SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1994-02-10** | Period of Report: **1994-01-02**
SEC Accession No. 0000034257-94-000001

(HTML Version on secdatabase.com)

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FAIRCHILD INDUSTRIES INC /DE/

CIK:**34257**| IRS No.: **520579835** | State of Incorp.:**DE** | Fiscal Year End: **0630**
Type: **10-Q** | Act: **34** | File No.: **001-03102** | Film No.: **94505697**
SIC: **3452** Bolts, nuts, screws, rivets & washers

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549

FORM 10-Q

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

For the quarterly period ended January 2, 1994

Commission File Number: 1-3102

FAIRCHILD INDUSTRIES, INC.
(Exact name of registrant as specified in its charter)

Delaware	52-0579835
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

Washington Dulles International Airport
300 West Service Road, P.O. Box 10803
Chantilly, Virginia 22021
(Address of principal executive offices)
(Zip Code)

(703) 478-5800
(Registrant's telephone number, including area code)

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 X No

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

Class	Outstanding at January 2, 1994

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Common Stock, $.01 par value 14,000,000

FAIRCHILD INDUSTRIES, INC. AND CONSOLIDATED SUBSIDIARIES*

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*For purposes of Part I of this Form 10-Q, the term "Company" means Fairchild Industries, Inc., and its subsidiaries, unless otherwise indicated. For purposes of Part II, the term "Company" means Fairchild Industries, Inc. unless otherwise indicated.

PART 1. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

<TABLE>

FAIRCHILD INDUSTRIES, INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS

<CAPTION>

(In thousands)

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ASSETS	January 2, 1994 (Unaudited)	June 30, 1993 (*)
<S>	<C>	<C>
Current Assets:		
Cash and cash equivalents....................	$ 4,785	$ --
Accounts receivable-trade, less allowances of $1,664 and $1,746......................	65,671	63,767
Inventories:		
Finished goods...........................	47,120	51,776
Work-in-process..........................	24,821	30,766
Raw materials............................	8,748	8,987
	80,689	91,529
Prepaid expenses and other current assets....	17,988	22,698
Total Current Assets........................	169,133	177,994
Property, plant and equipment, net of accumulated depreciation of $70,771 and $62,639.................................	168,160	176,869
Net assets held for sale.....................	29,604	27,808
Cost in excess of net assets acquired, (Goodwill) less accumulated amortization of $26,626 and $24,149......................	201,808	208,689
Prepaid pension assets.......................	18,935	15,837
Other assets.................................	29,151	32,813
Total Assets.................................	$616,791	$640,010

*Condensed from audited financial statements.

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.
</TABLE>
<TABLE>

FAIRCHILD INDUSTRIES, INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
<CAPTION>
(In thousands)

LIABILITIES AND STOCKHOLDERS' EQUITY	January 2, 1994 (Unaudited)	June 30, 1993 (*)
<S>	<C>	<C>
Current Liabilities:		
Bank notes payable and current maturities of long-term debt...........	$ 12,152	$ 50,437
Accounts payable.........................	26,606	28,826

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Due to affiliated companies..............	44,766	2,748
Other accrued liabilities................	61,473	63,704
	-------	-------
Total Current Liabilities................	144,997	145,715
Long-term debt, less current maturities..	228,826	232,929
Other long-term liabilities..............	16,792	15,733
Retiree health care liabilities..........	49,758	49,035
Noncurrent income taxes..................	26,353	23,950
	-------	-------
Total Liabilities........................	466,726	467,362
Redeemable Preferred Stock: $3.60 Cumulative Series A Convertible Preferred Stock, without par value, 424,701 shares authorized, issued and outstanding at redemption value of $45.00 per share....................	19,112	19,112
Stockholders' Equity:		
Series B Preferred Stock, without par value, 3,000 shares authorized, 2,025 and 1,976 issued and outstanding; liquidation value of $100,000 per share	202,500	197,600
Series C Cumulative Preferred Stock, without par value, 558,360 shares authorized, issued and outstanding; liquidation value of $45.00 per share..	24,015	24,015
Common stock, par value of $.01 per share, 14,000,000 shares authorized, issued, and outstanding................	140	140
Paid-in capital..........................	2,390	2,230
Accumulated deficit......................	(98,711)	(73,115)
Cumulative translation adjustment........	619	2,666
	-------	-------
Total Stockholders' Equity...............	130,953	153,536
	-------	-------
Total Liabilities and Stockholders' equity.................................	$616,791	$640,010
	=======	=======

*Condensed from audited financial statements.

