



**Financial Statements of Maxco, Inc. and Subsidiaries  
with Report of Independent Auditors**

**Years Ended March 31, 2008 and 2007**

**MAXCO, INC. AND SUBSIDIARIES**  
**Financial Statements**

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# INDEPENDENT AUDITORS' REPORT

September 10, 2008

Board of Directors and Stockholders  
Maxco, Inc. and Subsidiaries  
Grand Ledge, Michigan

We have audited the accompanying consolidated balance sheets of *Maxco, Inc. and Subsidiaries* (the "Company") as of March 31, 2008 and 2007, and the related consolidated statements of operations, stockholders' equity and cash flows for the years then ended. These consolidated financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

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

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of *Maxco, Inc. and Subsidiaries* as of March 31, 2008 and 2007, and the consolidated results of their operations and their cash flows for the years then ended in conformity with accounting principles generally accepted in the United States of America.

A handwritten signature in black ink that reads "Lehmann Johnson". The signature is written in a cursive, flowing style.

**CONSOLIDATED BALANCE SHEETS**

**MAXCO, INC. AND SUBSIDIARIES**

|   | <b>March 31,</b>      |                  |
|---|-----------------------|------------------|
|   | <b>2008</b>           | <b>2007</b>      |
|   | <i>(in thousands)</i> |                  |
| <b>ASSETS</b>   |                       |                  |
| <b>Current Assets</b>   |                       |                  |
| Cash and cash equivalents   | \$ 4,215              | \$ 26,004        |
| Restricted cash   | 100                   | 100              |
| Cash held in escrow - current portion   | 3,000                 | -                |
| Accounts and notes receivable   | 457                   | 213              |
| Recoverable income tax  | 500                   | -                |
| Prepaid expenses and other  | 97                    | 84               |
| <b>Total Current Assets</b>   | <b>8,369</b>          | <b>26,401</b>    |
| Building, real estate, and real estate investments held for sale, net of reserve of \$2.5 million at March 31, 2008 and \$2.0 million at March 31, 2007                           | 8,997                 | 9,703            |
| Cash held in escrow, net of current portion   | 2,000                 | 5,000            |
| Investments   | 313                   | 377              |
| Notes and contracts receivable  | 480                   | 505              |
| Other   | 303                   | 269              |
| Property and equipment, net   | 3                     | 8                |
|   | <b>\$ 20,465</b>      | <b>\$ 42,263</b> |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                       |                  |
| <b>Current Liabilities</b>  |                       |                  |
| Accounts payable  | \$ 505                | \$ 2,482         |
| Employee compensation   | 506                   | 578              |
| Taxes, interest, and other liabilities  | 436                   | 11,737           |
| Current maturities of long-term obligations   | 219                   | 89               |
| <b>Total Current Liabilities</b>  | <b>1,666</b>          | <b>14,886</b>    |
| <b>Long-Term Obligations, Less Current Maturities</b>   | <b>5,709</b>          | <b>5,985</b>     |
| <b>Total Liabilities</b>  | <b>7,375</b>          | <b>20,871</b>    |
| <b>Contingencies and Commitments—Note 6</b>   |                       |                  |
| <b>Stockholders' Equity</b>   |                       |                  |
| Common stock, \$1 par value; 10,000,000 shares authorized, 3,276,875 shares issued and outstanding at March 31, 2008 (3,454,039 shares issued and outstanding at March 31, 2007 ) | 3,277                 | 3,454            |
| Retained earnings   | 9,813                 | 17,938           |
| <b>Total Stockholders' Equity</b>   | <b>13,090</b>         | <b>21,392</b>    |
|   | <b>\$ 20,465</b>      | <b>\$ 42,263</b> |

See notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF OPERATIONS

### MAXCO, INC. AND SUBSIDIARIES

|  | <b>Year Ended March 31,</b>                  |                  |
|--|--|------------------|
|  | <b>2008</b>                                  | <b>2007</b>      |
|  | <i>(in thousands, except per share data)</i> |                  |
| <b>Revenue and Gains:</b>  |  |                  |
| Rental real estate income  | \$ 871                                       | \$ 538           |
| Investment and other income, net   | 99   | 287              |
| Interest income  | 647  | 274              |
|  | 1,617  | 1,099            |
| <b>Costs and Expenses:</b>   |  |                  |
| Selling, general, and administrative   | 1,247  | 1,975            |
| Impairment charges   | 564  | 3,567            |
| Interest expense   | 717  | 1,020            |
| Depreciation and amortization  | 325  | 167              |
|  | 2,853  | 6,729            |
| <b>Operating Loss</b>  | <b>(1,236)</b>                               | <b>(5,630)</b>   |
| Gain on sale of property and equipment   | -  | 8                |
| <b>Loss from Continuing Operations Before Federal Income Tax Benefit and Equity in</b> |  |                  |
| <b>Net Loss of Affiliates</b>  | <b>(1,236)</b>                               | <b>(5,622)</b>   |
| Federal income tax benefit   | 500  | 1,775            |
| <b>Loss from Continuing Operations Before Equity in Net Loss of Affiliates</b>         | <b>(736)</b>                                 | <b>(3,847)</b>   |
| Equity in net loss of affiliates, net of tax   | -  | (58)             |
| <b>Loss from Continuing Operations</b>   | <b>(736)</b>                                 | <b>(3,905)</b>   |
| Gain on sale of discontinued operation, net of tax                                     | -  | 19,284           |
| Income from discontinued operation, net of tax   | -  | 2,048            |
| <b>Net (Loss) Income</b>   | <b>(736)</b>                                 | <b>17,427</b>    |
| Less preferred stock dividends   | -  | (507)            |
| <b>Net (Loss) Income Applicable to Common Stock</b>                                    | <b>\$ (736)</b>                              | <b>\$ 16,920</b> |
| <b>Net (Loss) Income Per Common Share—Basic and Diluted</b>                            |  |                  |
| Continuing Operations  | \$ (0.22)                                    | \$ (1.28)        |
| Discontinued Operations  | -  | 6.18             |
| <b>Total</b>   | <b>\$ (0.22)</b>                             | <b>\$ 4.90</b>   |

See notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

### MAXCO, INC. AND SUBSIDIARIES

|   | Number of<br>Common Shares<br>Outstanding | Preferred<br>Stock | Common<br>Stock | Retained<br>Earnings | Totals    |
|---|---|--------------------|-----------------|----------------------|-----------|
| <i>(in thousands, except number of common shares outstanding)</i> |   |                    |                 |                      |           |
| <b>Balances at April 1, 2006</b>                                  | 3,454,039                                 | \$ 5,116           | \$ 3,454        | \$ 1,227             | \$ 9,797  |
| Net income for the year   |   |                    |                 | 17,427               | 17,427    |
| Preferred stock dividends   |   |                    |                 | (507)                | (507)     |
| Redemption of preferred stock                                     |   | (5,116)            |                 | (209)                | (5,325)   |
| <b>Balances at March 31, 2007</b>                                 | <b>3,454,039</b>                          | -                  | 3,454           | 17,938               | 21,392    |
| Net loss for the year   |   |                    |                 | (736)                | (736)     |
| Common stock dividends  |   |                    |                 | (6,852)              | (6,852)   |
| Acquisition and retirement of common shares                       | (177,164)                                 |                    | (177)           | (537)                | (714)     |
| <b>Balances at March 31, 2008</b>                                 | <b>3,276,875</b>                          | -                  | \$ 3,277        | \$ 9,813             | \$ 13,090 |

See notes to consolidated financial statements.

