

SECURITIES AND EXCHANGE COMMISSION

FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1994-05-13** | Period of Report: **1994-04-03**
SEC Accession No. [0000034257-94-000004](#)

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FAIRCHILD INDUSTRIES INC /DE/

CIK: [34257](#) | IRS No.: [520579835](#) | State of Incorporation: **DE** | Fiscal Year End: **0630**
Type: **10-Q** | Act: **34** | File No.: [001-03102](#) | Film No.: [94527999](#)
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 April 3, 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
April 3, 1994

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)

	April 3, 1994	June 30, 1993
	(Unaudited)	(*)
<S>	<C>	<C>
ASSETS		
-----	-----	-----
<S>	<C>	<C>
Current Assets:		
Cash and cash equivalents.....	\$ 4,335	\$ --
Accounts receivable-trade, less allowances of \$1,952 and \$1,746.....	69,672	63,767
Inventories:		
Finished goods.....	45,612	51,776
Work-in-process.....	27,037	30,766
Raw materials.....	9,260	8,987
	-----	-----
	81,909	91,529
Prepaid expenses and other current assets....	20,046	22,698
	-----	-----
Total Current Assets.....	175,962	177,994
Property, plant and equipment, net of accumulated depreciation of \$82,382 and \$62,639.....	165,602	176,869
Net assets held for sale.....	28,402	27,808
Cost in excess of net assets acquired, (Goodwill) less accumulated amortization of \$28,063 and \$24,149.....	200,371	208,689
Prepaid pension assets.....	18,553	15,837
Other assets.....	29,885	32,813
	-----	-----
Total Assets.....	\$618,775	\$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)

	April 3, 1994	June 30, 1993
	(Unaudited)	(*)
<S>	<C>	<C>
LIABILITIES AND STOCKHOLDERS' EQUITY		
-----	-----	-----
<S>	<C>	<C>
Current Liabilities:		
Bank notes payable and current		

maturities of long-term debt.....	\$ 11,446	\$ 50,437
Accounts payable.....	29,064	28,826
Due to affiliated companies.....	52,287	2,748
Accrued interest.....	2,860	7,222
Other accrued liabilities.....	58,216	56,482
	-----	-----
Total Current Liabilities.....	153,873	145,715
Long-term debt, less current maturities..	225,788	232,929
Other long-term liabilities.....	15,312	15,733
Retiree health care liabilities.....	49,364	49,035
Noncurrent income taxes.....	26,532	23,950
	-----	-----
Total Liabilities.....	470,869	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.....	(101,534)	(73,115)
Cumulative translation adjustment.....	1,283	2,666
	-----	-----
Total Stockholders' Equity.....	128,794	153,536
	-----	-----
Total Liabilities and Stockholders'		
equity.....	\$618,775	\$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
CONSOLIDATED STATEMENTS OF EARNINGS
(Unaudited)

<CAPTION>

(In thousands)	Three Months Ended		Nine Months Ended	
	April 3, 1994	March 28, 1993	April 3, 1994	March 28, 1993
<S>	<C>	<C>	<C>	<C>
Revenue:				
Sales.....	\$112,836	\$114,399	\$332,157	\$349,047
Other income - net.....	485	1,231	701	4,312
	-----	-----	-----	-----
	113,321	115,630	332,858	353,359
Costs and Expenses:				
Cost of sales.....	85,698	86,790	256,182	259,868
Selling, general & administrative..	17,641	17,967	53,851	55,311
Research and development.....	886	825	2,923	2,650
Amortization of goodwill.....	1,437	1,466	4,406	4,369
Restructuring.....	--	932	9,903	2,432
Unusual items.....	3,200	--	3,200	--
	-----	-----	-----	-----
	108,862	107,980	330,465	324,630
Operating income.....	4,459	7,650	2,393	28,729
Interest expense.....	8,299	8,344	22,466	22,700
Interest income.....	(103)	(184)	(282)	(643)
	-----	-----	-----	-----
Net interest expense.....	8,196	8,160	22,184	22,057
Investment income - net.....	379	--	3,179	--
Equity in earnings of affiliates.....	96	136	346	382
Minority interest.....	18	(16)	16	(205)
	-----	-----	-----	-----
Earnings (loss) from continuing operations before taxes.....	(3,244)	(390)	(16,250)	6,849
Income tax benefit (provision).....	828	(612)	3,346	(3,870)
	-----	-----	-----	-----
Earnings (loss) from continuing operations.....	(2,416)	(1,002)	(12,904)	2,979
Extraordinary items - net.....	--	--	--	(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).....	(2,416)	(1,002)	(24,642)	2,169
Series A Preferred Dividends.....	383	382	1,147	1,331
Series C Preferred Dividends.....	593	593	1,780	1,566
	-----	-----	-----	-----
Net loss after Preferred Dividends....	\$ (3,392)	\$ (1,977)	\$ (27,569)	\$ (728)
	=====	=====	=====	=====
Dividend to RHI Holdings, Inc. (parent)	\$ --	\$ --	\$ --	\$ 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
(Unaudited)