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

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<TABLE>

FAIRCHILD INDUSTRIES, INC. AND CONSOLIDATED SUBSIDIARIES
CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited)

<CAPTION>

	Three Months Ended		Six Months Ended	
(In thousands)	January 2, 1994	December 27, 1992	January 2, 1994	December 27, 1992

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<S> <C> <C> <C> <C>

Revenue:				
Sales	$105,392	$116,548	$211,742	$234,648
Other income - net	79	1,627	218	3,081
	105,471	118,175	211,960	237,729
Costs and Expenses:				
Cost of sales	81,030	86,895	165,878	173,078
Selling, general & administrative	16,983	18,399	34,944	37,344
Research and development	585	905	1,291	1,825
Amortization of goodwill	1,465	1,460	2,969	2,903
Restructuring	9,903	1,500	9,903	1,500
	109,966	109,159	214,985	216,650
Operating income (loss)	(4,495)	9,016	(3,025)	21,079
Interest expense	4,949	6,954	14,167	14,356
Interest income	(84)	(238)	(179)	(459)
Net interest expense	4,865	6,716	13,988	13,897
Investment income - net	1,900	--	2,800	--
Equity in earnings of affiliates	141	100	280	246
Minority interest	10	(51)	(2)	(189)
Earnings (loss) from continuing operations before taxes	(7,309)	2,349	(13,935)	7,239
Income tax (benefit) provision	(1,018)	1,058	(2,879)	3,258
Earnings (loss) from continuing operations	(6,291)	1,291	(11,056)	3,981
Extraordinary items - net	--	23	--	(810)
Cumulative effect of change in accounting for postretirement benefits	--	--	(252)	--
Cumulative effect of change in accounting for income taxes	--	--	(11,486)	--
Net earnings (loss)	(6,291)	1,314	(22,794)	3,171
Series A Preferred Dividends	382	567	764	949
Series C Preferred Dividends	594	593	1,187	973
Net earnings (loss) after Preferred Dividends	$ (7,267)	$ 154	$(24,745)	$ 1,249
Dividend to RHI Holdings, Inc. (parent)	$ --	$ 30,000	$ --	$ 50,000

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.
</TABLE>
<TABLE>

FAIRCHILD INDUSTRIES, INC. AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

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(Unaudited)

<CAPTION>
(In thousands)

<S>	Six Months Ended January 2, 1994 <C>	Six Months Ended December 27, 1992 <C>
Cash provided by (used for)		
Operations:		
Net earnings (loss)	$(22,794)	$ 3,171
Depreciation and amortization	15,830	13,998
Accretion of discount on long-term liabilities	1,560	2,014
Adjustments for other non-cash charges	19,510	2,499
Adjustments for non-cash credits	(280)	(246)
Loss (gain) on sale of fixed assets	347	(72)
Changes in assets and liabilities	(3,036)	5,513
Cash provided by operations	11,137	26,877
Investments:		
Capital expenditures	(5,620)	(5,806)
Other - net	(1,653)	(244)
Cash used for investments	(7,273)	(6,050)
Financing:		
Issuance of debt	89,920	129,139
Debt repayments - net	(90,293)	(98,277)
Issuance of Series B preferred stock	4,000	5,000
Issuance of Series C preferred stock	--	24,354
Exchange of Series A preferred stock	--	(25,126)
Dividends	(1,951)	(51,831)
Other - net	144	--
Cash provided by (used for) financing	1,820	(16,741)
Effect of exchange rate changes on cash	(899)	(1,028)
Net increase in cash	4,785	3,058
Cash, beginning of period	--	5,015
Cash, end of period	$ 4,785	$ 8,073

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.
</TABLE>

FAIRCHILD INDUSTRIES, INC. AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

Note 1 - Financial Statements

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The consolidated balance sheet as of January 2, 1994, and the consolidated statements of earnings and cash flows for the six months ended January 2, 1994 and December 27, 1992, have been prepared by the Company, without audit. In the opinion of management, all adjustments (consisting of normal recurring adjustments) necessary to present fairly the financial position, results of operations and cash flows at January 2, 1994, and for all periods presented have been made. The balance sheet at June 30, 1993, was condensed from audited financial statements as of that date.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in the Company's June 30, 1993, Form 10-K. The results of operations for the period ended January 2, 1994 are not necessarily indicative of the operating results for the full year. Certain amounts in prior years' quarterly financial statements have been reclassified to conform to the current presentation.

