

EASTERN CO  
Form 10-Q  
October 29, 2007

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549**

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED September 29, 2007**

**OR**

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM to**

**Commission File Number:** 0599

**THE EASTERN COMPANY**  
(Exact name of registrant as specified in its charter)

**Connecticut** 06-0330020  
(State or other jurisdiction of (I.R.S. Employer  
incorporation or organization) Identification No.)

**112 Bridge Street, Naugatuck, Connecticut** 06770  
(Address of principal executive offices) (Zip Code)

**(203) 729-2255**  
(Registrant's telephone number, including area code)

**Not applicable**  
(Former name, former address and former fiscal year, if changed since last report)

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.

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Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

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

Yes  No

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

Class  
Common Stock, No par value

Outstanding as of September 29, 2007  
5,737,999

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## PART 1 FINANCIAL INFORMATION

## ITEM 1 FINANCIAL STATEMENTS

## THE EASTERN COMPANY AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

ASSETS	<u>September 29, 2007</u>	<u>December 30, 2006</u>
<b>Current Assets</b>		
Cash and cash equivalents	\$ 7,610,063	\$ 3,101,458
Accounts receivable, less allowances: \$368,000 - 2007; \$319,000 - 2006	21,686,949	24,859,152
Inventories	28,502,943	28,042,566
Prepaid expenses and other assets	2,561,126	2,391,425
Deferred income taxes	1,207,826	931,641
<b>Total Current Assets</b>	<b>61,568,907</b>	<b>59,326,242</b>
<b>Property, Plant and Equipment</b>	<b>49,464,918</b>	<b>46,858,651</b>
<b>Accumulated depreciation</b>	<b>(24,242,564)</b>	<b>(21,042,934)</b>
	<b>25,222,354</b>	<b>25,815,717</b>
<b>Goodwill</b>	<b>13,931,776</b>	<b>13,742,160</b>
<b>Trademarks</b>	<b>117,959</b>	<b>117,959</b>
<b>Patents, technology, and licenses, less accumulated amortization</b>	<b>4,064,879</b>	<b>4,216,508</b>
<b>Prepaid pension cost</b>	<b>321,963</b>	<b>266,358</b>
	<b>18,436,577</b>	<b>18,342,985</b>
<b>TOTAL ASSETS</b>	<b>\$ 105,227,838</b>	<b>\$ 103,484,944</b>
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 8,680,318	\$ 13,170,491
Accrued compensation	2,418,319	3,098,525
Other accrued expenses	1,372,672	4,399,358
Current portion of long-term debt	3,120,728	3,111,908
<b>Total Current Liabilities</b>	<b>15,592,037</b>	<b>23,780,282</b>
<b>Deferred income taxes</b>	<b>1,123,537</b>	<b>1,123,537</b>
<b>Other long-term liabilities</b>	<b>1,231,358</b>	
<b>Long-term debt, less current portion</b>	<b>15,165,137</b>	<b>17,506,802</b>
<b>Accrued postretirement benefits</b>	<b>1,219,310</b>	<b>1,221,156</b>
<b>Accrued pension cost</b>	<b>4,022,288</b>	<b>5,323,550</b>
<b>Interest rate swap obligation</b>	<b>264,448</b>	<b>138,412</b>
<b>Shareholders Equity</b>		
Preferred Stock, no par value: Authorized and unissued 2,000,000 shares		
Common Stock, no par value: Authorized: 50,000,000 shares		
Issued: 8,278,861 shares in 2007 and 8,011,535 shares in 2006	21,353,979	17,974,115
Treasury Stock: 2,540,862 shares in 2007 and 2,533,089 shares in 2006	(16,878,126)	(16,655,041)
Retained earnings	65,834,749	58,279,371
Accumulated other comprehensive income (loss):		
Foreign currency translation	2,158,582	756,452
Unrecognized net pension and postretirement benefit costs, net of tax	(5,691,695)	(5,875,261)
Derivative financial instruments, net of taxes	(167,766)	(88,431)

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Accumulated other comprehensive loss	(3,700,879	)	(5,207,240	)
<b>Total Shareholders' Equity</b>	<b>66,609,723</b>		54,391,205	
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 105,227,838</b>		\$ 103,484,944	