<CAPTION>

(In thousands)

	Nine Months Ended	
	April 3, 1994	March 28, 1993
	<C>	<C>
Cash provided by (used for)		
Operations:		
Net earnings (loss).....	\$ (24,642)	\$ 2,169
Depreciation and amortization.....	24,119	21,387
Accretion of discount on long-term liabilities.....	2,740	3,428
Adjustments for other non-cash charges..	19,510	1,703
Adjustments for non-cash credits.....	(346)	(382)
Loss on sale of fixed assets.....	341	205
Changes in assets and liabilities.....	(12,093)	6,589
	9,629	35,099
Investments:		
Capital expenditures.....	(9,380)	(9,139)
Business acquisitions.....	--	(7,283)
Other - net.....	(235)	1,410
	(9,615)	(15,012)
Financing:		
Issuance of debt.....	97,878	129,270
Debt repayments - net.....	(94,471)	(102,267)
Issuance of Series B preferred stock....	4,000	5,000
Issuance of Series C preferred stock....	--	24,015
Exchange of Series A preferred stock....	--	(25,126)
Dividends.....	(2,926)	(52,807)
Other - net.....	144	--
	4,625	(21,915)
Effect of exchange rate changes on cash.....	(304)	(1,567)
Net increase in cash.....	4,335	(3,395)
Cash, beginning of period.....	--	5,015
	\$ 4,335	\$ 1,620
	=====	=====

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

The consolidated balance sheet as of April 3, 1994, and the consolidated statements of earnings and cash flows for the nine months ended April 3, 1994 and March 28, 1993 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 April 3, 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 April 3, 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

The Company has decided not to sell a division which previously was included in net assets held for sale. Accordingly, the Company is recording the current period's results from this division with the Company's Industrial Products Segment. Sales from the division formerly included in net assets held for sale, and not included in results of operations, were \$11,487,000 for the nine months ended March 28, 1993. The impact of this division's earnings on the prior year periods was immaterial.

Net assets held for sale at April 3, 1994 includes several 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.

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 Company was in compliance with the Credit Agreement as of the end of the third quarter of Fiscal 1994.

The Company has negotiated an amendment to the Credit Agreement (i) to accommodate the unusual loss from the January 17, 1994 Southern California earthquake, and (ii) to reduce by \$5,000,000 the Company's minimum requirement under the EBITDA Covenant for the duration of the Credit Agreement. To comply with the minimum EBITDA Covenant requirement (as amended) 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 fourth quarter of Fiscal 1994, \$68,600,000 for the first quarter of Fiscal 1995, \$70,360,000 for the second quarter of Fiscal 1995, and \$72,200,000 for the third quarter of Fiscal 1995. VSI's ability to meet the minimum requirement under the EBITDA Covenant in Fiscal 1994 is uncertain, and there can be no assurance that the Company will be able in the future to comply with the minimum requirement under the EBITDA Covenant and other financial covenants under the Credit Agreement. 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 basis differences.

Note 7 - Unusual Items

On January 17, 1994, the Company's Chatsworth, California Aerospace Fasteners manufacturing facility suffered damage from the Southern California earthquake. As a result, the Company relocated the Chatsworth manufacturing operations to its other Southern California facilities. This disruption has caused increased costs and reduced revenues in the Fiscal 1994 third quarter and will likely negatively impact the fourth quarter as well. While the company carries insurance for both business interruption and property damage caused by earthquakes, the policy has a 5% deductible. The Company has recorded an unusual pretax loss in the Fiscal 1994 third quarter for the Aerospace Fasteners segment of \$3,200,000 to cover the estimated net cost of the damages and business interruption caused by the earthquake. In addition, an insurance claim of \$3,500,000 has been recorded for recoverability of costs related to business interruption and property damage.