## CONSOLIDATED STATEMENTS OF CASH FLOWS

### MAXCO, INC. AND SUBSIDIARIES

|   | Year Ended March 31,  |                  |
|---|-----------------------|------------------|
|   | 2008                  | 2007             |
|   | <i>(in thousands)</i> |                  |
| <b>Operating Activities</b>   |                       |                  |
| Net (loss) income   | \$ (736)              | \$ 17,427        |
| Income from discontinued operations   | -                     | (21,332)         |
| <b>Loss From Continuing Operations</b>  | <b>(736)</b>          | <b>(3,905)</b>   |
| Amounts provided by discontinued operations   | -                     | 253              |
| Adjustments to reconcile income (loss) from continuing operations to net cash used in operating activities: |                       |                  |
| Impairment loss on investments  | 564                   | 3,567            |
| Depreciation  | 325                   | 167              |
| Reserve against receivables   | -                     | 385              |
| Equity in net loss of affiliates  | -                     | 58               |
| Gain on sale of property and equipment  | -                     | (8)              |
| Changes in operating assets and liabilities which used cash:  |                       |                  |
| Accounts receivable   | (200)                 | (82)             |
| Refundable income tax   | (500)                 | -                |
| Prepaid expenses and other  | (57)                  | (25)             |
| Accounts payable and other current liabilities  | (13,350)              | (3,180)          |
| <b>Net Cash Used in Operating Activities</b>  | <b>(13,954)</b>       | <b>(2,770)</b>   |
| <b>Investing Activities</b>   |                       |                  |
| Proceeds from sale of subsidiary, net of funded debt and costs of sale                                      | -                     | 42,174           |
| Purchase of building and building improvements  | (114)                 | (8,500)          |
| Decrease in real estate held for sale   | -                     | (287)            |
| Advance to affiliate  | -                     | (250)            |
| (Collections) issuance of notes receivable  | (9)                   | 184              |
| Purchase of treasury shares   | (714)                 | -                |
| Other   | -                     | (62)             |
| <b>Net Cash Provided by Investing Activities</b>  | <b>(837)</b>          | <b>33,259</b>    |
| <b>Financing Activities</b>   |                       |                  |
| Redemption of preferred stock   | -                     | (5,325)          |
| Payments of common stock dividends  | (6,852)               | -                |
| Proceeds from other debt obligations  | -                     | 4,375            |
| Net repayments on lines of credit   | -                     | (1,950)          |
| Repayments on other debt obligations  | (146)                 | (2,973)          |
| <b>Net Cash Used in Financing Activities</b>  | <b>(6,998)</b>        | <b>(5,873)</b>   |
| (Decrease) Increase in Cash and Cash Equivalents  | (21,789)              | 24,616           |
| Cash and Cash Equivalents at Beginning of Year  | 26,104                | 1,488            |
| <b>Cash and Cash Equivalents at End of Year</b>   | <b>\$ 4,315</b>       | <b>\$ 26,104</b> |
| Supplemental cash flows disclosure:   |                       |                  |
| Interest paid   | 613                   | 2,352            |
| Taxes paid (federal and state)  | \$ 11,300             | \$ -             |

See notes to consolidated financial statements.

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

### MAXCO, INC. AND SUBSIDIARIES

Years Ended March 31, 2008 and 2007

#### **NOTE 1 – BUSINESS**

**Nature of Business:** Maxco, Inc. (“Maxco” the “Company”) is a Michigan corporation incorporated in 1946. Maxco has investments in commercial real estate and investments representing less than majority ownership interests in the following businesses: a developer, a manufacturer and marketer of microprocessor-based process monitoring and inspection systems for use in industrial manufacturing environments; and an energy-related business.

**Operating Matter and Basis of Presentation:** The accompanying financial statements of Maxco have been prepared as required by Statement of Financial Accounting Standards (“SFAS”) No. 144, “Accounting for the Impairment or Disposal of Long-Lived Assets,” to reflect Maxco’s former wholly-owned subsidiary Atmosphere Annealing, Inc. (“AAI”) as a discontinued operation. On February 1, 2007, Maxco, Inc. sold substantially all of the assets of AAI and BCGW, Inc. (“BCGW”), the wholly owned subsidiary of AAI, pursuant to the terms of the Asset Sale and Purchase Agreement dated December 13, 2006 among Maxco, Inc, Quanex Technologies, Inc., Quanex Corporation, AAI, and BCGW.

