

# SECURITIES AND EXCHANGE COMMISSION

## FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **2004-08-12** | Period of Report: **2004-07-03**  
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### FILER

#### **X RITE INC**

CIK: **790818** | IRS No.: **381737300** | State of Incorpor.: **MI** | Fiscal Year End: **0102**  
Type: **10-Q** | Act: **34** | File No.: **000-14800** | Film No.: **04968894**  
SIC: **3861** Photographic equipment & supplies

Mailing Address  
3100 44TH STREET SW  
GRANDVILLE MI 49418

Business Address  
3100 44TH ST SW  
GRANDVILLE MI 49418  
6165347663

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# U.S. SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

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## FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED JULY 3, 2004

Commission file number 0-14800

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# X-RITE, INCORPORATED

(Name of registrant as specified in charter)

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**Michigan**  
(State of Incorporation)

**38-1737300**  
(I.R.S. Employer  
Identification No.)

**3100 44th Street S.W., Grandville, Michigan 49418**  
(Address of principal executive offices)

**616-534-7663**  
(Registrant's telephone number, including area code)

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Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

Indicate by checkmark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Act). Yes  No

On August 1, 2004, the number of shares of the registrant's common stock, par value \$.10 per share outstanding was 20,760,760.

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**X-RITE, INCORPORATED AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(in thousands)

**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

	<u>July 3,</u> <u>2004</u>	<u>January 3,</u> <u>2004</u>
	<u>(Unaudited)</u>	
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 7,976	\$ 10,752
Short-term investments	1,671	3,350
Accounts receivable, less allowance of \$1,558 in 2004 and \$1,527 in 2003	20,961	22,815
Inventories	16,467	16,014
Deferred taxes	2,013	1,656
Prepaid expenses and other current assets	2,112	1,526
	<u>51,200</u>	<u>56,113</u>
<b>Property plant and equipment:</b>		
Land	2,278	2,278
Buildings and improvements	17,163	17,123
Machinery and equipment	18,117	17,136
Furniture and office equipment	18,176	18,524

Construction in progress	1,923	696
	<u>57,657</u>	<u>55,757</u>
Less accumulated depreciation	(35,948)	(35,564)
	<u>21,709</u>	<u>20,193</u>
<b>Other assets:</b>		
Cash surrender values (founders policies)	25,211	21,044
Goodwill	7,040	7,008
Capitalized software (net of accumulated amortization of \$6,816 in 2004 and \$5,943 in 2003)	4,448	3,727
Other intangible assets	4,303	4,594
Deferred taxes	5,063	5,662
Other noncurrent assets	2,595	1,342
	<u>48,660</u>	<u>43,377</u>
	<u>\$ 121,569</u>	<u>\$ 119,683</u>

The accompanying notes are an integral part of these statements.

**X-RITE, INCORPORATED AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED BALANCE SHEETS - Continued**  
(in thousands)

	<u>July 3,</u> <u>2004</u>	<u>January 3,</u> <u>2004</u>
	(Unaudited)	
<b>LIABILITIES AND SHAREHOLDERS' INVESTMENT</b>		
Current liabilities:		
Accounts payable	\$ 3,396	\$ 4,574
Accrued liabilities:		
Payroll and employee benefits	6,146	8,501
Income taxes	2,661	2,378
Other	2,404	2,761
	<u>14,607</u>	<u>18,214</u>
Long term liabilities:		
Deferred gain on sale of assets	337	-
Value of shares subject to redemption agreements; 3,420,000 shares issued and outstanding, in 2004 and 2003 respectively	43,177	34,857
<b>Shareholders' investment:</b>		
Common stock	1,733	1,714
Additional paid-in capital	11,500	9,350
Retained earnings	48,327	53,627

Accumulated other comprehensive income	1,955	1,944
Stock conversion program	(67 )	(23 )
	63,448	66,612
	\$ 121,569	\$ 119,683

The accompanying notes are an integral part of these statements.

**X-RITE, INCORPORATED AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(in thousands, except per share data)

	Three Months Ended		Six Months Ended	
	July 3, 2004	June 28, 2003	July 3, 2004	June 28, 2003
<b>Net sales</b>	\$31,826	\$28,197	\$60,354	\$51,822
Cost of sales	10,732	10,551	21,103	18,955
<b>Gross profit</b>	21,094	17,646	39,251	32,867
Operating expenses:				
Selling and marketing	8,397	7,145	16,442	14,356
General and administrative	4,027	4,466	8,356	7,818
Research, development and engineering	3,866	3,472	7,943	6,570
	16,290	15,083	32,741	28,744
<b>Operating income</b>	4,804	2,563	6,510	4,123
Interest expense, Founders' stock redemption	(3,638)	-	(8,491)	-
Interest expense	(43 )	-	(52 )	-
Other income (expense)	(266 )	308	(331 )	348
Write down of other investments, net	-	(106 )	-	(246 )
<b>Income (loss) before income taxes</b>	857	2,765	(2,364)	4,225

Income taxes	1,537	804	2,083	1,252
<b>Net income (loss)</b>	<b>\$(680 )</b>	<b>\$1,961</b>	<b>\$(4,447 )</b>	<b>\$2,973</b>
Earnings (loss) per share, basic and diluted	<b>\$(.03 )</b>	<b>\$ .10</b>	<b>\$(.21 )</b>	<b>\$ .15</b>
Cash dividends per share	<b>\$.025</b>	<b>\$.025</b>	<b>\$.050</b>	<b>\$.050</b>

The accompanying notes are an integral part of these statements.



**X-RITE, INCORPORATED AND SUBSIDIARIES**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)**  
(in thousands)

	Six Months Ended	
	July 3, 2004	June 28, 2003
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>		
Net income (loss)	\$(4,447)	\$2,973
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	2,680	2,802
Allowance for doubtful accounts	203	210
Deferred income taxes	236	421
Increase in value of shares subject to redemption agreements	8,320	-
Tax benefit from stock options exercised	245	-
Write-down of other investments	-	246
Other	(168 )	146
Changes in operating assets and liabilities net of effects from acquisitions:		
Accounts receivable	1,627	958
Inventories	(481 )	(927 )
Prepaid expenses and other current assets	(1,150)	(907 )
Accounts payable	(1,207)	(207 )

Income taxes payable	281	(185 )
Other current and non current liabilities	(2,340)	(424 )
<b>Net cash provided by operating activities</b>	<b>3,799</b>	<b>5,106</b>

**CASH FLOWS FROM INVESTING ACTIVITIES:**

Proceeds from sales of short-term investments	2,685	7,234
Proceeds from maturities of short-term investments	70	30
Purchases of short-term investments	(1,065)	(570 )
Capital expenditures	(3,052)	(1,611)
Investment in founders life insurance, net	(4,167)	(4,127)
Increase in other assets	(1,604)	(1,052)
Acquisitions	(696 )	(2,007)
Disposition of business assets	125	-
Other investing activities	114	(33 )
<b>Net cash used for investing activities</b>	<b>(7,590)</b>	<b>(2,136)</b>

**CASH FLOWS FROM FINANCING ACTIVITIES:**

Dividends paid	(853 )	(1,012)
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Issuance of common stock	1,846	238
<b>Net cash provided by (used for) financing activities</b>	993	(774 )
<b>EFFECT OF EXCHANGE RATE CHANGES ON CASH AND CASH EQUIVALENTS</b>	22	342
<b>NET INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	(2,776)	2,538
<b>CASH AND CASH EQUIVALENTS AT BEGINNING OF YEAR</b>	10,752	10,100
<b>CASH AND CASH EQUIVALENTS AT END OF QUARTER</b>	\$7,976	\$12,638

The accompanying notes are an integral part of these statements.

**X-RITE, INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**NOTE 1–BASIS OF PRESENTATION**

The unaudited condensed consolidated financial statements included herein have been prepared by X-Rite, Incorporated (“X-Rite” or the “Company”), without audit, pursuant to the rules and regulations of the Securities and Exchange Commission. Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations, although the Company believes that the disclosures are adequate to make the information presented not misleading. It is suggested that these condensed consolidated financial statements be read in conjunction with the consolidated financial statements and notes thereto included in X-Rite’s 2003 annual report on Form 10-K.

In the opinion of management, the accompanying unaudited condensed consolidated financial statements contain all adjustments necessary to present fairly the financial position of the Company as of July 3, 2004 and the results of its operations and its cash flows for the three and six month periods ended July 3, 2004 and June 28, 2003. All such adjustments are of a normal and recurring nature. Certain prior year information has been reclassified to conform to current year presentation.

**NOTE 2–NEW ACCOUNTING STANDARDS**

In March 2004, The Emerging Issues Task Force completed its consensus on Issue No. 03-01, “*The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments*” (EITF 03-01). In this consensus, the Task Force required certain quantitative and qualitative disclosures related to debt and marketable equity securities classified as available-for-sale or held-to-maturity that are in an unrealized loss position at the balance sheet date but for which an other-than-temporary impairment has not been recognized. In addition, the Task Force developed a basic model in evaluating whether investments within the scope of EITF 03-01 have other-than-temporary impairment. The Company adopted the quantitative and qualitative disclosure provisions of the EITF as of January 3, 2004. The Company is required to adopt the measurement provisions of EITF 03-01 in the third quarter of fiscal 2004. Adoption of EITF 03-01 is not expected to have a material impact on the company’s financial statements.

In January 2003, the FASB issued Interpretation No. 46, “*Consolidation of Variable Interest Entities*” as revised December 2003 (FIN 46(R)). The new rule requires that companies consolidate a variable interest entity if the company is subject to a majority of the risk of loss from the variable interest entity’s activities, or is entitled to receive a majority of the entity’s residual returns or both. We do not have any special purpose entities, as defined, nor have we acquired a variable interest in an entity where we are the primary beneficiary since January 31, 2003. The provisions of FIN 46(R) currently are required to be applied as of the end of the first reporting period that ends after March 15, 2004, for variable interest entities in which we hold a variable interest that we acquired on or before January 31, 2003. Implementation of FIN 46 (R) did not have any effect on the Company’s consolidated financial statements as of July 3, 2004.

**NOTE 3–SHORT TERM INVESTMENTS**

The Company classifies all of its short-term investments as available-for-sale securities. Such short-term investments consist primarily of United States municipal securities, mutual funds, and corporate bonds, which are stated at market value, with unrealized gains and losses on such securities reflected net of tax, as other comprehensive loss in permanent shareholders’ investment. Realized gains and losses are included in earnings and are derived using the specific identification method for determining the cost of the securities. It is the Company’s intent to maintain a liquid portfolio to fund operating initiatives and other business opportunities as they arise; therefore, all securities are considered available-for-sale and are classified as current assets. The Company’s short-term investments are generally due on demand with no defined maturity.

**X-RITE, INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued**  
**(Unaudited)**

**NOTE 3—SHORT TERM INVESTMENTS - continued**

The carrying amount of the Company' s short-term investments is shown in the table below: (in thousands)

	July 3, 2004		January 3, 2004	
	Cost	Market Value	Cost	Market Value
Municipal securities	\$615	\$615	\$2,305	\$2,305
Mutual funds	1,530	1,046	1,530	1,036
Preferred stocks	10	10	10	9
	2,155	1,671	3,845	3,350
Allowance for unrealized losses	(484 )	—	(495 )	—
Total	\$1,671	\$1,671	\$3,350	\$3,350

Management has reviewed the unrealized losses in the Company' s mutual fund holdings as of July 3, 2004, and has determined that they are temporary in nature; accordingly, no losses have been recognized as of that date.