Note 2 - Acquisitions

Within the last few years, Fairchild Communications Services Company ("Fairchild Communications"), a partnership whose partners are indirect subsidiaries of the Company, has completed the acquisition of several small companies involved in the sale of telecommunications services and equipment to tenants in commercial office buildings. In the third quarter of Fiscal 1993, Fairchild Communications acquired all the telecommunication assets of Office Networks, Inc., for approximately $7,300,000.

Note 3 - Net Assets Held for Sale

Property, plant and equipment, for which sale is expected to be completed within one year, is included in net assets held for sale. Sales from a division included in net assets held for sale, and not included in results of operations, were $7,579,000 for the six months ended January 2, 1994. The impact of this division's earnings was immaterial.

Net assets held for sale are recorded at estimated net realizable values which reflect anticipated sales proceeds, operating results to the expected date of sale and other carrying costs to be incurred during the holding period. Interest is not allocated to net assets held for sale.

Note 4 - Credit Agreement Amendment

The Company's Credit Agreement requires the Company to comply with certain financial covenants, including achieving cumulative earnings before interest, taxes, depreciation and amortization, ("EBITDA Covenant"), and maintaining certain coverage ratios. The Credit Agreement was amended to relax the EBITDA Covenant to permit compliance as of October 3, 1993 despite the decline in the earnings of the Company's Aerospace Fasteners segment. To comply with the minimum EBITDA covenant requirements (as amended and defined) the Company's subsidiary, VSI Corporation ("VSI"), must earn for the cumulative total of the trailing four quarters EBITDA as follows: $62,000,000 for the third quarter of Fiscal 1994, $67,000,000 for the fourth quarter of Fiscal 1994, $73,600,000 for the first quarter of Fiscal 1995 and $75,360,000 for the second quarter of Fiscal 1995. VSI's ability to meet the EBITDA covenant in Fiscal 1994 is uncertain and there can be no assurance that the Company will be able to comply with the financial covenants in the

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future. Noncompliance with any of the financial covenants without cure or waiver would constitute an event of default under the Credit Agreement. An event of default resulting from a breach of a financial covenant may result, at the option of lenders holding a majority of the loans, in an acceleration of the principal and interest outstanding, and a termination of the revolving credit line.

Note 5 - Post Retirement Benefits

Effective July 1, 1993, the Company adopted Statement of Financial Accounting Standards No. 106 ("FASB 106"), "Accounting for Postretirement Benefits Other Than Pensions". This new standard requires that the expected cost of postretirement benefits be accrued and charged to expense during the years the employees render the service. This is a significant change from the Company's previous policy of expensing these costs for active employees when paid.

The Company elected the immediate recognition method of adoption of FASB 106. The unamortized portion of the overstated liability for discontinued operations substantially offset the transition obligation for active employees and retirees of continuing operations, and the charge to net earnings from the cumulative effect of this accounting change was $252,000. As a result of the reduction in the liability for discontinued operations, interest expense accrued on this liability will be lower in future years by approximately $1,500,000 compared to prior years. However, the adoption of FASB 106 will cause the postretirement medical expense for continuing operations to increase by approximately $1,100,000 per year.

Note 6 - Income Taxes

Effective July 1, 1993, the Company changed its method of accounting for income taxes from the deferred method to the liability method required by Statement of Financial Accounting Standards No. 109 ("FASB 109"), "Accounting for Income Taxes".

Under the liability method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. Prior to the adoption of FASB 109, income tax expense was determined using the deferred method. Deferred tax expense was based on items of income and expense that were reported in different years in the financial statements and tax returns and were measured at the tax rate in effect in the year the difference originated.

As permitted under FASB 109, prior years' financial statements have not been restated. The Company elected the immediate recognition method and recorded a $11,486,000 charge representing the prior years' cumulative effect. This charge represents deferred taxes that had to be recorded related primarily to fixed assets, prepaid pension expense, and inventory differences.