The Company has included the balance sheet and operating results of Capital Center Associates (“CCA”) in the accompanying financial statements as required by Financial Accounting Standards Board (FASB) Interpretation No. 46(R), “Consolidation of Variable Interest Entities,” due to Maxco’s guarantee of CCA’s debt, Maxco’s loan to CCA, and Maxco’s management control of CCA’s building.

Following the sale of AAI, which was Maxco’s only operating company, Company operations now consist of rental and other income from the operations of Capital Center Associates and its Ledges Commerce Park real estate investment. In addition to its interest in certain real estate investments, the Company has investments in Integral Vision, Inc., and, Robinson Oil, and holds other miscellaneous assets.

Management continues to evaluate and potentially explore all available strategic and operational alternatives for the Company and intends to continue to work to maximize stockholder interests with a goal of obtaining the highest value for the Company’s stockholders. Dates for future shareholder distributions are expected to be based on the timing of the sale of Maxco’s real estate interests and collection of escrows from the sale of AAI.

The Company believes that the funds generated by the sale of AAI will be sufficient to meet its short term and long term debt service and other obligations, as well as to fund continuing operations for the reasonably foreseeable future.

**Principles of Consolidation:** The consolidated financial statements include the accounts of Maxco, Inc., its majority owned subsidiaries, and Capital Center Associates. Upon consolidation, all intercompany accounts and transactions are eliminated. All significant investments are accounted for under the equity method.

**Use of Estimates:** The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from those estimates. Significant estimates include the allowance for doubtful accounts receivable, the valuation of equity method investments, and the fair value less costs to sell of real estate investments and building held-for-sale.

**Reclassifications:** Certain items in the prior year consolidated financial statements have been reclassified to conform with the presentation used in 2008.

**Cash and Cash Equivalents:** The Company considers cash and other highly liquid investments, including investments in interest bearing repurchase agreements with less than 90-day maturities, as cash and cash equivalents. Approximately \$3.6 million of the Company’s cash balance at March 31, 2008 exceeded federally insured limits.

**Properties and Depreciation:** Property and equipment used in conducting the Company’s business are stated on the basis of cost and include expenditures for new equipment and those which materially extend the useful lives of existing facilities and equipment.

Expenditures for normal repairs and maintenance are charged to operations as incurred. Depreciation for financial reporting purposes is computed by the straight-line method based on the shorter of the useful lives or lease terms of the assets (10 to 40 years for buildings and 3 to 10 years for equipment).

**Revenue Recognition:** Rental real estate revenue is recognized as earned on a straight-line basis over the lease term, regardless of when the rent payments are received. The difference between recognized rental income and rental cash receipts is recorded as either a receivable or a liability, as applicable, on the consolidated balance sheets. The Company believes its revenue recognition policy is appropriate and in accordance with generally accepted accounting principles.

**Advertising:** Advertising costs are expensed as incurred. The amounts were not material for either year presented.

## **NOTE 2 – DELISTING OF MAXCO FROM NASDAQ AND GOING PRIVATE TRANSACTION**

As a result of the sale of AAI, Maxco was delisted on April 20, 2007 from NASDAQ. Maxco common stock is now electronically quoted and traded on the Pink Sheets over-the-counter (OTC) market.

On May 31, 2007, through an odd-lot transaction, the Company repurchased 4,396 common shares from certain shareholders who had owned fewer than 100 shares of Maxco stock. The repurchase of shares reduced the number of shareholders to under 300, thereby allowing the Company to voluntarily terminate the registration of its common stock under the Securities Exchange Act of 1934. On June 8, 2007 the Company filed a Form 15 with the Securities and Exchange Commission to effect a termination of registration of its common stock.