**NOTE 4—INVENTORIES**

Inventories consisted of the following: (in thousands)

	July 3, 2004	January 3, 2004
Raw materials	\$6,087	\$5,433
Work in process	4,755	4,090
Finished goods	5,625	6,491

Total

\$16,467

\$ 16,014

**NOTE 5—INVESTMENTS CARRIED AT COST**

In 2000, the Company formed a strategic venture capital group XR Ventures, LLC (XRV), whose mission was to direct and manage the Company' s investments in start up companies in the high technology field. The Company retained a majority interest in XRV with the minority interest held by its mangers, Mr. James A. Knister and Dr. Peter M. Banks. Mr. Knister and Dr. Banks are also members of the Board of Directors of X-Rite, Incorporated. The Company funded acquisitions made by XRV and in exchange, will receive its investment back in full before any distributions are made. Subsequent to its formation, XRV has made investments in eleven different entities totaling \$12.0 million. Each investment represented less than 20 percent of the ownership of the respective investee. Because the Company is unable to exercise significant influence over the operating and financial policies of each respective investee, the investments were recorded at cost. The Company periodically evaluated the carrying value of each investment to determine whether a decline in fair value below the respective cost has occurred. If the decline was determined to be other than temporary, the carrying value was adjusted to the then current fair value and a loss was recognized. At various times in 2003, 2002 and 2001 the Company performed comprehensive assessments of the continuing value of each XR Ventures investment. Based on the erosion of the venture capital markets and the network middleware and tele/data communications sectors of the economy, the Company concluded that the value of certain investments had been permanently impaired. Therefore the Company recorded charges of \$3.7, \$7.2 and \$1.1 million in 2003, 2002 and 2001 respectively.

In 2002 and 2001 the Company concluded that it may not be able to realize tax benefits related to these impairments, therefore, it did not record a tax benefit at that time. In 2003, the Company re-evaluated that position and concluded the execution of certain qualified tax strategies which the Company is capable of completing, would allow for the realization of these tax benefits. Accordingly a tax benefit of \$2.8 million was recorded in the fourth quarter of 2003 related to the prior year' s impairments.

At January 3, 2004, all venture capital investments have been fully impaired. Although XRV continues to hold positions in several portfolio companies, no future investments will be made except where necessary to protect an existing position.

**X-RITE, INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued**  
**(Unaudited)**

**NOTE 6—GOODWILL AND OTHER INTANGIBLE ASSETS**

During 2003, the Company recorded goodwill in connection with two acquisitions. In April 2003, X-Rite, Ltd. recorded \$1.1 million of goodwill in connection with its acquisition of the ccDot meter product line of Centurfax Ltd. for \$1.56 million. In July 2003, X-Rite, Incorporated recorded \$5.5 million of goodwill in connection with its acquisition of Monaco Systems, Inc. valued at \$11.0 million in cash and stock. Annual impairment testing of the goodwill for these acquisitions will be conducted in the fourth quarter of each year beginning in 2004.

During 2003, the Company completed the annual impairment testing of goodwill as recorded by X-Rite, Mediterranee. This test indicated that the fair value of the reporting unit exceeded their book value; therefore, no impairment charge was necessary.

A summary of changes in goodwill by reporting unit during the six months ended July 3, 2004, consisted of the following (in thousands):

	January 3, 2004	Foreign Currency Adjustments	July 3, 2004
Monaco Systems	\$ 5,532	\$ —	\$5,532
X-Rite, Ltd.	1,243	36	1,279
X-Rite, Mediterranee	233	(4 )	229
<b>Total</b>	<b>\$ 7,008</b>	<b>\$ 32</b>	<b>\$7,040</b>

A summary of changes in intangible assets during the six months ended July 3, 2004, consisted of the following (in thousands):

	January 3, 2004	Accumulated Amortization	Foreign Currency Adjustments	July 3, 2004
Customer relationships	\$ 2,409	\$ (116 )	\$ —	\$2,293
Trademarks and trade names	931	(38 )	1	894
Technology and patents	721	(84 )	3	640
Covenants	533	(58 )	1	476

Total	\$ 4,594	\$ (296 )	\$ 5	\$4,303
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Estimated amortization expense for intangible assets as of July 3, 2004 for each of the succeeding years is as follows: (in thousands)

Remaining 2004	\$296
2005	563
2006	561
2007	556
2008	337

**NOTE 7—STOCK-BASED COMPENSATION**

In accordance with SFAS No. 123, *Accounting for Stock Based Compensation*, the Company has elected to account for stock- based compensation under APB Opinion No. 25 *Accounting for Stock Issued to Employees*.

The Company sets the exercise price of stock options granted equal to the market close on the date prior to the grant date; therefore, in accordance with APB Opinion No. 25 no compensation expense is recorded.

The fair value of employee and outside director stock options has been estimated using the Black Scholes option-pricing model, as required under accounting principles generally accepted in the United States. The Black Scholes model is a trading option-pricing model that considers neither the non-traded nature of employee stock options, nor the restrictions on trading, lack of transferability or the ability of employees to forfeit the options prior to expiration. If the model adequately permitted consideration of these unique characteristics, the resulting estimate of the fair value of X-Rite’ s stock options could be different.



**X-RITE, INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued**  
**(Unaudited)**

**NOTE 7—STOCK-BASED COMPENSATION- continued**

The following table summarizes the Company' s results as if it had recorded compensation expense for the 2004 and 2003 options grants: (in thousands)

	Three Months Ended		Six Months Ended	
	July 3 , 2004	June 28, 2003	July 3, 2004	June 28, 2003
Net income (loss)				
As reported	\$ (680)	\$ 1,961	\$(4,447)	\$ 2,973
Deduct: Compensation expense-fair value method	(85 )	(165 )	(1,166)	(245 )
Pro forma net income (loss)	\$ (765)	\$ 1,796	\$(5,613)	\$ 2,728
Basic and diluted net earnings (loss) per share:				
As reported	\$ (.03 )	\$ .10	\$(.21 )	\$ .15
Pro forma	\$ (.04 )	\$ .09	\$(.27 )	\$ .13

**NOTE 8—EARNINGS PER SHARE**

Basic earnings per share ("EPS") is computed by dividing net income by the weighted-average number of common shares outstanding in each quarter. Diluted EPS is computed by dividing net income by the weighted-average number of common shares outstanding plus all shares that would have been outstanding if every potentially dilutive common share had been issued. The following table reconciles the numerators and denominators used in the calculations of basic and diluted EPS for each period presented in the accompanying financial statements:

	Three Months Ended		Six Months Ended	
	July 3 , 2004	June 28, 2003	July 3, 2004	June 28, 2003
(in thousands, except for share and per share data)				
Numerators:				

Net income (loss) numerators for both basic and diluted EPS

\$ (680 )      \$1,961      \$(4,447 )      \$2,973

Denominators:

Denominators for basic EPS

Weighted-average common shares outstanding

20,744,593      20,250,200      20,692,093      20,240,703

Potentially dilutive shares

Shares subject to redemption agreements

—      —      —      179,825

Stock options

—      131,765      —      82,234

Denominators for diluted EPS

20,744,593      20,381,965      20,692,093      20,502,762

In 2004, the Company incurred a loss; therefore, a dilutive share calculation is not presented because to do so would have an anti-dilutive effect on earnings per share. Had the Company not recorded a loss, certain exercisable stock options would not be included in the computation of diluted EPS because the option prices were greater than the average market prices in each quarter. The number of stock options that would not have been included in the computation of diluted EPS and the range of exercise prices was 656,000 and \$13.38 - \$19.50.

Certain shares subject to redemption agreements (see Note 11) were considered dilutive in 2003. Also in 2003, certain exercisable stock options were not included in the computation of diluted EPS because the option prices were greater than the average market prices in each quarter. The number of stock options not included in the computation of diluted EPS and the range of exercise prices was 1,013,200 and \$7.38 - \$19.50.

#### NOTE 9—COMPREHENSIVE INCOME (LOSS)

Comprehensive income (loss) consisted of net income (loss), foreign currency translation adjustments and unrealized loss on short-term investments. Comprehensive income (loss) was \$(0.6) and \$(4.4) million for the three and six month periods ended July 3, 2004; and \$2.9 million and \$4.2 million for the three and six month periods ended June 28, 2003.

**X-RITE, INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued**  
**(Unaudited)**

**NOTE 10-ACQUISITIONS AND DIVESTITURES**

During the second quarter of 2004, the Company acquired Moniga Gremmo S.r.l, an industrial and ink formulation software developer located in Milan, Italy for \$0.7 million in cash. Under the terms of the agreement, the Company obtained all operating assets, software code, intellectual property and customer relationships. This acquisition will give the Company access to new markets and customers in Western Europe and additional software capabilities. The acquired products will be integrated with the existing X-Rite products within the next twelve months. Final determination and allocation of intangible asset values will be completed in the third quarter of 2004.

On June 30, 2004, the Company sold the primary assets of our Coherix subsidiary for \$0.8 million. Under the terms of the agreement, the purchaser received all operating assets and intellectual property of the Company. The purchaser made an initial payment of \$0.1 million with the remaining balance secured by a non-interest bearing note due in installments over a six-year period. The Company will record gains on the sale as payments are received on the note. As a result, the Company has recorded a deferred gain on the balance sheet of approximately \$0.5 million, representing the discounted value of the note.

In March 2003, the Company acquired the ColoRx<sup>®</sup> spectrophotometer product line and related assets of Thermo Electron Corporation for \$0.5 million. The Company has assumed service and support for the current installed base of ColoRx as part of the transaction. In an event related to this transaction, the Company entered into a five-year agreement with Benjamin Moore & Co. to be the preferred provider of color management solutions to Benjamin Moore authorized dealers. Prior to the acquisition, Thermo Electron was the preferred provider of color measurement equipment to Benjamin Moore & Co.

In April 2003, the Company acquired the ccDot meter product line of Centurfax Ltd. for \$1.5 million, including all intellectual property and related software for the products. Centurfax Ltd. is a London based company that develops and distributes products serving the pre-press and printing industries. The acquired products consist of quality control instruments that ensure accurate measurement of film, offset litho plates and digital proofing solutions.

On July 1, 2003, the Company acquired the assets of Monaco Systems Incorporated of Andover, Massachusetts, a leading developer of color management software to the graphic arts and photographic markets valued at \$11.0 million. The purchase price included a cash payment of \$7.0 million and X-Rite common stock valued at \$2.5 million. In addition, the seller is also eligible for contingent payouts of \$0.75 million in cash and \$0.75 million in X-Rite common stock.

The following unaudited pro forma consolidated results of operations for the three months and six months ended June 28, 2003, assumes the acquisition of Monaco Systems occurred as of the beginning of the period (in thousands, except share and per share data).

	<b>Three Months Ended</b>	<b>Six Months Ended</b>
	<b>June 28, 2003</b>	<b>June 28, 2003</b>
Net sales	\$ 29,940	\$ 54,605
Net income	2,325	3,410
Earnings per share:		
Basic	\$ 0.11	\$ 0.17

Diluted	\$ 0.11	\$ 0.16
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Weighted Average Shares Outstanding:

Basic	20,502,981	20,493,484
Diluted	20,634,746	20,755,543

The pro forma results above include certain adjustments to give effect to amortization of intangible assets and certain other adjustments and related income tax effects. The pro forma results are not necessarily indicative of the operating results that would have occurred, had the acquisitions been completed as of the beginning of the period presented, nor are they necessarily indicative of future operating results.