Note 7 - Redeemable Preferred Stock

The Company's Series A Preferred Stock has a mandatory redemption value of $45.00 per share and an annual dividend requirement of $3.60 per share. There were 424,701 shares of Series A Preferred Stock authorized, issued and outstanding at January 2, 1994 and June 30, 1993.

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Note 8 - Commitments and Contingencies

Lease Guaranties
- ----------------

In connection with the sale of Metro Credit Corporation, the Company remained contingently liable as a guarantor of the payment and performance of obligations of third party lessees under aircraft leases, which call for aggregate annual base lease payments of approximately $3,454,000 in 1994, and approximately $13,124,000 over the remaining 5-year guaranty period. In each case, the Company has been indemnified by the purchasers and lessees from any losses related to such guaranties.

Government Claims
- -----------------

In 1989, the Company learned through its own quality assurance procedures, and voluntarily disclosed to its customers and the Department of Defense, that certain units of VSI had not performed certain production lot tests mentioned in the military specifications for some limited product lines. As a result, VSI is subject to an ongoing investigation, in which the Company is cooperating, by the Inspector General of the Department of Defense (the "IG") relating to these tests. The Company does not believe that VSI's level of testing resulted in shipment of unsafe products or that purchasers were otherwise damaged, and the government subsequently reduced certain of the test requirements. The government and the Company haved reached an agreement in principle to settle this matter for $330,000.

VSI has agreed to plead guilty to a two-count Information under which it would pay a fine of $230,000, upon acceptance of the plea by a federal court in the Western District of Washington. The Information alleges that VSI conspired (i) to submit non-competitive bids for certain contracts for a single class of aluminum fast rivets, in violation of Section 1 of the Sherman Act, and (ii) to impede a legitimate function of the Internal Revenue Service.

Following an investigation by the Inspector General of NASA, the civil division of the United States Department of Justice alleged improprieties in years 1982 and 1984 through 1986 in indirect costs rates and labor charging practices for a former subsidiary of the Company. The Company entered into settlement discussions with the Department of Justice to attempt to resolve these claims and has reached an agreement in principle with the government to settle this matter for $5,000,000, payable in six equal semi-annual installments, with interest at 6.0% per year. The unpaid balance will likely be collateralized by certain excess real estate. If the settlement is not consummated, the government may initiate suit under the False Claims Act, seeking treble damages and penalties, and under the Truth in Negotiations Act, seeking a price reduction on certain contracts and subcontracts.

The Corporate Administrative Contracting Officer (the "ACO"), based upon the advice of the United States Defense Contract Audit Agency has made a determination that FII did not comply with Cost Accounting Standards in accounting for (i) the 1985 reversion to FII of certain assets of terminated defined benefit pension plans and (ii) pension costs upon the closing of segments of the Company's business. The ACO has directed FII to prepare cost impact proposals relating to such plan terminations and segment closings and, following receipt of such cost impact proposals, may seek adjustments to contract prices, in amounts which the Company cannot determine. The ACO

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alleges that substantial amounts will be due if such adjustments are made. The Company believes it has properly accounted for the asset reversions in accordance with applicable accounting standards. The Company has entered into discussions with the government to attempt to resolve these pension accounting issues.

Environmental Matters

The Company and other aerospace fastener and industrial product manufacturers are subject to stringent Federal, state and local environmental laws and regulations concerning, among other things, the discharge of materials into the environment and the generation, handling, storage, transportation and disposal of waste and hazardous materials. To date, such laws and regulations have not had a material effect on the financial condition of the Company, although the Company has expended, and can be expected to expend in the future, significant amounts for investigation of environmental conditions and installation of environmental control facilities, remediation of environmental conditions and other similar matters, particularly in the Aerospace Fasteners segment.

In connection with its plans to dispose of certain real estate, the Company must investigate environmental conditions and may be required to take certain corrective action prior or pursuant to any such disposition. In addition, management has identified several areas of potential contamination at or from other facilities owned, or previously owned, by the Company, that may require the Company either to take corrective action or to contribute to a clean-up. The Company is also a defendant in certain lawsuits and proceedings seeking to require the Company to pay for investigation or remediation of environmental matters and has been alleged to be a potentially responsible party at various "Superfund" sites. Management of the Company believes that it has recorded adequate reserves in its financial statements to complete such investigation and take any necessary corrective actions or make any necessary contributions. No amounts have been recorded as due from third parties including insurers, or set off against, any liability of the Company, unless such parties are contractually obligated to contribute and are not disputing such liability.

