
Franklin Electric Company, Inc.

David M. Wathen,
Retired President and Chief Executive Officer,
Balfour Beatty, Inc. (B, C)

Howard B. Witt,
Retired Chairman of the Board, President and
Chief Executive Officer,
Littelfuse, Inc. (B)

Thomas L. Young,
President,
Titus Holdings Ltd. (A, C)

(A) Member of Audit Committee

(B) Member of Management Organization and
Compensation Committee

(C) Member of Corporate Governance Committee

Officers

R. Scott Trumbull,
Chairman of the Board and Chief Executive Officer

Peter C. Maske,
Senior Vice President and President of Europa

Gregg C. Sengstack,
Senior Vice President, International & Fueling Systems

Daniel J. Crose,
Vice President, North American Submersible
Operations

Thomas A. Miller,
Vice President, Engineering and Electronic Technology

Kirk M. Nevins,
Vice President, Office of the Chairman

Robert J. Stone,
Vice President, Sales, Marketing and Technology

Thomas J. Strupp,
Vice President, Chief Financial Officer and Secretary

Gary D. Ward,
Vice President, Human Resources

Corporate Headquarters

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Fax: 260.824.2909
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Worldwide Operations

Water Systems Products

Berzo Demo, Italy
Brno, The Czech Republic
Grant County, IN, U.S.A.
Johannesburg, South Africa
Linares, Mexico
Little Rock, AR, U.S.A.
Melbourne, Australia
Monterrey, Mexico
Motta di Livenza, Italy
Oklahoma City, OK, U.S.A.
Shanghai, China
Siloam Springs, AR, U.S.A.
Suzhou, China
Tokyo, Japan
Toronto, Canada
Wilburton, OK, U.S.A.
Wittlich, Rhineland, Germany

Fueling Systems Products

Hudson, NH, U.S.A.
Madison, WI, U.S.A.
Saco, ME, U.S.A.
Wittlich, Rhineland, Germany

Independent Auditors

Deloitte & Touche LLP, Chicago, IL, U.S.A.

Transfer Agent

LaSalle Bank National Association, Chicago, IL, U.S.A.

Stock Exchange

Franklin Electric's common stock is traded on the
Nasdaq National Market under the symbol FELE.

Shareowners' Information

The Company will provide a copy of supplemental
information and Form 10-K Annual Report to the
Securities and Exchange Commission free of charge to
any shareowner requesting a copy in writing. Inquiries
should be directed to: Corporate Secretary, Franklin
Electric Co., Inc., 400 East Spring Street, Bluffton,
Indiana 46714

Notice of Annual Meeting

The Annual Meeting of Shareowners will be held on
April 27, 2007, at 11:00 a.m., C.T., at 1301 W. Stovall
Rd., Wilburton, Oklahoma 74578.



Franklin Electric

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