**X-RITE, INCORPORATED AND SUBSIDIARIES**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - Continued**  
**(Unaudited)**

**NOTE 11-FOUNDERS' STOCK REDEMPTION AGREEMENTS**

During 1998, the Company entered into agreements with its founding shareholders for the future repurchase of 4.5 million shares of the Company's outstanding stock. The stock purchases will occur following the later of the death of each founder and his spouse. The price the Company will pay the founders' estates for these shares will reflect a 10 percent discount from the average closing price for the ninety trading days preceding the later death of the founder and his spouse, although the discounted price may not be less than \$10 per share (a total of \$45.4 million) or more than \$25 per share (a total of \$113.5 million). The cost of the purchase agreements will ultimately be funded by \$160.0 million of proceeds from life insurance policies the Company has purchased on the lives of certain of these individuals. However the stock purchases may not necessarily coincide with the receipt of insurance proceeds; therefore, borrowed funds may be needed from time to time to finance the Company's purchase obligations. Insurance was purchased at the \$160.0 million level in order to cover both the maximum aggregate purchase price and anticipated borrowing costs.

The Company purchased 1,120,000 shares at \$10 per share or \$11.2 million under the terms of the agreement in January 2002. This founder was not insured; therefore, as anticipated at the time the agreement was entered into, the Company funded this obligation with cash and short-term investments.

In July 2003, the Company adopted SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity*. This Statement establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity. SFAS No. 150 generally requires liability classification for classes of financial instruments that represent, or are indexed to, an obligation to buy back the issuer's shares. Many of the financial instruments within the scope of SFAS No. 150 were previously classified by the issuer as equity or temporary equity. This Statement requires the Company to reclassify its temporary shareholders' investment related to the Founders Shares Redemption program to a long-term liability. Future changes in the valuation of the liability, as well as dividend payments on the program shares will be classified as interest expense. Because the underlying shares in the program are the Company's common stock, they will remain as a component of the calculation of basic and diluted earnings per share. The remaining shares subject to the agreements have been classified on the balance sheet as a long-term liability. The valuation of \$43.2 million at July 3, 2004 was determined by multiplying the applicable shares by \$12.62 which represents the average closing price of the Company's common stock, after applying the 10 percent discount, for the ninety trading days preceding that date. At January 3, 2004, the valuation of \$34.9 million was determined by multiplying the applicable shares by \$10.19 which represents the average closing price of the Company's common stock, after applying the 10 percent discount, for the ninety trading days preceding that date. The increase in the value of this liability in 2004, was classified as interest expense and included as a component of other income (expense).

Dividend payments of \$0.09 million were paid on Founders' program shares during the first two quarters of 2004 and 2003. The 2004 payments have been classified as interest expense as required by SFAS No. 150, whereas the 2003 payments were prior to the adoption of SFAS No. 150 and therefore have been classified as a reduction in shareholders' equity.

**NOTE 12-CONTINGENCIES, COMMITMENTS AND GUARANTEES**

On February 19, 2002, Ivoclar Vivadent, Inc. and Shade Analyzing Technologies, Inc. commenced litigation in U.S. District Court for the Western District of New York, alleging infringement of certain U.S. patents by the Company's ShadeVision™ system. In August 2003, the Company entered into a confidential settlement agreement with the plaintiffs under which the Company has a worldwide license to use the patented technology. The resolution of this matter did not have a material adverse effect on the Company's consolidated financial statements.

The Company is also involved in other legal proceedings, legal actions and claims arising in the normal course of business, including proceedings related to product, labor and other matters. Such matters are subject to many uncertainties, and outcomes are not predictable with assurance. The Company records amounts for losses that are deemed probable and subject to reasonable estimate. The Company does not believe that the ultimate resolution of these matters will have a material adverse effect on its consolidated financial statements.

Pursuant to a standby letter of credit agreement, the Company has provided a financial guarantee to a third party on behalf of its subsidiary located in England. The term of the letter of credit is one year, with an automatic renewal provision at the grantor' s discretion. The face amount of the agreement is 130,000 British Pounds Sterling or approximately \$0.2 million at July 3, 2004.

The Company' s product warranty reserves and operating lease commitments are not significant.

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**NOTE 13—SHAREHOLDER PROTECTION RIGHTS AGREEMENT**

In November of 2001, the Company's Board of Directors adopted a Shareholder Protection Rights Plan ("Plan"), which was implemented in the first quarter of 2002. The Plan is designed to protect shareholders against unsolicited attempts to acquire control of the Company in a manner that does not offer a fair price to all shareholders.

Under the Plan, one purchase right automatically trades with each share of the Company's common stock. Each Right entitles a shareholder to purchase 1/100 of a share of junior participating preferred stock at a price of \$30, if any person or group attempts certain hostile takeover tactics toward the Company. Under certain hostile circumstances, each Right may entitle the holder to purchase the Company's common stock at one-half its market value or to purchase the securities of any acquiring entity at one-half their market value. Rights are subject to redemption by the Company at \$.005 per Right and, unless earlier redeemed, will expire in the first quarter of 2012. Rights beneficially owned by holders of 15 percent or more of the Company's common stock, or their transferees and affiliates, automatically become void.

**FORWARD-LOOKING STATEMENTS:**

This discussion and analysis of financial condition and results of operations, as well as other sections of the Company's Form 10-Q, contain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act, as amended, that are based on management's beliefs, assumptions, current expectations, estimates and projections about the industries it serves, the economy, and about the Company itself. Words such as "anticipates," "believes," "estimates," "expects," "likely," "plans," "projects," "should," variations of such words and similar expressions are intended to identify such forward-looking statements. These statements are not guarantees of future performance and involve certain risks, uncertainties, and assumptions that are difficult to predict with regard to timing, extent, likelihood and degree of occurrence. Therefore, actual results and outcomes may materially differ from what may be expressed or forecasted in such forward-looking statements. Furthermore, X-Rite, Incorporated undertakes no obligation to update, amend or clarify forward-looking statements, whether as a result of new information, future events or otherwise. Forward statements include, but are not limited to statements concerning liquidity, capital resources needs, tax rates dividends and potential new markets.

The Company also reports certain non-GAAP (Generally Accepted Accounting Principles) financial measures. A "non-GAAP financial measure" is defined as a numerical measure of a company's financial performance that excludes or includes amounts so as to be different from the most directly comparable measure calculated and presented in accordance with GAAP in the Consolidated Statements of Operations, Balance Sheets or Statements of Cash Flows of the Company. Pursuant to the requirements of Regulation G, each non-GAAP measure is immediately preceded with the most directly comparable GAAP financial measure, and the difference in all cases is the exclusion of items the Company considers "non-recurring" due to their nature, size or infrequency. Those items included as specific items are discussed in several sections of this discussion and analysis. Each non-GAAP financial measure is presented because we monitor our business using this information, and we believe that it gives a more meaningful comparison of the results of our core business operations.

The following management's discussion and analysis describes the principal factors affecting the results of operations, liquidity, and capital resources, as well as the critical accounting policies, of X-Rite, Incorporated (also referred to as "X-Rite" and "the Company"). This discussion should be read in conjunction with the accompanying condensed consolidated financial statements, which include additional information about the Company's significant accounting policies, practices and transactions that underlie its financial results.

**Overview of Second Quarter and Year to Date Results for 2004**

During the second quarter of 2004, the Company continued to achieve growth in its sales and operating income. Highlights include:

Record second quarter net sales of \$31.8 million, up 13 percent over second quarter 2003.

Eighth consecutive quarter of year-over-year sales growth.

Gross margins were 66.3 percent, up 6 percent from the second quarter 2003.

Operating income increased by 87 percent from the second quarter 2003.

Acquired Moniga Gremmo S.r.l., an industrial and ink formulation software company based in Milan, Italy.

Launched seven new products under the Streamlined Color Management™ banner at Drupa, the world's largest International graphic arts expo, held in Germany in May.

The Company reported second quarter 2004 net sales of \$31.8 million, an increase of 13 percent over the second quarter of last year. Operating income was \$4.8 million for the quarter, compared with \$2.6 million in the second quarter of 2003. Gross margins increased to 66.3 percent in 2004 from 62.6 percent in 2003, due principally to changes in product mix and lower manufacturing costs. Operating income was 15.1 percent of sales in the second quarter of 2004 as compared to 9.1 percent in the prior year period.



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

The Company reported a net loss of \$680 thousand or 3 cents per share in the second quarter of 2004 after a non-cash charge of \$3.6 million (17 cents per share) related to Statement of Financial Accounting Standards No. 150, Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity (SFAS No. 150). SFAS No. 150 requires certain long-term liabilities be adjusted quarterly based on the Company's current stock price. These liabilities relate to the repurchase agreements with the Company's founders, the value of which was previously reflected as temporary equity prior to the implementation of SFAS No. 150.

The following table reconciles the Company's adjusted results to GAAP net income (loss) and earnings per share, for both year to date and the second quarters of 2004 and 2003 respectively: (in thousands except for per share data)

	For the Three Months Ended				For the Six Months Ended			
	July 3, 2004		June 28, 2003		July 3, 2004		June 28, 2003	
	EPS		EPS		EPS		EPS	
Net income (loss) (GAAP basis)	\$(680 )	\$(0.03)	\$1,961	\$0.10	\$(4,447)	\$(0.21)	\$2,973	\$ 0.15
Specific items (net of tax):								
SFAS No. 150 adjustment	3,638	0.17	—	—	8,491	0.41	—	—
Expense reimbursement from customer	—	—	—	—	—	—	(680 )	(0.03)
Net income and earnings per share excluding specific items	\$2,958	\$0.14	\$1,961	\$0.10	\$4,044	\$0.20	\$2,293	\$ 0.12

## RESULTS OF OPERATIONS

### Net Sales

The Company recorded sales of \$31.8 and \$60.4 million for the second quarter and year to date 2004, respectively. Both amounts are Company records and represent the eighth consecutive quarter of year over year sales growth. Sales increases were noted across all of the Company's principal color product lines, as well as its primary geographic markets. Quarterly and year to date sales for the same periods in 2003 were \$28.2 and \$51.8 million, respectively. On a percentage basis, quarterly and year to date sales increased 12.8 and 16.6 percent respectively in 2004 as compared to 2003. Changes in foreign exchange rates accounted for \$0.6 and \$1.5 million of the quarterly and year to date sales increase in 2004.

The Graphic Arts product lines recorded sales of \$13.3 million for the second quarter of 2004, compared to \$12.3 million for the same period of 2003, an increase of \$1.0 million or 8.1 percent. On a year to date basis Graphic Arts sales were \$27.0 million in 2004, compared to \$23.5 million in 2003, an increase of \$3.5 million, or 14.9 percent. Of the two components of Graphic Arts product lines printing and imaging, larger gains were noted in printing sales which increased 12.1 percent and 18.1 percent respectively for the second quarter and year to date 2004, as compared to 2003. Imaging sales increased 4.5 percent and 11.5 percent respectively for the second quarter and year to date 2004, as compared to 2003. These increases were driven by the introduction of new products and the integration of the ccDot and Monaco Systems product lines, which were acquired in the second and third quarters of 2003, respectively.