Other Matters

The Company is involved in various other claims and lawsuits incidental to its business, some of which involve substantial amounts. The Company either on its own or through its insurance carriers is contesting these matters.

In the opinion of management, the ultimate resolution of the legal proceedings, including those discussed above, will not have a material adverse effect on the financial condition or the future operating results of the Company.

Note 9 - Subsequent Event

On January 17, 1994 the Company's Chatsworth, California Aerospace Fasteners manufacturing facility suffered damage from the Southern California earthquake. While the company carries insurance for both business interruption and property damage caused by earthquakes, the policy has a five percent deductible. Once reliable estimates of the net cost of the damages

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are developed, they will be recorded as an unusual loss in the third quarter of Fiscal 1994.

ITEM 2. MANAGEMENT DISCUSSION AND ANALYSIS OF RESULTS OF OPERATIONS AND FINANCIAL CONDITION

RESULTS OF OPERATIONS

During the first quarter of Fiscal 1994, the Company adopted Statements of Financial Accounting Standards No. 106, "Employer's Accounting for Postretirement Benefits Other Than Pensions", and No. 109, "Accounting for Income Taxes", and elected to take one-time non-cash charges totaling $11.7 million, of which $.2 million was for postretirement benefits and $11.5 million for the change in accounting for income taxes and these charges are reflected in the six month period ended January 2, 1994. The charges represent cumulative effects on prior years of the accounting changes. The effect of the changes on pretax income from continuing operations for the six months ended January 2, 1994 was not material.

The Company currently operates in three principal business segments: Aerospace Fasteners, Industrial Products and Communications Services. Set forth below is a comparison of the results from continuing operations of the Company for the three and six month periods ended January 2, 1994 and December 27, 1992.

<TABLE>
<CAPTION>
(In thousands)

	Three Months Ended		Six Months Ended	
	January 2, 1994	December 27, 1992	January 2, 1994	December 27, 1992
<S>	<C>	<C>	<C>	<C>
Sales by Business Segment				
Aerospace Fasteners................	$ 50,446	$ 62,913	$102,024	$130,069
Industrial Products................	36,506	37,063	73,135	72,088
Communications Services............	18,440	16,572	36,583	32,491
Total..............................	$105,392	$116,548	$211,742	$234,648
Operating Income (loss) by Business Segment				
Aerospace Fasteners................	$(11,654)	$ 176	$(18,031)	$ 4,886
Industrial Products................	4,366	4,711	8,938	8,728
Communications Services............	4,114	3,649	8,045	7,123
Total..............................	(3,174)	8,536	(1,048)	20,737
Corporate administrative expense...	(954)	(815)	(1,897)	(1,729)
Other corporate income (expense)...	(367)	1,295	(80)	2,071
Operating income (loss)............	(4,495)	9,016	(3,025)	21,079
Net interest expense...............	(4,865)	(6,716)	(13,988)	(13,897)
Investment income..................	1,900	--	2,800	--

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Equity in earnings of affiliates - net of minority interest	151	49	278	57
Earnings (loss) from continuing operations before income taxes	(7,309)	2,349	(13,935)	7,239
Income tax (benefit) provision	(1,018)	1,058	(2,879)	3,258
Earnings (loss) from continuing operations	$ (6,291)	$ 1,291	$(11,056)	$ 3,981