## **NOTE 3 – RESTRICTED CASH AND CASH HELD IN ESCROW**

At March 31, 2008 the Company had restricted cash of \$100,000 held as collateral under a letter of credit issued on behalf of the Company's former worker's compensation insurer. Subsequent to March 31, 2008 the amount required to be held was reduced to \$25,000. During the year ended March 31, 2008, the Company deposited \$500,000 into a certificate of deposit as security under its \$500,000 line of credit with a bank.

Cash held in escrow (related to the sale of AAI) in the amount of \$3.0 million was released to Maxco in the beginning of August 2008. Accordingly, this amount has been reclassified to current assets at March 31, 2008.

## **NOTE 4 – RELATED PARTY TRANSACTIONS**

Accounts and notes receivable include an unsecured cash advance to certain officers and stockholders. The net amounts to be collected in cash totaled approximately \$325,000 and \$148,000 at March 31, 2008 and 2007, respectively. Approximately \$240,000 of these notes receivable at March 31, 2008 is being charged interest at the Company's cost of funds.

In April 2004 the Company entered into an incentive agreement with the then President of its formerly wholly-owned subsidiary Atmosphere Annealing, Inc. The agreement provided for compensation to the former officer based on the increased value, as defined, of the subsidiary. The Company paid \$3.0 million in incentive compensation to the former officer in February 2007 using the proceeds from the sale of Atmosphere Annealing, Inc. An additional \$500,000 of incentive compensation, which is accrued and is expected to be paid to the former officer when \$5.0 million from the sale, which is held in escrow, is paid to the Company. These amounts held in escrow are anticipated to be received as follows: \$3.0 million in fiscal 2009 and \$2.0 million in fiscal 2010.

Included in accrued wages was \$119,000 at March 31, 2007, that was due Mr. Max Coon, the company's Chairman and CEO. The accrued wages were paid to Mr. Coon in January 2008.

## **NOTE 5 – INVESTMENTS**

At December 31, 2007, Maxco owned 2,410,183 shares of Integral Vision's common stock (aggregate market value of \$313,000 as of March 31, 2008), representing approximately 8% of Integral Vision's total common stock outstanding.

Maxco's investment in Integral Vision is accounted for under the equity method for all years presented, however, due to the continued losses at Integral Vision, Maxco has discontinued writing down the investment based on its ownership percentage. Management periodically reviews the carrying value of this investment for impairment.

In March 2007, Maxco advanced Integral Vision \$250,000 to permit Integral Vision to meet its obligations. This loan, secured by payments received on certain orders, is evidenced by a written document and provided for interest at the rate of 10%. Interest income is recorded only as received.

## **NOTE 6 – DEBT**

A summary of the Company's debt obligations follows as of March 31:

|  | 2008                  | 2007     |
|--|-----------------------|----------|
|  | <i>(in thousands)</i> |          |
| <b>Line of Credit</b>                                    | -                     | -        |
| <b>Long term obligations:</b>                            |                       |          |
| Mortgage notes payable (various variable interest rates) | \$ 4,211              | \$ 4,313 |
| Contingent liability (interest at the prime rate) (1)    | 1,717                 | 1,761    |
|  | 5,928                 | 6,074    |
| Less current maturities                                  | 219                   | 89       |
|  | \$ 5,709              | \$ 5,985 |

<sup>1</sup> At March 31, 2008 the prime rate was 5.25%.

The Company renegotiated in October, 2007 its \$1.75 million debt facility which matured in August, 2007 to a \$500,000 line of credit that requires interest only payments and matures in October 2008. There were no outstanding draws on this facility at March 31, 2008. As security for this line of credit the bank required the Company to deposit \$500,000 in a certificate of deposit with the bank. The certificate currently pays interest of 4.5% per annum.