Strengthening global capital goods spending and sales of the new benchtop product line led to double-digit percentage sales increases in the Industrial product lines. Sales were \$8.7 million for the second quarter of 2004, as compared to \$6.7 million for the comparable quarter in 2003, an increase of \$2.0 million, or 29.9 percent. On a year to date basis, sales in 2004 were \$15.4 million compared to \$12.2 million in 2003, and increase of \$3.2 million or 26.2 percent.

The Retail products group which provides product solutions to the home décor industry recorded sales of \$5.2 million for the second quarter of 2004 compared to \$4.5 million for the same quarter of 2003, an increase of \$0.7 million, or 15.6 percent. On a year to date basis, sales were \$9.5 million in 2004, compared to \$7.4 million for the same period in 2003, an increase of \$2.1 million or 28.4 percent. These increases are attributable to increased sales penetration among the large retail chains and major paint companies, as well as the continued product rollout under the Benjamin Moore agreement which was signed in conjunction with the ColoRx product line acquisition in March 2003.

Labsphere recorded sales of \$3.0 million in the second quarter of 2004, compared to \$2.9 million for the second quarter 2003, an increase of \$0.1 million, or 3.4 percent. On a year to date basis, sales were \$5.4 million in 2004, compared to \$4.9 million in 2003, an increase of \$0.5 million, or 10.2 percent.

Other product sales which consist primarily of the ShadeVision dental product line were \$1.6 million for the second quarter of 2004, compared to \$1.8 million for the same quarter in 2003, a decrease of \$0.2 million or 11.1 percent. Year to date sales were \$3.1 million and \$3.8 million in 2004 and 2003 respectively, a decrease of \$0.7 million or 18.4 percent. Much of this decrease is due to a revised pricing structure for the Shade Vision product agreed to in connection with a new marketing agreement reached at the end of 2003 with Sullivan Schein, Inc. This agreement grants Sullivan Schein exclusive sales and marketing privileges in North America. In return for a reduced pricing, Sullivan Schein has assumed all sales and marketing costs.

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

Significant sales gains were noted in both the Asia Pacific and European regions for both second quarter and year to date 2004. Asia Pacific sales grew by 48.8 and 46.5 percent for the second quarter and year to date 2004 respectively, as compared to 2003. European sales increased by 23.9 and 20.7 percent for the second quarter and year to date 2004 respectively, as compared to the comparable periods in 2003. Included in the European sales percentage gains were foreign exchange gains of 8.4 percent and 12.0 percent for the second quarter and year to date 2004 respectively, as compared to 2003. North American sales grew by 4.1 percent on a quarter over quarter basis and 8.8 percent on a year over basis in 2004.

### Cost of Sales and Gross Profit

Our gross profit percentages continue to improve in 2004. Gross profit as a percentage of sales was 66.3 and 65.0 percent for the second quarter and year to date 2004 respectively. Comparable period gross profit percentages for 2003 were 62.6 and 63.4 percent respectively. These improvements are due to several factors including higher overhead absorption due to increased sales volumes, favorable changes in sales mix and the weak US dollar.

### Operating Expenses

Total operating expenses were \$16.3 million and \$32.7 million for the second quarter and year to date 2004 respectively, compared to \$15.1 million and \$28.7 million respectively for the comparable periods in 2003. The year over year increases were \$1.2 million or 7.9 percent for the quarter and \$4.0 million or 13.9 percent year to date. In the first quarter of 2003, we received a one-time payment of \$1.0 million for the reimbursement of expenses in connection with renegotiation of a customer supply agreement, which was classified as a reduction of general and administrative expenses, thereby lowering that line item. Had this transaction not occurred, the year to date increase in total operating expenses would have been \$3.0 million or 10.1 percent.

Included in 2004 expenses are \$0.7 million and \$1.5 million of operating expenses for the second quarter and year to date 2004, respectively for Monaco Systems which was acquired in the third quarter of 2003. Changes in foreign exchange rates also accounted for \$0.2 and \$0.6 million of additional operating expenses for the second quarter and year to date 2004 respectively, as compared to 2003.

The following table compares year to date operating expense components as a percentage of net sales with adjustment for the aforementioned customer expense reimbursement. This metric is an important element of the Company's strategic planning process. (dollars in millions)

Operating Expenses	2004			2003 As Reported			2003 As Adjusted		
	Amount	Percentage of Net Sales		Amount	Percentage of Net Sales		Amount	Percentage of Net Sales	
Selling and marketing	\$ 16.4	27.2	%	\$ 14.3	27.7	%	\$ 14.4	27.7	%
General and administrative:	8.4	13.8	%	7.8	15.1	%	7.8	15.1	%
Expense reimbursement from customer	-	-		-	-		1.0	1.9	%
Subtotal General and administrative	8.4	13.8	%	7.8	15.1	%	8.8	17.0	%
Research, development and engineering	7.9	13.2	%	6.6	12.7	%	6.6	12.7	%

Total operating expenses	\$ 32.7	54.2	%	\$ 28.7	55.5	%	\$ 29.8	57.4	%
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Selling and marketing expenses were \$8.4 million for the second quarter of 2004, as compared to \$7.1 million for the second quarter of 2003, an increase of \$1.3 million, or 18.3 percent. Year to date costs in 2004 were \$16.4 million compared to \$14.4 million in 2003, an increase of \$2.0 million or 13.9 percent. The increases for both quarterly and year to date amounts are attributable to increased costs for sales staff including commissions, unfavorable foreign exchange rate fluctuations and the reclassification in 2004 of certain costs from general and administrative. In addition, costs totaling \$.7 million were incurred in 2004 related to the DRUPA Graphic Arts trade show which is held in Germany every four years. DRUPA is the largest graphic arts trade show in the world and is held over a sixteen-day period. As a percentage of sales, sales and marketing expenses have remained consistent year over year.

General and administrative expenses were \$4.0 million for the second quarter of 2004, compared to \$4.5 million for the second quarter of 2003, a decrease of \$0.5 million, or 11.1 percent. This decrease can be attributable to lower costs incurred for our self funded health plan covering employees in the United States, as well the reclassification of certain expense to sales and marketing. On a year to date basis general and administrative expenses were \$8.4 million in 2004 compared to \$7.8 million for same period in 2003, an increase of \$0.6 million, or 7.7 percent. The 2003 expenses were offset by a release payment of \$1.0

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - continued**

million received in the first quarter of 2003 in connection with the renegotiation of a customer supply agreement. Had this payment not occurred, 2003 expenses would have exceeded those of 2004 by \$0.4 million. Other cost containment measures we have undertaken have allowed us to overcome the unfavorable effects of foreign exchange rates on our general and administrative expenses. As a percentage of net sales, general and administrative expenses have decreased to 13.8 percent year to date in 2004, compared to 15.1 percent for the same period in 2003.

Research, development and engineering (RD&E) expenses were \$3.9 million for the second of 2004 compared to \$3.5 million for comparable quarter of 2003, an increase of \$0.4 million, or 11.4 percent. On a year to date basis, RD&E expenses were \$7.9 million in 2004, compared to \$6.6 million in 2003, an increase of \$1.3 million or 19.7 percent. Included in the 2004 expenses are \$0.4 and \$0.7 million for the second quarter and year to date respectively of engineering costs at Monaco Systems which was acquired on July 1, 2003. The overall increase in spending including the Monaco Systems expenses reflects our increased new product development investment. This new product research is being conducted in our core color markets as we develop a wider array of total product solutions consisting of advanced instrumentation and related software. As a percentage of sales RD&E spending is 13.2 percent for year to date 2004, compared to 12.7 percent for the comparable period in 2003. We anticipate spending will remain in the 12 to 14 percent of sales range for the foreseeable future.

### **Other Income**

Other income consists of investment income and gains and losses from foreign exchange. The Company's investment portfolio consists of short-term tax-exempt bonds, mutual funds and corporate securities.

For the first six months of 2004, the Company recorded other losses of \$0.3 million, compared to an income of \$0.3 million for the same period of 2003. The year over year change is attributable to currency exchange losses generated by the foreign sales offices.

### **Interest Expense**

The Company has recorded \$3.7 million and \$8.5 million of interest expense for the second quarter and year to date 2004, respectively. Almost all of this expense has been recorded in connection with the adoption of SFAS No. 150. As discussed more fully in Note 11 to the Condensed Consolidated Financial Statements, and below in financing and investing activities, these costs represent the potential increase in the ultimate payout under the Founders' Shares redemption program, as well as dividend payments made on program shares. Future calculations of this charge are tied to changes in the price of the Company's stock; as required by SFAS No. 150, therefore it is not possible to project with any certainty the impact on future earnings.

### **Write Down of Other Investments**

At June 28, 2003, the Company had \$3.4 million related to investments made by its strategic venture capital group, XR Ventures, LLC, and (XRV). Each investment represented less than 20 percent of the ownership of the respective portfolio companies. Since the Company did not exercise significant influence over the operating and financial policies of each investee, the investments were recorded at cost.

We periodically evaluate the carrying value of each investment to determine whether a decline in fair value below the cost has occurred. If the decline is determined to be other than temporary, the carrying value is adjusted to the current fair value and a loss is recognized. At various times in 2003, comprehensive assessments of the continuing value of each investment were performed. Based on the continued erosion of the venture capital markets, the technology sectors of the economy and specific reviews of its portfolio, we concluded that the value of these investments has been permanently impaired. Therefore, a charge of \$3.4 million was recorded in December 2003. As of January 3, 2004, all venture capital investments have been fully impaired. Although the Company continues to hold positions in several XR Ventures' portfolio companies no future investments in the remaining portfolio companies will be made, except where necessary to protect any existing investments.

In the second quarter of 2003, XRV provided a working capital advance of \$0.1 million to a company in which it had previously invested and subsequently expensed that investment. This funding was intended to provide the investee operating cash for a period of time while it sought

new sources of investment capital. The investee was not successful in securing new capital and upon further analysis, this investment was deemed impaired, and the appropriate charge taken.

### **Income Taxes**

The Company recorded an income tax expense of \$1.5 million for the second quarter against a pre-tax income of \$0.9 million for the first quarter of 2004. On a year to date basis the income tax expense was \$2.1 million, against a pre tax loss \$2.4 million. The provision calculations were negatively impacted in both instances by the non-deductible aspects of the Founders' Shares redemption program adjustments. As previously noted, we do not believe it is possible to project future adjustments to the

## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - continued**

Founders' Shares redemption liability with certainty, as they are directly tied to stock price changes. The Company's tax rates for the second quarter and year to date 2004, excluding the Founders' Shares redemption adjustments, were 34.2 and 33.7 percent respectively. The second quarter and year to date tax rates in 2003, were 29.0 and 29.6 percent respectively. The U.S statutory rate for both tax years was 35.0 percent. Both years' effective tax rates have benefited from the execution of certain international tax strategies and tax credits.

### **Net Income**

The Company incurred a net loss of \$0.7 and \$4.4 million for the second quarter and year to date respectively in 2004. For the comparable periods in 2003, the Company recorded net income of \$2.0 and \$3.0 million respectively. On a per share basis, the 2004 net loss per share was \$.03 and \$.21 for the second quarter and year to date respectively. In 2003, fully diluted net income per share was \$.10 and \$.15 for the second quarter and year to date respectively.

The average number of common shares outstanding was approximately the same for both years. Common stock equivalent calculations were not presented for 2004 due to the anti-dilutive effect they have on earnings per share calculations when there is a net loss.