</TABLE>

General

Overall sales declined by 9.6% in the second quarter and 9.8% for the six month period compared to sales for the same periods in Fiscal 1993, primarily caused by price erosion due to excess capacity in the aerospace fasteners industry and reduced order rates from commercial and military aerospace customers in the Aerospace Fasteners segment. Reduced order rates were in part due to the sluggish general economy, reductions in defense spending and reduced build rates of commercial airplane original equipment manufacturers due to conditions in the airline industry. The decline in sales at the Aerospace Fasteners segment was partially offset by sales increases at the Industrial Products and Communication Services segments in the six month period. Operating income decreased $13.5 million in the second quarter and $24.1 million for the six month period compared to operating income for the same periods in Fiscal 1993 and included a restructuring charge of $9.9 million in the Fiscal 1994 second quarter and six month periods to further implement the Aerospace restructuring plan. The Fiscal 1993 second quarter and six month period included a restructuring charge of $1.5 million. Operating income in the Industrial Products segment was down for the quarter, but was up for the six month period by 2.4%. In the Communications Services segment operating income was up for both periods of Fiscal 1994. However, in the Aerospace Fasteners segment, operating income declined $11.8 million for the quarter and $22.9 million for the six month period compared to the prior year periods. Other corporate income also decreased (see discussion below).

Aerospace Fasteners

Sales in the Aerospace Fasteners segment decreased 19.8% in the second quarter and 21.6% for the six month period ended January 2, 1994, compared to the comparable Fiscal 1993 periods, primarily due to reduced order rates. Ordering activity remained at low levels both at original equipment manufacturers and in the replacement market.

The operating income in the Aerospace Fasteners segment decreased by $11.8 million in the second quarter and $22.9 million for the six month period ended January 2, 1994 in relation to the comparable Fiscal 1993 periods. As a result of the sustained soft worldwide demand for aircraft, aircraft engines, and the resulting decline in new order rates and prices for aerospace fasteners, the Company has undertaken further restructuring actions to further downsize, reduce costs, increase quality, reduce cycle times and improve margins. These restructuring efforts include discontinuance of certain aircraft engine bolt product lines, increased cellularization of manufacturing processes, including extensive retraining of the workforce, relocation of its New Jersey operations to California and reengineering

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certain manufacturing processes and methods to meet increased customer quality standards.

The Company has recorded a pretax restructuring charge of $9.9 million in the second quarter of fiscal 1994 to cover the cost of these restructuring activities, including the write down of goodwill and surplus assets related to certain aircraft engine bolt product lines, severance benefits and the nonrecurring costs associated with the cellularization and reengineering of manufacturing processes and methods.

Depending on future demand and prices of aerospace fasteners the Company may take further restructuring actions in the future and may record additional restructuring charges to cover the cost of these activities. In addition, on January 17, 1994, the Company's Chatsworth, California Aerospace Fasteners manufacturing facility suffered damage from the Southern California earthquake. While the Company carries insurance for both business interruption and property damage caused by earthquakes, the policy has a five percent deductible. Once reliable estimates of the net cost of the damages are developed, they will be recorded as an unusual loss in the third quarter of Fiscal 1994.

Operating income in the second quarter and six months of Fiscal 1994 was also affected by (1) reduced demand and price erosion; and (2) higher quality control costs resulting from customers' intensified quality requirements. A large customer's disapproval of the quality system at one of the Aerospace Fasteners segment's plants in the third quarter of Fiscal 1993 negatively affected sales and operating income in the first six months of fiscal 1994. The disapproval resulted in the plant being ineligible to receive new orders, delayed shipments due to on-site customer inspection of finished product, and increased quality costs. The segment has implemented a program to comply with the customer's quality requirements and the plant's quality system was requalified by the customer during the first quarter. The quality improvement program requires that the plant reinspect its inventories and modify certain manufacturing processes and quality procedures at all major facilities. This program has resulted in both one time start-up costs and increased recurring quality costs, which negatively affected the first six months of Fiscal 1994 operating results and will likely negatively impact the future profit margins of this segment.

Industrial Products
- -------------------

Sales in the Industrial Products segment decreased 1.5% in the second quarter due to fewer shipping days in the current year quarter compared to the prior year quarter. Sales increased 1.5% for the six month period ended January 2, 1994, compared to the same period in Fiscal 1993. The increase in sales in the current six month period reflects customer response to the D-M-E Company's fast delivery programs, new products, and the improving domestic economy. Domestic demand for tooling for plastics has been strong while foreign demand has been weak, reflecting the economic conditions abroad. However, expansion into selected foreign markets is being pursued and appears to have potential.