Mortgage notes payable and the contingent liability as of March 31, 2008 and 2007 relate to liabilities for real estate entities which were guaranteed by the Company or Max A. Coon, President. On August 11, 2005, the Company agreed to indemnify Mr. Coon for any amounts he would be required to pay as result of personal guarantees he had on the Company's real estate entities that were made for the sole benefit of the Company.

Mortgage notes payable consist of two mortgages. One mortgage is a note financing the land and building owned by Ledges Commerce Park. The balance of this note was approximately \$1.5 million at March 31, 2008. The note, secured by a mortgage and an assignment of certain rents and leases, calls for Ledges to make the remaining 40 regular monthly payments of \$16,900 (principal and interest) and one irregular payment of \$1.3 million on August 10, 2011.

The second mortgage relates to a mortgage loan agreement dated August 30, 2006 between Huntington National Bank (HNB) and CCA which was guaranteed by the Company. This note resulted from borrowings needed to payoff \$8.5 million under a liability settlement agreement related to CCA's building, which the Company agreed to pay by September 1, 2006. The Agreement, which is secured by a first mortgage on a commercial building in Lansing, Michigan ("CCA Building"), calls for CCA to make 60 monthly payments of principal and interest of \$22,364 plus a final payment of the remaining principal and any accrued interest on September 15, 2011 to HNB. At March 31, 2008 the principal balance on this mortgage was approximately \$2.7 million. The \$5.8 million balance paid under the settlement agreement was advanced to Maxco separately by HNB under AAI's line of credit and was repaid by the Company from the proceeds of the AAI sale on February 1, 2007.

The contingent liability relates to a \$1.8 million guarantee resulting from the sale of a major real estate portfolio. Since the Company is presently paying the interest and principal related to this debt and will in all likelihood control the disposition of the underlying asset, the Company originally recorded the asset value of \$1.8 million and the \$1.8 million obligation in the accompanying financial statements. Approximately \$85,000 in accrued interest was due on the note which was paid by the Company in September 2007. Beginning in September, 2007, monthly payments of approximately \$19,500 (including principal and interest) are required on the note with the final balance of \$1.6 million due at maturity on June 15, 2009.

#### **NOTE 7 – PREFERRED STOCK**

The Company redeemed all outstanding shares of preferred stock, including accrued dividends as of March 31, 2007. The face value of the preferred stock and accrued dividends aggregated approximately \$7.7 million, of which approximately \$5.9 million had been held by related parties.

#### **NOTE 8 - COMMON STOCK DIVIDEND**

On May 24, 2007 the Board of Directors of the Company declared a cash dividend of \$2.00 per share, payable June 29, 2007, to common shareholders of record as of June 20, 2007. The dividend paid June 29, 2007 totaled approximately \$6.9 million.

#### **NOTE 9 – COMMON STOCK OPTIONS**

Effective May 30, 2007 the Company terminated its stock option plans. There were no stock options outstanding and exercisable at March 31, 2008. There were no options granted during either of the years ended March 31, 2008 or 2007.

#### **NOTE 10 – 401(K) EMPLOYEE SAVINGS PLANS**

Company contributions charged to operations under its 401(K) employee savings plan were approximately \$8,400 and \$5,300 for the years ended March 31, 2008 and March 31, 2007, respectively. Maxco terminated its 401(K) Employees Savings Plan as of December 10, 2007. All participants balances were distributed to the participants prior to December 31, 2007. Effective January 1, 2008, Maxco adopted a "5304 Savings Incentive Match Plan" for Employees of Small Employers (SIMPLE).