## **FINANCIAL CONDITION AND LIQUIDITY**

### **Liquidity and Capital Resources**

At July 3, 2004, cash, cash equivalents and short-term investments totaled \$9.6 million compared to \$14.1 million at January 3, 2004, a decrease of \$4.5 million. Operating activities for the first two quarters of 2004 provided a positive cash flow of \$3.8 million. Investing activities required the use of \$7.6 million, while financing activities provided funds of \$1.0 million. Changes in foreign exchange rates provided an additional \$0.02 million of cash during the first two quarters of 2004. During the first six months of 2003, funds provided by operating activities were \$5.1 million. Net cash used for investing and financing activities was \$2.1 and \$0.8 million, respectively, while changes in foreign exchange rates provided \$0.3 million.

### **Operating Activities**

Net cash provided by operating activities was \$3.8 million in the first six months of 2004 compared to \$5.1 million for the same period of 2003, a decrease of \$1.3 million or 25.5 percent. In 2004, net cash provided by operating activities was comprised of a net loss of \$4.4 million adjusted for non-cash items of \$11.5 million and net cash used for changes in operating assets and liabilities of \$3.3 million. Included in the 2004 adjustments for non-cash items were expenses that reduced net income but did not require the use of cash. These items include \$2.7 million for depreciation and amortization and \$8.3 million for the increase in the value of shares subject to redemption agreements. In 2003, depreciation and amortization for the first six months was \$2.8 million and there was not an adjustment for the Founders' Shares Redemption program as this period was prior to the adoption of SFAS No. 150. Working capital changes for 2004 include an increase in other current and non current assets of \$1.2 million as well as a decrease in accounts payable of \$1.2 million and other current liabilities of \$3.6 million. These uses of funds were offset by funds provided from a reduction in accounts receivable of \$1.6 million. Working capital changes in 2003 included a reduction in accounts receivable of \$1.0 million. Uses of funds for working capital items included increased inventory and other assets of \$1.8 million combined and a reduction in other current liabilities of \$0.4 million.

In July 2003, the Company adopted SFAS No. 150, "Accounting for Certain Financial Instruments with Characteristics of both Liabilities and Equity". This Statement establishes standards for classifying and measuring as liabilities certain financial instruments that embody obligations of the issuer and have characteristics of both liabilities and equity. Statement 150 generally requires liability classification for classes of financial instruments that represent, or are indexed to, an obligation to buy back the issuer's shares. Many of the financial instruments within the scope of Statement 150 were previously classified by the issuer as equity or temporary equity. This Statement requires the Company to reclassify its temporary shareholders' investment related to the Founders' Shares Redemption program to a long-term liability. Because the underlying shares in the program are the Company's common stock, they will remain as a component of the calculation of basic and diluted earnings per share. In addition, future changes in the valuation of the liability, as well as dividend payments on the program shares will be classified as interest expense.

The remaining shares subject to the agreements have been classified on the balance sheet as a long-term liability. The valuation at July 3, 2004 of \$43.2 million was determined by multiplying the applicable shares by \$12.62 which represents the average closing price of the Company's common stock, after applying the 10 percent discount, for the ninety trading days proceeding quarter end. At January 3, 2004, the valuation of \$34.9 million was determined by multiplying the applicable shares by \$10.19. Increases in the value of this liability are classified as interest expense and included as a component of other income (expense).



## **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations - continued**

### **Investing Activities**

Net cash used for investing activities was \$7.6 million year to date 2004, compared to a use of \$2.1 million for the comparable period in 2003, an increase of \$5.5 million, or 261.9 percent. Of those investing activities requiring the use of cash in 2004, the largest amounts were for an increase in the founders' life insurance program of \$4.2 million, capital expenditures of \$3.1 million and an increase in other assets of \$1.6 million. Funding for these activities was generated in part by the sale of short-term investments of \$2.7 million. In 2003, proceeds from the sale of short-term investments provided \$7.2 million. Funding was required for an increase in the founders' life insurance of \$4.1 million, acquisitions of \$2.0 million and capital expenditures of \$1.6 million.

The Company had short-term investments of \$1.7 million at July 3, 2004 as compared to \$3.4 million at January 3, 2004. Its portfolio of investments consists primarily of tax-free municipal bonds and mutual funds. An allowance for unrealized gains and losses related to this portfolio has been established. Changes to the allowance are reported as a component of other comprehensive income. The allowance was \$0.5 million at both July 3, and January 3, 2004.

Capital expenditures of \$3.1 million have been made so far in 2004. These expenditures were made primarily for machinery, equipment, computer hardware and software. Capital expenditures for the comparable period of 2003 were \$1.6 million. We anticipate capital expenditures for the remaining six months of 2004 will be approximately \$4.7 million. The emphasis of these expenditures will focus on global information technology upgrades that support both current operations and an expanded research and development effort and continued improvements in our manufacturing capabilities.

During 1998 the Company entered into agreements with its founding shareholders for the future repurchase of 4.5 million shares of the Company's outstanding stock. The stock purchases will occur following the later of the death of each founder and his spouse. The price the Company will pay the founders' estates for these shares will reflect a 10 percent discount from the average closing price for the ninety trading days preceding the later death of the founder and his spouse, although the discounted price may not be less than \$10 per share (a total of \$45.4 million) or more than \$25 per share (a total of \$113.5 million). The cost of the purchase agreements will be funded by \$160.0 million of proceeds from life insurance policies the Company has purchased on the lives of certain of these individuals. We anticipate that stock purchases will not coincide with the receipt of insurance proceeds; therefore, borrowed funds may be needed from time to time to finance the Company's purchase obligations. Insurance was purchased at the \$160.0 million level in order to cover both the maximum aggregate purchase price and anticipated borrowing costs. Life insurance premiums total \$4.3 million each year while all the policies remain in effect. The Company purchased 1.12 million shares at \$10 per share or \$11.2 million under the terms of the agreement in January 2002. This founder was not insured; therefore, as anticipated at the time the agreement was entered into, the Company funded this obligation with cash and short-term investments.

### **Financing Activities**

Financing activities provided \$1.0 million of cash during the year to date 2004, compared to using \$0.8 million of cash in the comparable period of 2003. The Company issued 177,500 shares of common stock during in 2004 in connection with exercises under its two stock option plans. These issuances generated \$1.8 million of cash. Dividends of \$1.0 million have been paid in 2004. Of this amount, \$0.2 million was paid to shares in the founders' share redemption program, in accordance with SFAS No. 150 these payments have been classified as interest expense and included as a component of other income (expense).

In September 2000, the Board of Directors authorized a common stock repurchase program of up to one million shares of outstanding stock. The timing of the program and amount of the stock repurchases will be dictated by overall financial and market conditions. There were no shares repurchased in 2004 or 2003 under this program. During 2001, the Company repurchased 231,364 shares at an average cost of \$7.56 per share.

The Company believes its current liquidity, future cash flows and bank credit lines give it the financial resources to meet its expected requirements for the foreseeable future. These requirements include the funding of operations, life insurance premiums, and capital expenditures. Should additional funding be required, supplemental borrowing arrangements are the most probable alternative for meeting

capital resource and liquidity needs. The Company maintains a revolving line of credit of \$20 million and a capital expenditure line of credit of \$5 million.

## **Item 2. Management' s Discussion and Analysis of Financial Condition and Results of Operations - continued**

### **Acquisitions and Divestitures**

During the second quarter of 2004, the Company acquired Moniga Gremmo S.r.l, an industrial and ink formulation software developer located in Milan, Italy for \$0.7 million in cash. Under the terms of the agreement, we obtained all operating assets, software code, intellectual property and customer relationships. This acquisition will give the Company access to new markets and customers in Western Europe and additional software capabilities. The acquired products will be integrated with the existing X-Rite products within the next twelve months. Final determination and allocation of intangible asset values will be completed in the third quarter of 2004.

On June 30, 2004, the Company sold the primary assets of our Coherix subsidiary for \$0.8 million. Under the terms of the agreement, the purchaser received all operating assets and intellectual property. The purchaser made an initial payment of \$0.1 million with the remaining balance secured by a non-interest bearing note due in installments over a six-year period. The Company will record gains on the sale as payments are received on the note. As a result, the Company has recorded a deferred gain on the balance sheet of approximately \$0.5 million, representing the discounted value of the note.

On July 1, 2003, the Company acquired the assets of Monaco Systems Incorporated of Andover, Massachusetts, a leading developer of color management software to the graphic arts and photographic markets in a transaction valued at \$11.0 million. The purchase price included a cash payment of \$7.0 million and X-Rite common stock valued at \$2.5 million. In addition, the seller is also eligible for contingent payouts of \$0.75 million in cash and \$0.75 million in X-Rite common stock.

In April 2003, the Company acquired the ccDot meter product line of Centurfax Ltd. for \$1.5 million, including all intellectual property and related software for the products. Centurfax Ltd. is a London based company that develops and distributes products serving the pre-press and printing industries. The acquired products consist of quality control instruments that ensure accurate measurement of film, offset litho plates and digital proofing solutions.

In March 2003, the Company acquired the ColoRx<sup>®</sup> spectrophotometer product line and related assets of Thermo Electron Corporation for \$0.5 million. The Company has assumed service and support for the current installed base of ColoRx as part of the transaction. In an event related to this transaction, the Company entered into a five-year agreement with Benjamin Moore & Co. to be the preferred provider of color management solutions to Benjamin Moore authorized dealers. Prior to the acquisition, Thermo Electron was the preferred provider of color measurement equipment to Benjamin Moore & Co.

### **Critical Accounting Policies and Estimates**

The preparation of financial statements in accordance with generally accepted accounting principles in the United States requires management to adopt accounting policies and make significant judgments and estimates to develop amounts reflected and disclosed in the financial statements. In some instances, there may be alternative policies or estimation techniques that could be used. Management maintains a thorough process to review the application of accounting policies and to evaluate the appropriateness of the many estimates that are required to prepare the financial statements. However, even under optimal circumstances, estimates routinely require adjustment based on changing circumstances and the receipt of new or better information.

Management has discussed the development and selection of the Company' s accounting policies with the Audit Committee of the Board of Directors. There have been no material changes in estimates or accounting policies during the six months ended July 3, 2004.

### **Off Balance Sheet Arrangements and Contractual Obligations**

The Company has no significant off balance sheet transactions other than operating leases for equipment, real estate and vehicles. It is not the Company' s policy to issue guarantees to third parties

The Company is exposed to a variety of risks including foreign currency exchange fluctuations, and market volatility in its investment and insurance portfolios. In the normal course of business, the Company employs established procedures to evaluate its risks and take corrective actions when necessary to manage these exposures. The Company is not a party to any derivative instruments



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

During 1998, the Company entered into agreements with its founding shareholders for the future repurchase of 4.5 million shares of the Company's outstanding stock, see Note 11 to the Consolidated Financial Statements for a full description of these arrangements. Changes in the Company's stock price will vary the ultimate payout under the agreements within the prescribed price ranges, as well as reported results of operations for the periods during which the changes occur.

During the first six months of 2004, there were no material changes in foreign exchange risk. The founders stock redemption program valuation has increased by \$8.3 million. The change in valuation was recorded as interest expense.

### Item 4. Controls and Procedures

The Company's Chief Executive Officer and Chief Financial Officer have concluded, based on their evaluation as of the end of the period covered by this report on Form 10-Q, that the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)) are effective to ensure that information required to be disclosed in the reports that the Company files or submits under the Securities Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms. There were no changes in the Company's internal control over financial reporting during the fiscal quarter ended July 3, 2004 that have materially affected, or are reasonably likely to materially affect, the Company's internal controls over financial reporting.