Operating income in the Industrial Products segment decreased 7.3% in the second quarter primarily due to lower operating margins resulting from reduced sales in the current quarter compared to the prior year quarter. Operating income increased 2.4% for the six month period ended January 2, 1994, compared to the same period in Fiscal 1993. The improved results in

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the first six months resulted from a higher sales volume and improved operating margins. The Industrial Products segment has implemented several cost savings steps, including overhead reduction and improved inventory management programs, which have contributed to the higher operating margins. The improvements in inventory management and delivery systems resulted in faster deliveries, reduction in inventory, and higher inventory turnover. In addition, D-M-E Company has continued to implement improved manufacturing methods that have reduced cycle time and costs.

Communications Services
- ------------------------

Sales in the Communications Services segment increased 11.3% in the second quarter and 12.6% for the six month period ended January 2, 1994, compared to the same periods in Fiscal 1993, primarily due to the inclusion of sales from acquisitions, the addition of telecommunications franchises in new office buildings, and growth at existing sites.

Operating income in the Communications Services segment increased 12.7% in the second quarter and 12.9% for the six month period ended January 2, 1994, compared to the same periods in Fiscal 1993, primarily due to increased sales resulting from the reasons given above and related economies of scale. Operating income as a percent of sales in the first six months of Fiscal 1994 approximated the return on sales in the comparable period of Fiscal 1993.

Other Expenses/Income
- ---------------------

Corporate Administrative Expense - The Company's corporate staff performs work for several corporate entities including The Fairchild Corporation ("TFC"), RHI Holdings, Inc. ("RHI"), and the Company. Corporate administrative expense incurred by the Company is invoiced to RHI and to TFC on a monthly basis and represents the estimated cost of services performed on behalf of such companies by the Company. The estimated cost is based primarily on estimated hours spent by corporate employees on functions related to RHI and to TFC. Management believes that the corporate administrative expense of the Company would be higher if it operated as a separate independent entity. Corporate administrative expense increased by 17.1% in the second quarter and 9.7% for the six month period as compared to the same periods in the prior year, due to nonrecurring expense incurred for severance payouts. Excluding severance payouts, corporate administrative expense for the current six month period approximated the prior year six month period.

Other Corporate Income - Other corporate income decreased $1.7 million in the second quarter and $2.2 million for the six month period ended January 2, 1994, primarily due to the absence of amortization of overaccrued retiree health care expense in the Fiacal 1994 periods and recording a favorable pension adjustment in the prior year periods.

Net Interest Expense - Net interest expense decreased a net $1.9 million in the second quarter and included a $3.8 million reduction in interest expense on intercompany borrowings, which resulted from reducing the rate from 12.23% to approximate market rates since January 1, 1993. For the six month period ended January 2, 1994, net interest expense approximated the prior year period.

Investment Income - Net - In the first six months of Fiscal 1994, the

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Company recorded $2.8 million of dividends realized on participating annuity contracts. No such dividends were realized in the Fiscal 1993 first half.

Income Taxes - In the first six months of Fiscal 1994, the Company recorded a tax benefit of 20.7%. The benefit tax rate was lower than the statutory rate, largely due to the write off and amortization of goodwill which is not deductible for tax purposes.

Accounting Changes and Extraordinary Items
- --

Postretirement Benefits - Using the immediate recognition method, the charge to earnings representing the cumulative effect of this accounting change was immaterial. The unamortized portion of an overstated liability for discontinued operations substantially offset the transition obligation for active employees and retirees of continuing operations.

Accounting for Income Taxes - The Company elected the immediate recognition method and recorded a $11.5 million charge representing the cumulative effect on prior years. This charge represents deferred taxes related primarily to fixed assets, prepaid pension expense, and inventory differences.

Extraordinary Item - Net - The extraordinary item in Fiscal 1993 represents the write-off of $1.3 million of deferred loan fees from the portion of the term loan repaid, or $.8 million after tax.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Working capital at January 2, 1994, was $8.1 million lower than at June 30, 1993. The primary reasons for this reduction included a $10.8 million decrease in inventory and $4.7 million decrease in prepaids and other current assets resulting from lower net tax assets as a result of the adoption of FASB 109 offset partially by higher cash of $4.8 million and a $4.5 million decrease in accounts payable and accrued liabilities.

The Company's principal sources of liquidity are cash generated from operations and borrowings under its credit agreement. As a result of certain amendments to its credit agreement, and the issuance of FII's new Senior Secured Notes due 1999, $50 million of VSI's revolving credit facility has been extended from 1994 to 1997.