Note 8- 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 April 3, 1994 and June 30, 1993.

Note 9- Commitments and Contingencies

Lease Guaranties

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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 \$12,260,000 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

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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. 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 have reached an agreement in principle to settle this matter for \$330,000.

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 cost 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 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

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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.

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. These charges are reflected in the nine month period ended April 3, 1994, and represent cumulative effects on prior years of the accounting changes. For the nine months ended April 3, 1994, the effect of the changes on pretax income from continuing operations 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 nine month periods ended April 3, 1994 and March 28, 1993.

<TABLE>

<CAPTION>

(In thousands)

	Three Months Ended		Nine Months Ended	
	April 3, 1994	March 28, 1993	April 3, 1994	March 28, 1993
	-----	-----	-----	-----
<S>	<C>	<C>	<C>	<C>
Sales by Business Segment:				
Aerospace Fasteners.....	\$ 50,619	\$ 60,002	\$152,643	\$190,071
Industrial Products.....	43,208	37,325	123,922	109,413
Communications Services.....	19,009	17,072	55,592	49,563
	-----	-----	-----	-----

Total.....	\$112,836	\$114,399	\$332,157	\$349,047
	=====	=====	=====	=====
Operating Income (loss) by Business Segment:				
Aerospace Fasteners.....	\$ (5,177)	\$ (1,394)	\$ (23,208)	\$ 3,492
Industrial Products.....	6,086	5,051	15,983	13,779
Communications Services.....	4,153	3,728	12,198	10,851
	-----	-----	-----	-----
Total.....	5,062	7,385	4,973	28,122
Corporate administrative expense...	(872)	(872)	(2,769)	(2,601)
Other corporate income.....	269	1,137	189	3,208
	-----	-----	-----	-----
Operating income.....	4,459	7,650	2,393	28,729
Net interest expense.....	(8,196)	(8,160)	(22,184)	(22,057)
Investment income.....	379	--	3,179	--
Equity in earnings of affiliates - net of minority interest.....	114	120	362	177
	-----	-----	-----	-----
Earnings (loss) from continuing operations before income taxes.....	(3,244)	(390)	(16,250)	6,849
Income tax benefit (provision).....	828	(612)	3,346	(3,870)
	-----	-----	-----	-----
Earnings (loss) from continuing operations.....	\$ (2,416)	\$ (1,002)	\$ (12,904)	\$ 2,979
	=====	=====	=====	=====

</TABLE>

General

- - - - -

Overall sales declined by 1.4% in the third quarter and 4.8% for the nine 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, reduced order rates from commercial and military aerospace customers in the Aerospace Fasteners segment and lower revenues due to the disruption caused by the earthquake. Reduced order rates were principally due to 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 third quarter and nine month periods. The Industrial Products segment included sales in the current periods by Fairchild Data Corporation which had been classified as a discontinued operation in the prior year periods.

Operating income decreased \$3.2 million in the third quarter and \$26.3 million for the nine month period compared to operating income for the same periods in Fiscal 1993 and included a \$3.2 million charge for earthquake damage and related business interruption in the Company's Aerospace Fasteners segment during the third quarter of Fiscal 1994. A restructuring charge of \$9.9 million was recorded in the Fiscal 1994 nine month period to further implement the Aerospace Fasteners segment's restructuring plan. The Fiscal 1993 third quarter and nine month periods included restructuring charges of \$0.9 million and \$2.4 million, respectively. Operating income in the Industrial Products and Communications Services segments was up for both periods of Fiscal 1994. The Industrial Products segment included operating

income in the current periods by Fairchild Data Corporation which had been classified as a discontinued operation in the prior year periods. However, in the Aerospace Fasteners segment, operating income declined \$3.8 million for the quarter and \$26.7 million for the nine 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 15.6% in the third quarter and 19.7% for the nine month period ended April 3, 1994, compared to the 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 \$3.8 million in the third quarter and \$26.7 million for the nine month period ended April 3, 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 certain manufacturing processes and methods to meet increased customer quality standards.

The Company recorded a pretax restructuring charge of \$9.9 million in the second quarter of Fiscal 1994 to cover the cost of the above mentioned 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.