## PART II OTHER INFORMATION

### Item 1 Legal Proceedings—None

### Item 2 Changes in Securities; Use of Proceeds and Issuers Purchases of Equity Securities—None

### Item 3 Defaults upon Senior Securities—None

### Item 4 Submission of Matters to a vote of Security Holders—

At the Annual Meeting of Shareholders on May 4, 2004, X-Rite's shareholders voted on the following matters:

1. Election of the following directors to three-year terms expiring in 2007 for all but Mr. Ferrara whose term expires in 2006.

	<u>Affirmative</u> <u>Votes</u>	<u>Votes</u> <u>Withheld</u>	<u>Broker Non-</u> <u>votes</u>
Peter M. Banks	11,000,481	7,928,210	-0-
L. Peter Frieder	17,031,460	1,902,662	-0-
Ronald A. Vandenberg	15,267,292	3,666,830	-0-
Michael C. Ferrara	17,018,187	1,915,935	-0-

Company directors Stanley W. Cheff, James A. Knister and John E. Utley (whose terms expire in 2005) and Paul R. Sylvester and Mark D. Weishaar (whose terms expire in 2006) continued as directors of the Company following the annual meeting.

	Affirmative Votes	Negative Votes	Votes Withheld	Broker Non-votes
2. Proposal to Amend and Restate the Employee Stock Purchase Plan:	15,646,297	368,941	41,045	2,872,408

**Item 5 Other Information**—None

**Item 6 Exhibits and Reports on Form 8-K**

(a) **Exhibit Index**

- \*10(a) Amended and Restated Bylaws of X-Rite, Incorporated, adopted February 10, 2004.
- \*10(b) First Amendment to the Amended and Restated Outside Directors Stock Option Plan, effective November 25, 2003.
- \*10(c) X-Rite, Incorporated Amended and Restated Employee Stock Purchase Plan, adopted February 10, 2004 (filed as Appendix A to the definitive proxy statement dated April 7, 2004 relating to the Company' s 2004 annual meeting (Commission File No. 0-14800) and incorporated herein by reference)
- 31.1 Certification of the Chief Executive Officer and President of X-Rite, Incorporated pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 31.2 Certification of the Chief Financial Officer of X-Rite, Incorporated pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 32.1 Certification of Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).
- 32.2 Certificate of Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350).

(b) During the three months ended July 3, 2004, one report on Form 8-K, was furnished or filed. On April 26, 2004, a Form 8-K was furnished to the Securities and Exchange Commission to disclose the Company' s financial results for the quarter ending April 3, 2004.

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**SIGNATURES**

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

**X-RITE, INCORPORATED**

August 12, 2004

/s/ Michael C. Ferrara

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Michael C. Ferrara

Chief Executive Officer

August 12, 2004

/s/ Mary E. Chowning

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Mary E. Chowning, Vice President and

Chief Financial Officer

**AMENDED AND RESTATED BYLAWS**  
**of**  
**X-RITE, INCORPORATED**

**A Michigan Corporation**  
**As Amended and Restated February 10, 2004**

**ARTICLE I. OFFICES**

**Section 1. Registered Office.** The registered office of the Corporation shall be as specified in the Articles of Incorporation. The Corporation shall keep records containing the names and addresses of all shareholders, the number, class and series of shares held by each, and the dates when they respectively became holders of record thereof, at its registered office or at the office of its transfer agent.

**Section 2. Other Offices.** The business of the Corporation may be transacted in such locations other than the registered office, within or outside the State of Michigan, as the Board of Directors may from time to time determine.

**ARTICLE II. CAPITAL STOCK**

**Section 1. Stock Certificates.** Certificates representing shares of the capital stock of the Corporation shall be in such form as is approved by the Board of Directors. Certificates shall be signed by the Chairman of the Board of Directors, Chief Executive Officer, President or a Vice President, and may also be signed by another officer designated by the Board of Directors, and shall be sealed with the seal of the Corporation, or a facsimile thereof, if one be adopted. The signatures of the officers may be facsimiles. In the event an officer who has signed, or whose facsimile signature has been placed upon, a certificate ceases to be such officer before the certificate is issued, it may be issued by the Corporation with the same effect as if he were such officer at the date of issue.

**Section 2. Replacement of Lost or Destroyed Certificates.** In the event of the loss or destruction of a stock certificate, no new certificate shall be issued in place thereof until the Corporation has received from the registered holder such assurances, representations, warranties and/or guarantees as the Board of Directors, in its sole discretion, shall deem advisable, and until the Corporation receives sufficient indemnification protecting it against any claim that may be made on account of such loss or destroyed certificate, or the issuance of any new certificate in place thereof, including an indemnity bond in such amount and with sureties, if any, as the Board of Directors, in its sole discretion, deems advisable.

**Section 3. Transfer of Shares.** Shares of stock of the Corporation shall be transferable only upon the books of the Corporation. The old certificates shall be surrendered to the Corporation by delivery thereof to the person in charge of the stock transfer books of the Corporation, or to such other person as the Board of Directors may designate, properly endorsed for transfer, and such certificates shall be canceled before a new certificate is issued. The Corporation shall be entitled to treat the person in whose name any share, right or option is registered as the owner thereof for all purposes, and shall not be bound to recognize any equitable or other claim with respect thereto, regardless of any notice thereof, except as may be specifically required by the laws of the State of Michigan.

**Section 4. Rules Governing Stock Certificates.** The Board of Directors shall have the power and authority to make all such rules and regulations as they may deem expedient concerning the issue, transfer and registration of certificates of stock, and may appoint a transfer agent and a registrar of transfer, and may require all such certificates to bear the signature of such transfer agent and of such registrar of transfers.

**Section 5. Record Date for Stock Rights.** The Board of Directors may fix in advance a date not exceeding sixty (60) days preceding the date of payment of any dividend, or the date for the allotment of rights, or the date when any change or conversion or exchange of capital stock shall go into effect, as a record date for the determination of the shareholders entitled to receive payment of any such dividends, or any such allotment of rights, or to exercise the rights with respect to any such change, conversion, or exchange of capital stock; and in such case,



only shareholders of record on the date so fixed shall be entitled to receive payment of such dividends, or allotment of rights, or exercise such rights, as the case may be, notwithstanding any transfer of any stock on the books of the Corporation after any such record date is fixed.

In the event the Board of Directors shall fail to fix a record date as provided in this Section 5 of Article II, the record date for the purposes specified herein shall be the close of business on the day on which the resolution of the Board of Directors relating thereto is adopted.

**Section 6. Dividends.** The Board of Directors, in its discretion, may from time to time declare and make a distribution to shareholders in respect of the Corporation's outstanding shares, payable in cash, the Corporation's indebtedness (but not the Corporation's shares) or the Corporation's other property, including the shares or indebtedness of other corporations; provided, however, no such distribution shall be made if, after giving effect to the distribution, the Corporation would not be able to pay its debts as they become due in the usual course of business, or the Corporation's total assets would be less than its total liabilities plus the amount that would be needed if the Corporation were to be dissolved at the time of the distribution to satisfy the preferential rights upon dissolution of shareholders whose preferential rights are superior to those receiving the distribution.

In addition, the Board of Directors, in its discretion, from time to time may declare and direct the payment of a share dividend of the Corporation's shares, issued pro rata and without consideration, to the Corporation's shareholders or to the shareholders of one or more classes or series; provided, however, shares of one class or series may not be issued as a share dividend in respect of shares of another class or series unless the Articles of Incorporation so authorize, a majority of the votes entitled to be cast by the class or series to be issued approve the issue, or there are no outstanding shares of the class or series to be issued.

**Section 7. Treasury Shares.** Shares that have been issued and reacquired by the Corporation shall constitute authorized but unissued shares.

**Section 8. Redemption of Control Shares.** Control shares acquired in a control share acquisition, with respect to which no acquiring person statement has been filed with the Corporation, shall, at any time during the period ending 60 days after the last acquisition of control shares or the power to direct the exercise of voting power of control shares by the acquiring person, be subject to redemption by the Corporation. After an acquiring person statement has been filed with the Corporation and after the meeting at which the voting rights of the control shares acquired in a control share acquisition are submitted to the shareholders, the shares shall be subject to redemption by the Corporation unless the shares are accorded full voting rights by the shareholders as provided in Section 798 of the Michigan Business Corporation Act. Redemptions of shares pursuant to this bylaw shall be at the fair value of the shares pursuant to procedures adopted by the Board of Directors of the Corporation.

The terms "control shares," "control share acquisition," "acquiring person statement" "acquiring person" and "fair value" as used in this bylaw, shall have the meanings ascribed to them, respectively, in Chapter 7B of the Michigan Business Corporation Act.

### ARTICLE III. SHAREHOLDERS

**Section 1. Place of Meetings.** Meetings of shareholders shall be held at the registered office of the Corporation or at such other place, within or outside the State of Michigan, as may be determined from time to time by the Board of Directors; provided, however, if a meeting of shareholders is to be held at a place other than the registered office of the Corporation, the notice of the meeting shall designate such place.

**Section 2. Annual Meeting.** Annual meetings of shareholders for election of directors and for such other business as may come before the meeting shall be held on such date prior to June 1 of each year and at such time as may be fixed from year to year by the Board of Directors.

**Section 3. Special Meetings.** Special meetings of shareholders may be called by the Chairman or the Secretary, and shall be called by either of them pursuant to resolution therefor by the Board of Directors, or upon receipt by them of a request in writing, stating the purpose or purposes thereof, and signed by shareholders of record owning a majority of the voting shares of the Corporation issued and outstanding.

**Section 4. Record Date for Notice and Vote.** The Board of Directors may fix a date not more than sixty (60) days nor less than ten (10) days before the date of a shareholders' meeting as the record date for the purposes of determining shareholders entitled to notice of and to vote at the meeting or adjournments thereof; provided, however, that the record date shall not precede the date on which the Board takes action to fix the record date. In the event the Board of Directors fails to fix a record date as provided in this Section 4 of Article III, the record date for determination of shareholders entitled to notice of or to vote at a meeting of shareholders shall be the close of business on the day preceding the day on which notice is given, or if no notice is given, the day next preceding the day on which the meeting is held.

**Section 5. Notice of Shareholder Meetings.** Written notice of the time, place, and purposes of any meeting of shareholders shall be given to shareholders entitled to vote thereat, not less than ten (10) nor more than sixty (60) days before the date of the meeting, which notice may be given either by delivery in person to such shareholders or by mailing such notice to shareholders at their addresses as the same appear on the stock books of the Corporation. A shareholder's attendance at a meeting will result in a waiver of objection to lack of notice or defective notice unless the shareholder, at the beginning of the meeting, objects to the holding of the meeting or the transaction of business at the meeting, and a waiver of objection to consideration of a particular matter at the meeting as not being within the purpose or purposes described in the meeting notice unless the shareholder objects to considering the matter when it is presented.

**Section 6. Voting Lists.** The Corporation's officer or agent having charge of its stock transfer books shall prepare and certify a complete list of the shareholders entitled to vote at a shareholders' meeting or any adjournment thereof, which list shall be arranged alphabetically within each class and series, and shall show the address of, and the number of shares held by each shareholder. The list shall be produced at the time and place of the meeting of shareholders and be subject to inspection by any shareholder at any time during the meeting. If for any reason the requirements with respect to the shareholder list specified in this Section 6 of Article III have not been complied with, any shareholder, either in person or by proxy, who in good faith challenges the existence of sufficient votes to carry any action at the meeting, may demand that the meeting be adjourned and the same shall be adjourned until the requirements are complied with; provided, however, that failure to comply with such requirements does not affect the validity of any action taken at the meeting before such demand is made.