*See accompanying notes.*

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## THE EASTERN COMPANY AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Nine Months Ended		Three Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
<b>Net sales</b>	<b>\$ 122,520,357</b>	<b>\$ 88,735,730</b>	<b>\$ 36,027,712</b>	<b>\$ 31,206,388</b>
Cost of products sold	(93,359,015 )	(69,165,262 )	(29,038,496 )	(24,594,665 )
Gross margin	29,161,342	19,570,468	6,989,216	6,611,723
Selling and administrative expenses	(14,708,553 )	(13,145,284 )	(4,796,997 )	(4,422,616 )
Operating profit	14,452,789	6,425,184	2,192,219	2,189,107
Interest expense	(985,423 )	(732,294 )	(292,962 )	(261,193 )
Other income	152,933	132,337	62,971	84,707
<b>Income before income taxes</b>	<b>13,620,299</b>	<b>5,825,227</b>	<b>1,962,228</b>	<b>2,012,621</b>
Income taxes	4,427,063	1,801,738	255,586	345,454
<b>Net income</b>	<b>\$ 9,193,236</b>	<b>\$ 4,023,489</b>	<b>\$ 1,706,642</b>	<b>\$ 1,667,167</b>
<b>Earnings per Share:</b>				
Basic	\$ 1.64	\$ .74	\$ .30	\$ .30
Diluted	\$ 1.54	\$ .70	\$ .29	\$ .29
<b>Cash dividends per share:</b>	<b>\$ .24</b>	<b>\$ .23</b>	<b>\$ .08</b>	<b>\$ .08</b>

See accompanying notes.

## THE EASTERN COMPANY AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Nine Months Ended		Three Months Ended	
	September 29, 2007	September 30, 2006	September 29, 2007	September 30, 2006
Net income	\$ 9,193,236	\$ 4,023,489	\$ 1,706,642	\$ 1,667,167
Other comprehensive income/(loss):				
Change in foreign currency translation	1,402,130	180,073	543,948	(20,884)
Change in unrecognized net pension and postretirement benefit costs, net of taxes of \$105,788 and \$35,581	183,566		61,740	
Change in fair value of derivative financial instruments, net of income taxes of:				
2007 (\$46,701) and				
(\$115,183), respectively				
2006 \$14,680 and				
(\$34,407), respectively	(79,335 )	26,339	(199,868 )	(60,218 )

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Reclassification adjustment for termination of  
derivative financial instrument net of income  
taxes of \$26,477

<b>1,506,361</b>	(46,623 )	<b>405,820</b>	(46,623 )
	159,789		(127,725 )

Comprehensive income	<b>\$ 10,699,597</b>	\$ 4,183,278	<b>\$ 2,112,462</b>	\$ 1,539,442
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*See accompanying notes.*

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## THE EASTERN COMPANY AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine Months Ended September 29, 2007	September 30, 2006
<b>Operating Activities</b>		
Net income	\$ 9,193,236	\$ 4,023,489
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	3,384,316	2,649,880
Provision for doubtful accounts	33,075	14,385
Loss on sale of equipment and other assets	9,997	
Issuance of Common Stock for directors' fees	39,884	56,803
Changes in operating assets and liabilities:		
Accounts receivable	3,429,937	(3,116,304 )
Inventories	(38,620 )	(3,151,149 )
Prepaid expenses and other	(149,578 )	(420,103 )
Prepaid pension cost	(1,067,512 )	(557,307 )
Other assets	(166,120 )	(117,572 )
Accounts payable	(4,632,587 )	3,176,055
Accrued compensation	(707,479 )	392,272
Other accrued expenses	(2,491,632 )	(571,254 )
<b>Net cash provided by operating activities</b>	<b>6,836,917</b>	<b>2,379,195</b>
<b>Investing Activities</b>		
Purchases of property, plant and equipment	(2,039,394 )	(3,371,840 )
Business acquisition		(7,025,000 )
Proceeds from sale of equipment and other assets	23,350	15,035
<b>Net cash used in investing activities</b>	<b>(2,016,044 )</b>	<b>(10,381,805 )</b>
<b>Financing Activities</b>		
Principal payments on long-term debt	(2,332,844 )	(15,191,389 )
Proceeds from issuance of long-term debt		20,000,000
Proceeds from revolving credit loan		304,837
Proceeds from sales of Common Stock	1,966,728	203,700
Tax benefit from exercise of incentive stock options	1,373,253	
Purchases of Common Stock for treasury	(223,085 )	
Dividends paid	(1,341,929 )	(1,276,768 )
<b>Net cash (used in)/provided by financing activities</b>	<b>(557,877 )</b>	<b>4,040,380</b>
<b>Effect of exchange rate changes on cash</b>	<b>245,609</b>	<b>(71,210 )</b>
<b>Net change in cash and cash equivalents</b>	<b>4,508,605</b>	<b>(4,033,440 )</b>
Cash and cash equivalents at beginning of period	3,101,458	6,345,947
<b>Cash and cash equivalents at end of period</b>	<b>\$ 7,610,063</b>	<b>\$ 2,312,507</b>

See accompanying notes.





THE EASTERN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

SEPTEMBER 29, 2007

**Note A - Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by generally accepted accounting principles in the United States for complete financial statements. Refer to the Company's consolidated financial statements and notes thereto included in its Form 10-K for the year ended December 30, 2006 for additional information.