On January 17, 1994, the Company's Chatsworth, California Aerospace Fasteners manufacturing facility suffered damage from the Southern California earthquake. As a result, the Company has relocated the Chatsworth manufacturing operations to its other Southern California facilities. This disruption has caused increased costs and reduced revenues in the Fiscal 1994 third quarter and will likely negatively affect the fourth quarter as well. While the Company carries insurance for both business interruption and property damage caused by earthquakes, the policy has a 5% deductible. The Company has recorded an unusual pretax loss in the Fiscal 1994 third quarter of \$3.2 million to cover the currently estimated net cost of the damages and business interruption caused by the earthquake. Included in prepaids and other current assets is an insurance claim of \$3.5 million for recoverability of costs related to business interruption and property damage.

Operating income in the third quarter and nine 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 in the third quarter of Fiscal 1993, of the quality system at one of the Aerospace Fasteners segment's plants negatively affected sales and operating income in the first nine 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 of Fiscal 1994. 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 one time start-up costs and increased recurring quality costs, each of which negatively affected the first nine months of Fiscal 1994 operating results, and will likely negatively affect the future profit margins of this segment.

Industrial Products

Sales in the Industrial Products segment increased 15.8% in the third quarter and 13.3% for the nine month period ended April 3, 1994, compared to the same periods in Fiscal 1993. The inclusion of Fairchild Data Corporation sales in Fiscal 1994 accounted for 51.1% and 73.0% of the increase in sales in this segment in the third quarter and nine month current year periods, respectively. The increase in sales in the current quarter and nine month periods at D-M-E Company reflects customer response to the 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 increased 20.5% in the third quarter and 16.0% for the nine month period ended April 3, 1994, compared to the same periods in Fiscal 1993. The inclusion of Fairchild Data Corporation operating income in Fiscal 1994 accounted for 15.9% and 51.0% of the increase in operating income in this segment in the third quarter and nine month current year periods, respectively. The improved results at D-M-E 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 third quarter and 12.2% for the nine month period ended April 3, 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 11.4% in the third quarter and 12.4% for the nine month period ended April 3, 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 nine 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 was flat in the third quarter and up 6.6% for the nine 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 nine month period decreased 8.1% compared to the prior year nine month period.

Other Corporate Income - Other corporate income decreased \$0.9 million in the third quarter and \$3.0 million for the nine month period ended April 3, 1994, primarily due to the absence of amortization of over accrued retiree health care expense in the Fiscal 1994 periods and recording a favorable pension adjustment in the prior year periods.

Net Interest Expense - In both the third quarter and nine month periods ended April 3, 1994, net interest expense approximated the prior year periods.

Investment Income - Net - Investment income includes \$2.8 million of dividends realized on participating annuity contracts. No such dividends were realized in the Fiscal 1993 first nine months.

Income Taxes - In the first nine months of Fiscal 1994, the Company recorded a tax benefit of 20.6%. 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 prepaid, or \$.8 million after tax.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Working capital at April 3, 1994, was \$10.2 million lower than at June 30, 1993. The primary reasons for this reduction included a \$9.6 million decrease in inventory and a net increase in borrowings from the banks and affiliated companies of \$10.5 million offset partially by higher cash of \$4.3 million and accounts receivable of \$5.9 million.

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 April 3, 1994 had a book value of \$28.4 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 nine month period ended April 3, 1994, capital expenditures were \$9.4 million. The Company anticipates that total capital expenditures for the fiscal year ending June 30, 1994 will be approximately \$16.0 million.

During Fiscal 1994, 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 Company was in compliance with the Credit Agreement as of the end of the third quarter of Fiscal 1994. The Company has negotiated an amendment to the Credit Agreement (i) to accommodate the unusual loss from the January 17, 1994 Southern California earthquake, and (ii) to reduce by \$5.0 million the Company's minimum requirement under the EBITDA Covenant for the duration of the Credit Agreement. To comply with the minimum EBITDA Covenant requirements (as amended) 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 fourth quarter of Fiscal 1994, \$68.6 million for the first quarter of Fiscal 1995, \$70.4 million for the second quarter of Fiscal 1995 and \$72.2 million for the third quarter of Fiscal 1995. VSI's ability to meet the minimum requirement under the EBITDA Covenant in Fiscal 1994 is uncertain, and there can be no assurance that the Company will be able in the future to comply with the minimum requirements under the EBITDA Covenant and other financial covenants under the Credit Agreement. 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 April 3, 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 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 9 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: May 13, 1994