**Section 7. Voting.** Each shareholder entitled to vote at a meeting of shareholders or to express consent or dissent without a meeting, shall be entitled to one (1) vote, in person or by proxy, for each share entitled to vote that is held by such shareholder; provided, however, no proxy shall be voted after three years from its date unless such proxy expressly provides for a longer period. A vote may be cast either orally or in writing as announced or directed by the person presiding at the meeting prior to the taking of the vote. When an action other than the election of directors is to be taken by vote of the shareholders, it shall be authorized by a majority of the votes cast by the holders of shares entitled to vote on the action, unless a greater vote is required by the Michigan Business Corporation Act. Directors shall be elected by a plurality of the votes cast in an election.

**Section 8. Quorum.** Shares equaling a majority of all of the voting shares of the capital stock of the Corporation issued and outstanding represented in person or by proxy, shall constitute a quorum at the meeting. Meetings at which less than a quorum is represented may be adjourned by a vote of a majority of the shares present to a further date without further notice other than the announcement at such meeting, and when the quorum shall be present upon such adjourned date, any business may be transacted which might have been transacted at the meeting as originally called. Shareholders present in person or by proxy at any meeting of shareholders may continue to do business until adjournment, notwithstanding the withdrawal of shareholders to leave less than a quorum.

**Section 9. Conduct of Meetings.** The officer who is to preside at meetings of shareholders pursuant to Article V of these Bylaws, or his or her designee, shall determine the agenda, the order in which business shall be conducted and rules for the conduct of the meeting (which shall be fair to shareholders), unless the agenda, the order of business and/or such rules have been fixed by the Board of Directors. Such officer or designee shall call meetings of shareholders to order and shall preside, shall appoint a person to act as secretary of the meeting, and may appoint a parliamentarian, who may be the same person as the secretary.

**Section 10. Inspectors of Elections.** The Board of Directors may, in advance of a meeting of shareholders, appoint one or more inspectors to act at the meeting or any adjournment thereof. In the event inspectors are not so appointed, or an appointed inspector fails to appear or act, the person presiding at the meeting of shareholders may appoint one or more persons to fill such vacancy or vacancies, or to act as inspector. The inspector(s) shall determine the number of shares outstanding and the voting power of each, the shares represented at the meeting, the existence of a quorum, the validity and effect of proxies, and shall receive votes, ballots, or consents, hear and determine challenges and questions arising in connection with the right to vote, count and tabulate votes, ballots or consents, determine the results, and do such acts as are proper to conduct the election or vote with fairness to all shareholders.

### **Section 11. Notice of Shareholder Proposals.**

(a) Except for the election of directors, which is governed by Article V of the Corporation's Articles of Incorporation, only such business shall be conducted at any meeting of shareholders, and only such proposals shall be acted upon at such meetings, as shall have been brought before the meeting: (i) by, or at the direction of, the Board of Directors; or (ii) by any shareholder of the Corporation who complies with the notice procedures set forth in this Section of these Bylaws. For a proposal to be properly brought before the meeting by a shareholder, the shareholder must have given timely notice thereof in writing to the Secretary of the Corporation. To be timely, a shareholder's notice must be delivered to, or mailed and received at, the principal executive offices of the Corporation not less than sixty (60) days nor more than ninety (90) days prior to the scheduled meeting date, regardless of any postponements, deferrals, or adjournments of that meeting to any later date; provided, however, that if less than seventy (70) days' notice, or prior public disclosure of the date of a scheduled meeting is given or made, notice by the shareholder to be timely must be delivered or received not later than the close of business on the tenth (10) day following the earlier of the day on which such notice of the date of the scheduled meeting was mailed or the day on which such public disclosure was made. A shareholder's notice to the Secretary shall set forth, as to each matter the shareholder proposes to bring before the meeting: (i) a brief

description of a proposal desired to be brought before the meeting and the reasons for conducting such business at the meeting; (ii) the name and address, as they appear, on the Corporation' s stock record of the shareholder proposing such business and any other shareholders known by such shareholder to be supporting such proposal; (iii) the class and number of shares of the Corporation' s stock which are beneficially owned by the shareholder on the date of such shareholder notice and by any other shareholders known by such shareholder to be supporting such proposal on the date of such shareholder notice; and (iv) any financial interest of the shareholder in such proposal.

(b) If the presiding officer at the meeting of shareholders determines that a shareholder proposal was not made in accordance with the terms of this Section, the presiding officer shall declare the matter to be out of order and the matter shall not be acted upon at the meeting.

(c) Nothing contained in this Section shall prevent the consideration and approval or disapproval at any meeting of shareholders of reports of officers, directors, and committees of the Board of Directors, but, in connection with such reports, no business shall be acted upon at such meeting unless stated, filed, and received as provided herein.

## ARTICLE IV. DIRECTORS

**Section 1. Board of Directors.** The authority and size of the Board of Directors, and the procedures for nominating, electing and removing directors shall be as specified in the Corporation's Articles of Incorporation. No person shall be elected as a director after he or she attains age seventy-two (72), and the term of any director shall expire upon the earlier to occur of: (i) the third succeeding annual meeting when his or her successor shall be duly elected and qualified; (ii) his or her resignation or removal; or (iii) his or her attaining age seventy-two (72).

**Section 2. Place of Meetings and Records.** The directors shall hold their meetings, and maintain the minutes of the proceedings of meetings of shareholders, Board of Directors, and executive and other committees, if any, and keep the books and records of account for the Corporation, in such place or places, within or outside the State of Michigan, as the Board may from time to time determine.

**Section 3. Regular Meetings of the Board.** Regular meetings of the Board of Directors may be held at such times and places and pursuant to such notice, if any, as may be established from time to time by resolution of the Board of Directors.

**Section 4. Special Meetings of the Board.** Special meetings of the Board of Directors may be called by the Chairman of the Board, or the Secretary, and shall be called by one of them upon the written request of a majority of the directors. Notice of the time and place of special meetings of the Board shall be given to each director at least twenty-four (24) hours prior thereto. Notices of special meetings may state a purpose or purposes for the meeting, but such notices shall not be required to state any purpose and shall not be deemed deficient if the statement or purpose is incomplete or inaccurate. Notice of any meeting may be made by hand delivery, telephone, facsimile or e-mail with confirmation, nationally recognized overnight mail service, or first class mail, to each director at such location as he or she may have furnished to the Corporation. The notice shall be deemed to have been given at the time of personal delivery, or telephone contact, or the time of confirmation for facsimile or e-mail, and as of the close of business on the first business day following the date delivered to the overnight or government mail carrier.

**Section 5. Quorum and Vote.** A majority of the members of the Board then in office constitutes a quorum for the transaction of business, and the vote of a majority of the members present at any meeting at which a quorum is present constitutes the action of the Board of Directors.

**Section 6. Meeting Participation.** A director may participate in a meeting of the Board of Directors or any committee by means of conference telephone or similar communications equipment through which all persons participating in the meeting can communicate with all other participants. Participation in a meeting pursuant to this Section shall constitute presence in person at the meeting.

**Section 7. Action of the Board Without a Meeting.** Any action required or permitted to be taken pursuant to authorization voted at a meeting of the Board of Directors may be taken without a meeting if, before or after the action, all members of the Board of Directors consent thereto in writing. Such written consent shall be filed with the minutes of the proceedings of the Board of Directors and the consent shall have the same effect as a vote of the Board of Directors for all purposes.

**Section 8. Report to Shareholders.** At least once in each year the Board of Directors shall cause a financial report of the Corporation for the preceding fiscal year to be made and distributed to each shareholder within four months after the end of such fiscal year. The report shall include the Corporation's statement of income, its year-end balance sheet and, if prepared by the Corporation's statement of source and application of funds.

**Section 9. Corporate Seal.** The Board of Directors may provide a suitable corporate seal, which seal shall be kept in the custody of the Secretary.

**Section 10. Compensation of Directors.** Each of the directors shall be entitled to receive compensation for service as a director and/or member of a committee of the Board of Directors and shall be reimbursed their expenses for attendance at meetings of the Board of Directors or any committee of which a director is a member, all in accordance with resolutions adopted by the Board of Directors from time to time.

**Section 11. Executive Committee.** The Board of Directors may by resolution establish an executive committee composed of two (2) or more of the directors to exercise such powers and authority of the Board of Directors to the extent provided in such resolution and not prohibited by the Michigan Business Corporation Act for the management of the business and affairs of the Corporation. Such committee shall exist, and each member thereof shall serve, at the pleasure of the Board of Directors.

**Section 12. Other Committees.** The Board of Directors shall establish a compensation committee and an audit committee, each composed of two (2) or more directors with such authority and responsibilities as are specified in the charters for those committees that are approved by the Board of Directors. In addition, the Board of Directors may, by resolution, establish such other committees from time to time as the directors think advisable with such purposes, authority and membership as may be set forth in the resolution establishing any such committee.

**Section 13. Directors Emeritus.** Any director of the Corporation serving prior to February 10, 2004, who serves the shorter of at least: (i) nine years or (ii) three maximum length terms of office as a director and who either resigns as a director or does not stand for reelection, shall be entitled to be considered for the position of "Director Emeritus." If nominated by the Nominating and Governance Committee and elected by the Board of Directors, a Director Emeritus shall continue in that position for a period equal to the time served as a regular director prior to February 10, 2004, or until an earlier resignation or death. During their tenure, Directors Emeritus shall be given notices of all meetings of the Board of Directors, and they shall perform such consulting services for the Corporation as the Board of Directors may reasonably request from time to time. Directors Emeritus shall be entitled to attend and participate in all such meetings of the Board of Directors, except that they may not vote and they shall not be counted for purposes of determining a quorum. Directors Emeritus shall receive an annual cash retainer fee equal to the lesser of: (i) the annual cash retainer fee in place at the time the director resigned as a director or did not stand for reelection; or (ii) the annual cash retainer fee in place at any time during the period such director holds the position of Director Emeritus, and shall be entitled to reimbursement for expenses of attendance at meetings of the Board, but they shall receive no other compensation from the Corporation.

## ARTICLE V. OFFICERS

**Section 1. Designation of Officers.** The officers of the Corporation shall consist of such officers as the Board of Directors shall determine from time to time, and may include a Chairman of the Board, a Chief Executive Officer, a President, a Secretary, a Treasurer, one or more Vice Presidents, and such other or different offices as may be established by the Board of Directors. The officers of the Corporation need not be directors or shareholders. Any two or more offices may be held by the same person, but an officer shall not execute, acknowledge or verify any instrument in more than one capacity if the instrument is required by law to be executed, acknowledged or verified by two or more officers.

**Section 2. Election of Officers.** The officers of the Corporation shall be elected at the first meeting of the Board of Directors, or by action taken pursuant to written consent, after the annual meeting of shareholders. Officers shall hold office for the term of their election and until their respective successors are elected and qualified, or until resignation or removal.

**Section 3. Resignation and Removal.** An officer may resign by written notice to the Corporation, which resignation is effective upon its receipt by the Corporation or at a subsequent time specified in the notice of resignation. Officers of the Corporation serve at the pleasure of the Board of Directors and may be removed by the Board at any time, with or without cause.