The Company also expects to generate cash from the sale of certain assets. Net assets held for sale at January 2, 1994 had a book value of $29.6 million and included two parcels of real estate in California and an 88 acre parcel of real estate located in Farmingdale, New York, which the Company plans to sell or develop, subject to the resolution of certain environmental matters and market conditions.

The Company's principal cash requirements include debt service, capital expenditures, acquisitions, payment of other liabilities and payment of dividends on preferred stock.

The level of the Company's capital expenditures varies from year to year, depending upon the timing of capital spending for new production equipment, periodic plant and facility expansion as well as cost reduction and labor efficiency programs. For the six month period ended January 2, 1994, capital expenditures were $5.6 million. The Company anticipates that

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total capital expenditures for the fiscal year ending June 30, 1994 will be approximately $16.0 million.

During the Fiscal 1994 second quarter, goodwill was reduced by $4.0 million as a result of the restructuring charge which included a write down of goodwill related to certain aircraft engine bolt product lines which were discontinued.

Other liabilities that require the use of cash include post-employment benefits for retirees, environmental investigation and remediation obligations, litigation settlements and related costs.

The Company expects that cash on hand, cash generated from operations, borrowings, asset sales and the ability to refinance portions of its long-term debt will be adequate to satisfy cash requirements. If such sources are not adequate, the Company believes that additional capital resources would be available from RHI, via either new equity contributions or the assumption of certain of the Company's obligations. However, there can be no assurance that RHI would make these additional capital resources available to the Company.

The Company's Credit Agreement requires the Company to comply with certain financial covenants, including achieving cumulative earnings before interest, taxes, depreciation and amortization, ("EBITDA Covenant"), and maintaining certain coverage ratios. The Credit Agreement was amended to relax the EBITDA Covenant to permit compliance as of October 3, 1993, despite the decline in the earnings of the Company's Aerospace Fasteners segment. To comply with the minimum EBITDA covenant requirements (as amended and defined) the Company's subsidiary, VSI Corporation ("VSI"), must earn for the cumulative total of the trailing four quarters EBITDA as follows: $62.0 million for the third quarter of Fiscal 1994, $67.0 million for the fourth quarter of Fiscal 1994, $73.6 million for the first quarter of Fiscal 1995 and $75.4 million for the second quarter of Fiscal 1995. VSI's ability to meet the EBITDA covenant in Fiscal 1994 is uncertain and there can be no assurance that the Company will be able to comply with the financial covenants in the future. Noncompliance with any of the financial covenants without cure or waiver would constitute an event of default under the Credit Agreement. An event of default resulting from a breach of a financial covenant may result, at the option of lenders holding a majority of the loans, in an acceleration of the principal and interest outstanding, and a termination of the revolving credit line.

Any available cash may be paid as dividends to RHI if the purpose of such dividends is to provide TFC with funds necessary to meet its debt service requirements under specified notes and debentures. All other dividends to RHI are subject to certain limitations under the Credit Agreement. As of January 2, 1994, the Company was unable to provide dividends to RHI. The Credit Agreement also restricts additional borrowings under the Credit Facilities for the payment of any dividends.

IMPACT OF FUTURE ACCOUNTING CHANGES

Accounting for Certain Investments in Debt and Equity Securities

In May 1993, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 115 ("FASB 115"), Accounting for Certain Investments in Debt and Equity Securities. FASB 115 provides new

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rules on accounting and reporting for investments in equity securities that have readily determinable fair values and for all investments in debt securities. The Company is required to implement FASB 115 as of the beginning of Fiscal 1995 or as of the end of Fiscal 1994. The Company believes the impact of implementing FASB 115 will be immaterial.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

Reference is made to Note 8 of Notes to Consolidated Financial Statements (Unaudited).

Item 6. Exhibits and Reports on Form 8-K

None.

SIGNATURE

Pursuant to the requirements of the Securities Exchange Act of 1934, the Company has duly caused this report to be signed on its behalf by the undersigned hereunto duly authorized.

For FAIRCHILD INDUSTRIES, INC.
(Registrant) and as its Chief
Financial Officer:

By: Christopher Colavito
Vice President, Controller
and Chief Accounting Officer

By: Michael T. Alcox
Vice President and Chief
Financial Officer

Date: February 10, 1994

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