The accompanying condensed consolidated financial statements are unaudited. However, in the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of the results of operations for interim periods have been reflected therein. All intercompany accounts and transactions are eliminated. Operating results for interim periods are not necessarily indicative of the results that may be expected for the full year.

Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications had no effect on previously reported net income.

The condensed consolidated balance sheet as of December 30, 2006 has been derived from the audited consolidated balance sheet at that date.

As discussed in Note K, effective December 31, 2006, the Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* ( FIN 48 ).

**Note B Earnings Per Share**

The denominators used in the earnings per share computations follow:

	<b>Nine Months Ended September 29, 2007</b>	<b>September 30, 2006</b>	<b>Three Months Ended September 29, 2007</b>	<b>September 30, 2006</b>
<b>Basic:</b>				
Weighted average shares outstanding	<b>5,589,905</b>	5,472,682	<b>5,669,274</b>	5,477,302
<b>Diluted:</b>				
Weighted average shares outstanding	<b>5,589,905</b>	5,472,682	<b>5,669,274</b>	5,477,302

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Dilutive stock options	<b>384,329</b>	266,776	<b>273,255</b>	288,845
Denominator for diluted earnings per share	<b>5,974,234</b>	5,739,458	<b>5,942,529</b>	5,766,147

**Note C - Inventories**

The components of inventories follow:

	<b>September 29, 2007</b>	<b>December 30, 2006</b>
<b>Raw material and component parts</b>	\$ 8,151,842	\$ 8,008,603
<b>Work in process</b>	6,470,168	6,366,354
<b>Finished goods</b>	13,880,933	13,667,609
	<b>\$ 28,502,943</b>	<b>\$ 28,042,566</b>

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**Note D Segment Information**

Segment financial information follows:

	Nine Months Ended September 29, 2007	September 30, 2006	Three Months Ended September 29, 2007	September 30, 2006
<b>Revenues:</b>				
<b>Sales to unaffiliated customers:</b>				
<b>Industrial Hardware</b>	\$ 66,015,019	\$ 43,279,116	\$ 16,662,475	\$ 15,930,809
<b>Security Products</b>	46,127,092	36,034,888	16,180,366	12,529,709
<b>Metal Products</b>	10,378,246	9,421,726	3,184,871	2,745,870
	\$ 122,520,357	\$ 88,735,730	\$ 36,027,712	\$ 31,206,388
<b>Income/(loss) before income taxes:</b>				
<b>Industrial Hardware</b>	\$ 11,932,596	\$ 4,330,439	\$ 798,509	\$ 2,131,709
<b>Security Products</b>	4,056,059	3,502,032	1,662,688	1,080,067
<b>Metal Products</b>	(1,535,866 )	(1,407,287 )	(268,978 )	(1,022,669 )
<b>Operating Profit</b>	14,452,789	6,425,184	2,192,219	2,189,107
<b>Interest expense</b>	(985,423 )	(732,294 )	(292,962 )	(261,193 )
<b>Other income</b>	152,933	132,337	62,971	84,707
	\$ 13,620,299	\$ 5,825,227	\$ 1,962,228	\$ 2,012,621

**Note E Recent Accounting Pronouncements**

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* ( SFAS No. 157 ). This standard clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The Company has not yet determined the impact, if any, that the adoption of SFAS No. 157 will have on our results of operations or financial condition. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* ( SFAS No. 159 ). SFAS No 159, which amends SFAS No. 115 allows certain financial assets and liabilities to be recognized, at the company's election, at fair market value, with any gains or losses for the period recorded in the statement of income. This gives a company the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Currently, the Company records the gains or losses for the period in the statement of comprehensive income and in the equity section of the balance sheet. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company has not determined the impact, if any, of the adoption of SFAS No. 159.

**Note F - Debt**

The interest rates on the term and the revolving credit portions of the Loan Agreement vary. The interest rates may vary based on the LIBOR rate plus a margin spread of 1.0% to 1.65% for the term portion and 1.0% to 1.6% for the revolving credit portion. The margin rate spread is based on operating results calculated on a rolling-four-quarter basis. The Company may also borrow funds at the lender's prime rate. On September 29, 2007, the interest rate on the term portion of the Loan Agreement was 6.36%. The interest rate on interim borrowings during the

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first quarter of 2007 under the revolving loan was 8.25%, the bank's prime rate. The Company did not utilize the revolver during the second or third quarter of 2007.

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**Note G Goodwill**

The following is a roll-forward of goodwill from year-end 2006 to the end of the third quarter 2007:

	<b>Industrial Hardware Segment</b>	<b>Security Products Segment</b>	<b>Metal Products Segment</b>	<b>Total</b>
Beginning balance	\$ 1,908,344	\$ 11,833,816	\$	\$ 13,742,160
Foreign exchange	189,616			