**Section 4. Compensation of Officers.** The Board of Directors, or an appropriate committee if one be appointed, may establish compensation of officers for services to the Corporation irrespective of the personal interest of any such director or committee member.

**Section 5. Chairman of the Board.** The Chairman of the Board of Directors shall be elected by the directors from among the directors then serving. The Chairman of the Board, shall preside at all meetings of the Board of Directors and shareholders, and shall perform such other duties as from time to time may be determined by resolution of the Board of Directors not inconsistent with these Bylaws.

**Section 6. Chief Executive Officer.** The Chief Executive Officer of the Corporation shall have such authority and shall perform such duties in the management of the Corporation as are usually vested in or incident to the office of a chief executive officer of a corporation. In



the absence or nonelection of the Chairman of the Board of Directors, the Chief Executive Officer shall preside at all meetings of the Board of Directors and meetings of the shareholders.

**Section 7. President.** The President shall be the chief operating officer of the Corporation and shall have such authority and shall perform such duties in the management of the Corporation as from time to time may be determined by resolution of the Board of Directors not inconsistent with these Bylaws.

**Section 8. Vice Presidents.** The Vice Presidents shall have such authority and shall perform such duties as shall be assigned to them by the Board of Directors and may be designated by such special titles as the Board of Directors shall approve.

**Section 9. Treasurer.** The Treasurer, if one be elected, shall have such authority and responsibilities as may be determined by the Board of Directors from time to time.

**Section 10. Secretary.** The Secretary shall give, or cause to be given, notice of all meetings of shareholders and directors and all other notices required by law or by these Bylaws, and in the case of his or her absence or refusal or neglect to do so, any such notice may be given by any person so directed by the Chief Executive Officer or by the directors. The Secretary shall maintain a record of all of the proceedings of minutes of shareholders, the Board of Directors and committees of the Board in one or more books provided for that purpose, and shall perform all duties incident to the office of Secretary, and such other duties as may be assigned by the Board of Directors.

**Section 11. Other Officers.** Other officers elected by the Board of Directors shall have such authority and shall perform such duties in the management of the Corporation as may be determined by resolution of the Board of Directors not inconsistent with these Bylaws. In addition, the Chairman of the Board and the Chief Executive Officer may jointly approve the employment of managerial employees for positions which may involve the use of the title of "Vice President" or some other official title, without the necessity of the Board of Directors' election of such person as an officer of the Corporation. In such case, such persons shall not constitute officers of the Corporation within the meaning of the Corporation's Articles of Incorporation or Bylaws, and they shall have such duties and authority as may be assigned to them by the Chairman and the Chief Executive Officer.

## ARTICLE VI. MISCELLANEOUS

**Section 1. Contracts.** The Board of Directors may authorize any officer or officers, agent or agents to enter into any contract or execute and deliver any instrument in the name of and on behalf of the Corporation, and such authority may be general or confined to specific instances.

**Section 2. Loans.** No loans shall be contracted on behalf of the Corporation, and no evidences of indebtedness shall be issued in its name, unless authorized by a resolution of the Board of Directors. Such authorization may be general or confined to specific instances.

**Section 3. Checks.** All checks, drafts, or other orders for the payment of money, notes or other evidences of indebtedness issued in the name of the Corporation shall be signed by such officer or officers, agent or agents of the Corporation and in such manner as shall from time to time be determined by resolution of the Board of Directors.

**Section 4. Deposits.** All funds of the Corporation, not otherwise employed, shall be deposited from time to time to the credit of the Corporation in such banks, trust companies, or other depositories as the Board of Directors may determine.

**Section 5. Fiscal Year.** The fiscal year of this Corporation shall be as determined by the Board of Directors.

**Section 6. Waiver of Notice.** Whenever any notice is required to be given under the provisions of any law, or the Articles of Incorporation for this Corporation, or these Bylaws, a waiver thereof in writing, signed by the person or persons entitled to said notice, whether before or after the time stated therein, shall be deemed equivalent thereto.

**Section 7. Voting of Securities.** Securities of another corporation or other equity interests standing in the name of this Corporation which are entitled to vote may be voted in person or by proxy by any executive officer of this Corporation or such other persons as may be designated by the Board of Directors.

**Section 8. Interpretation.** Unless the context of these Bylaws otherwise requires, the terms used in these Bylaws shall have the meanings specified in, and these Bylaws shall be interpreted and construed in accordance with, the Michigan Business Corporation Act.

## ARTICLE VII. AMENDMENTS

These Bylaws may be amended, repealed or new Bylaws adopted either by a majority vote of the Board of Directors at any regular or special meeting of the Board, and without prior notice of intent to do so, or by majority vote of shareholders at any annual or special meeting, if notice of the proposed amendment, repeal, or adoption be contained in the notice of such meeting.

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## ARTICLE VIII. INDEMNIFICATION

**Section 1. Indemnification of Directors.** The Corporation shall indemnify, to the fullest extent authorized or permitted by the Michigan Business Corporation Act, any person, and his or her estate and personal representatives, who is made or threatened to be made a party to an action, suit, or proceeding, whether civil, criminal, administrative or investigative, because such person is or was a director of the Corporation or served any other enterprise at the request of the Corporation.

**Section 2. Indemnification of Certain Officers.** The Corporation shall indemnify, to the fullest extent authorized or permitted by the Michigan Business Corporation Act, any officer or former officer of the Corporation, and his or her estate and personal representatives, who is made or threatened to be made a party to an action, suit, or proceeding, whether civil, criminal, administrative or investigative, that in any way involves or is related to such officer or former officer's duties, as specifically set forth by the Corporation's Board of Directors, involving any of the following: (a) dealing with persons buying, selling, proposing to buy or sell, or otherwise holding any securities issued by the Corporation, (b) dealing with securities analysts or any other security industry professionals with respect to securities issued by the Corporation, or (c) signing any statements certifying to the public, to the Securities Exchange Commission, or to any securities exchange, the Corporation's financial statements or any other reports of the Corporation. The determination as to whether an officer or former officer of the Corporation is entitled to indemnification under this provision shall be made by the Corporation's Board of Directors, in its sole discretion.

**FIRST AMENDMENT TO THE  
X-RITE, INCORPORATED AMENDED AND RESTATED  
OUTSIDE DIRECTOR STOCK OPTION PLAN**

THIS FIRST AMENDMENT TO THE X-RITE, INCORPORATED AMENDED AND RESTATED OUTSIDE DIRECTOR STOCK OPTION PLAN (the "Plan") has been adopted by the Board of Directors of X-Rite, Incorporated (the "Company") as of November 25, 2003, as follows:

**BACKGROUND**

1. Effective January 26, 2003, the Company's Board of Directors took action to amend and restate the Plan, subject to the approval of the Company's shareholders.
2. Effective May 19, 2003, the Company's shareholders approved the Plan.
3. Under Section 3.3 of the Plan, the Company's Board of Directors may amend the Plan from time to time, except with respect to certain matters.
4. The subject of this Amendment is within the Board of Directors' authority under the Plan.
5. The Board of Directors has elected to amend Section 1.5 of the Plan to provide for the pro-ration of the stock options granted to a director during a term in which that director reaches age 72.

**AGREEMENT**

1. Section 1.5 of the Plan is hereby deleted in its entirety and replaced as follows:
  - 1.5 Eligibility; Grant of Options. Only Outside Directors shall be eligible to receive options under this Plan. Effective as of the date of each annual meeting of the shareholders of X-Rite, Incorporated, each Outside Director who is newly elected or continues in office as a director subsequent to that meeting shall be granted an option to acquire 8,000 shares of stock; provided, however, that as of the date of the annual meeting immediately prior to the term year in which any director will attain age 72 (the "Final Annual Meeting"), the option granted shall be only for that number of shares that is equal to 8,000 shares of stock multiplied by a fraction, the numerator of which shall be the number of days to be served from the Final Annual Meeting to the date on which the director attains age 72, and the denominator of which shall be 365; the result shall be rounded to the nearest whole share. Any Outside Director who is elected as a director by the Board shall be granted an option to acquire that number of shares that is equal to 8,000 shares of stock multiplied by a fraction that is equal to 365 minus the number of days that have elapsed since the last annual meeting of shareholders and dividing that difference by 365; the result shall be rounded to the nearest whole share.
2. Except as set forth above, the Plan and its terms are hereby ratified and shall continue in full force and effect.

**CERTIFICATION**

The foregoing Amendment to the Plan was duly adopted and approved by the Company's Board of Directors on November 25, 2003.

**X-RITE, INCORPORATED**

s/s Mary E. Chowning

Mary E. Chowning

Secretary

**Certificate of the Chief Executive Officer  
of X-Rite, Incorporated**

I, Michael C. Ferrara, certify that:

(1) I have reviewed this annual report on Form 10-Q of X-Rite, Incorporated;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15 (e)) for the registrant and have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

(5) The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 12, 2004

/s/ Michael C. Ferrara

Michael C. Ferrara

Chief Executive Officer and President

**Certificate of the Chief Financial Officer  
of X-Rite, Incorporated**

I, Mary E. Chowning, certify that:

(1) I have reviewed this annual report on Form 10-Q of X-Rite, Incorporated;

(2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

(3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

(4) The registrant's other certifying officers and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15 (e)) for the registrant and have:

(a) designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

(b) evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

(c) disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

(5) The registrant's other certifying officers and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

(a) all significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

(b) any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: August 12, 2004

/s/ Mary E. Chowning

Mary E. Chowning

Vice President and Chief Financial Officer

**Certificate of the Chief Executive Officer  
of X-Rite, Incorporated.**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350):

I, Michael C. Ferrara, Chief Executive Officer of X-Rite, Incorporated, certify, to the best of my knowledge and belief, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350) that:

(1) The quarterly report on Form 10-Q for the quarter ending July, 3, 2004, which this statement accompanies, fully complies with requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and;

(2) The information contained in this quarterly report on Form 10-Q for the quarter ending July 3, 2004 fairly presents, in all material respects, the financial condition and results of operations of X-Rite, Incorporated as of and for the period covered by this report.

Date: August 12, 2004

By: /s/ Michael C. Ferrara

Michael C. Ferrara

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to X-Rite, Incorporated, and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

The foregoing certification is being furnished to the Securities and Exchange Commission as an exhibit to the Form 10-Q and shall not be considered filed as part of the Form 10-Q.



**Certificate of the Chief Financial Officer  
of X-Rite, Incorporated.**

Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350):

I, Mary E. Chowning, Chief Financial Officer of X-Rite, Incorporated, certify, to the best of my knowledge and belief, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 (18 U.S.C. 1350) that:

(1) The quarterly report on Form 10-Q for the quarterly period ending July 3, 2004, which this statement accompanies, fully complies with requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 and;

(2) The information contained in this quarterly report on Form 10-Q for the quarterly period ending July 3, 2004 fairly presents, in all material respects, the financial condition and results of operations of X-Rite, Incorporated as of and for the period covered by this report.

Date: August 12, 2004

By: /s/ Mary E. Chowning

Mary E. Chowning

A signed original of this written statement required by Section 906, or other document authenticating, acknowledging, or otherwise adopting the signature that appears in typed form within the electronic version of this written statement required by Section 906, has been provided to X-Rite, Incorporated, and will be retained by the Company and furnished to the Securities and Exchange Commission or its staff upon request.

The foregoing certification is being furnished to the Securities and Exchange Commission as an exhibit to the Form 10-Q and shall not be considered filed as part of the Form 10-Q.