#### **NOTE 11 – FEDERAL INCOME TAXES**

Federal income taxes consist of the following components:

|   | <b>Year Ended March 31,</b> |             |
|---|-----------------------------|-------------|
|   | <b>2008</b>                 | <b>2007</b> |
|   | <i>(in thousands)</i>       |             |
| Current refundable tax  | \$ (500)                    | \$ (1,775)  |
|   | (500)                       | (1,775)     |
| Amount allocated to income from discontinued operations and equity in net loss affiliates | -                           | 11,485      |
|   | \$ (500)                    | \$ 9,710    |

The reconciliation of the income taxes computed at the United States federal statutory tax rate to income tax expense (benefit) reported in these financial statements is as follows:

|  | <b>Year Ended March 31,</b> |                   |
|--|-----------------------------|-------------------|
|  | <b>2008</b>                 | <b>2007</b>       |
|  | <i>(in thousands)</i>       |                   |
| Income tax (benefit) computed at United States statutory rate (34% in 2008, and in 35% 2007) | \$ (420)                    | \$ (1,968)        |
| Increase in deferred tax asset valuation allowance   | 114                         | 102               |
| Other  | (194)                       | 91                |
|  | <b>\$ (500)</b>             | <b>\$ (1,775)</b> |

In June 2007, the Company paid \$10.0 million in federal income taxes for the year ended March 31, 2007.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. Significant components of the Company's deferred tax liabilities and assets were as follows as of March 31:

|  | <b>2008</b>  | <b>2007</b>           |
|--|--------------|-----------------------|
|  |              | <i>(in thousands)</i> |
| <b>Deferred Tax Assets:</b>                        |              |                       |
| Net cumulative asset impairment losses             | \$ 2,689     | \$ 2,484              |
| Wages/incentives not paid                          | 170          | 170                   |
| Other  | 26           | 117                   |
| <b>Total Deferred Tax Assets</b>                   | <b>2,885</b> | <b>2,771</b>          |
| <b>Valuation Allowance for Deferred Tax Assets</b> | <b>2,885</b> | <b>2,771</b>          |
| <b>Net Deferred Tax Assets</b>                     | <b>\$ -</b>  | <b>\$ -</b>           |

The Company in a prior period amended its March 31, 2002 Federal income tax return to reflect the write offs of its investment in a discontinued affiliate, Foresight, Inc.'s stock, for amounts the Company was required to pay as guarantor of Foresight's banking agreement, and certain other advances to Foresight. As a result of this amendment, the Company received a federal income tax refund of approximately \$790,000. An Internal Revenue Service (IRS) audit of the Company has been completed and the Company settled in September 2007 with the appeals division of the IRS on the Foresight issue. Federal income tax expense was adjusted during the year ended March 31, 2007, to reflect the anticipated settlement amount. In September 2007, Maxco paid the IRS approximately \$300,000 (including interest) in settlement of this issue.

The Company will carryback its net operating loss for 2008 against the Company's taxable income for 2007. As a result, Maxco recorded a \$500,000 receivable at March 31, 2008 for recoverable incomes taxes.

#### **NOTE 12 – BUILDING, REAL ESTATE AND REAL ESTATE INVESTMENTS HELD FOR SALE**

The Company's Capital Center Associates ("CCA") building, real estate, and real estate investments held for sale are comprised of the following:

|                                       | <b>March 31,</b>      |                 |
|---------------------------------------|-----------------------|-----------------|
|                                       | <b>2008</b>           | <b>2007</b>     |
|                                       | <i>(in thousands)</i> |                 |
| Building held for sale                | \$ 6,376              | \$ 6,500        |
| Real estate held for sale             | 2,745                 | 2,853           |
| Real estate investments held for sale | 2,376                 | 2,350           |
|                                       | 11,497                | 11,703          |
| Valuation allowance                   | (2,500)               | (2,000)         |
|                                       | <b>\$ 8,997</b>       | <b>\$ 9,703</b> |

#### **Building Held For Sale:**

The Company has included the balance sheets and operating results of CCA in the accompanying financial statements as required by FASB Interpretation No. 46(R), "Consolidation of Variable Interest Entities," due to Maxco's guarantee of CCA's debt, Maxco's loan to CCA, and Maxco's management control of CCA's building (see Note 6).

#### **Real Estate Held for Sale:**

In May 2005, Maxco acquired the common stock of Ledges Commerce Park and as such, has recorded the assets acquired at their estimated fair value and the liabilities assumed at the amount at which they are expected to be settled.

### **Real Estate Investments Held For Sale:**

In 2003, the Company's affiliated entity, L/M Associates II, sold substantially all of the properties in its real estate portfolio. Pursuant to the terms of the sale agreement, Maxco, through its real estate entity L/M Associates, LLC retained an ownership interest in the new entity. The real estate investments held for sale account includes the Company's portion of the estimated fair value of the net assets in this entity.

### **Asset Valuation Allowance:**

The Company had a valuation allowance of \$2.5 million and \$2.0 million related to its investments in real estate and building held for sale at March 31, 2008 and 2007, respectively.

### **NOTE 13 – SALE OF ATMOSPHERE ANNEALING, INC.**

On February 1, 2007, Maxco, Inc. sold substantially all of the assets of Atmosphere Annealing, Inc. ("AAI"), the wholly owned subsidiary of Maxco, Inc., and BCGW, Inc. ("BCGW"), the wholly owned subsidiary of AAI, pursuant to the terms of the Asset Sale and Purchase Agreement dated December 13, 2006 among Maxco, Inc., Quanex Technologies, Inc., Quanex Corporation, AAI, and BCGW.

MACSTEEL Atmosphere Annealing, Inc. (formerly known as Quanex Technologies, Inc.), a wholly owned subsidiary of Quanex Corporation, acquired substantially all of the operating assets of AAI and BCGW for \$57.5 million in cash (the "Transaction"), net of an adjustment for the estimated net working capital of AAI as of January 31, 2007. There were two escrows established from the sale proceeds. An escrow of \$2.0 million is to last for a minimum of 3 years and up to 4 years, depending on satisfaction of certain conditions, to assure compliance with our environmental warranties. An escrow of \$3 million is to be held for 18 months to assure the accuracy of representations and warranties, including any environmental claims that exceed the \$2 million environmental escrow. Other than the assumption of normal operating liabilities, MACSTEEL Atmosphere Annealing, Inc. did not assume any liabilities for borrowed money or certain other liabilities including certain product liabilities, tax and environmental liabilities. Assets excluded from the transaction included cash, cash equivalents, certain corporate records, all tax benefits and rights to refunds, all rights relating to borrowed money, related party receivables, and all rights to prepaid insurance and insurance deposits.

As part of the closing of the Transaction, certain outstanding liabilities secured by the assets of AAI and BCGW were required to be paid, which were approximately \$10.9 million. In addition, the Company paid net federal and state income taxes of approximately \$11.0 million, and closing costs and other costs and obligations in connection with the closing totaled approximately \$5.2 million.

The results of operations for this unit have been reported separately as a discontinued operation in the consolidated statements of operations for the year ended March 31, 2007. The results of operations of AAI for the ten months ended January 31, 2007 were as follows:

| <b>Ten Months Ended January 31, 2007</b>            |                  |
|---|------------------|
| <i>(in thousands)</i>                               |                  |
| <b>Net sales</b>                                    | \$ 36,777        |
| <b>Cost of sales and operating expenses</b>         | 22,319           |
| <b>Selling, general, and administrative</b>         | 7,956            |
| <b>Depreciation and amortization</b>                | 2,611            |
| <b>Operating profit</b>                             | 3,891            |
| <b>Interest expense</b>                             | 739              |
| <b>Interest income</b>                              | (2)              |
| <b>Loss (Gain) on sale of assets</b>                | 4                |
| <b>Earnings before income taxes</b>                 | 3,150            |
| <b>Income tax provision</b>                         | 1,102            |
| <b>Net income</b>                                   | \$ 2,048         |
| <b>Gain on sale of business assets (net of tax)</b> | <u>\$ 19,284</u> |