FORM 10-Q

Quarterly report pursuant to sections 13 or 15(d)

Filing Date: **1994-05-13** | Period of Report: **1994-03-31**
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TALLEY MANUFACTURING & TECHNOLOGY INC

CIK:**909783**| IRS No.: **860739329** | State of Incorp.:**DE** | Fiscal Year End: **1231**
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SIC: **8711** Engineering services

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Form 10-Q
UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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

For the quarterly period ended March 31, 1994

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 No. 33-49869-01

TALLEY MANUFACTURING AND TECHNOLOGY, INC.
(Exact name of registrant as specified in its charter)

Delaware	86-0739329
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

2702 North 44th Street, Phoenix, Arizona	85008
(Address of principal executive offices)	(Zip Code)

Registrant's telephone number, including area code:(602) 957-7711

(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, and (2) has been subject to such filing requirement for the past 90 days.

YES[ ] NO[X] *

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

Class of Common Stock	Outstanding at March 31, 1994
$1.00 par value	1,000

* The Company has only been subject to filing requirements since registration effective date of October 15, 1993.

TALLEY MANUFACTURING AND TECHNOLOGY, INC.

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PART I - FINANCIAL INFORMATION

TALLEY MANUFACTURING AND TECHNOLOGY, INC.

Consolidated Balance Sheet
(thousands)

	March 31, 1994	December 31, 1993
ASSETS		
Cash and cash equivalents	$ 3,993	$ 6,417
Accounts receivable, net of allowance for doubtful accounts of $1,074,000 at March 31, 1994 and $1,091,000 at December 31, 1993	52,361	60,376
Inventories, net	63,816	64,808
Deferred income taxes	1,400	900
Prepaid expenses	9,117	9,367
Current assets	130,687	141,868
Long-term receivables	9,577	7,093
Property, plant and equipment, net	48,366	49,489

Intangibles	44,388	44,928
Other assets	8,404	8,465
Total assets	$241,422	$251,843
LIABILITIES AND STOCKHOLDER'S EQUITY		
Current maturities of long-term debt	$ 3,187	$ 2,176
Accounts payable	21,411	23,095
Accrued expenses	35,942	31,652
Current liabilities	60,540	56,923
Long-term debt	147,399	160,002
Deferred income taxes	7,216	12,320
Other liabilities	4,054	4,196
Stockholder's equity:		
Preferred stock, $1 par value, authorized 100 shares:		
Series A, issued 8 shares	-	-
Common stock, $1 par value, authorized 1,000 shares	1	1
Capital in excess of par	17,261	15,753
Foreign currency translation	(660)	(370)
Retained earnings	5,611	3,018
Total stockholder's equity	22,213	18,402
Total liabilities & stockholder's equity	$241,422	$251,843

The accompanying notes are an integral part of the financial statements.

TALLEY MANUFACTURING AND TECHNOLOGY, INC.
Consolidated Statement of Earnings
(thousands, except per share amounts)

	Three Months Ended March 31,	
	1994	1993
Sales	$55,616	$57,504
Services	15,521	15,119
Royalties	3,979	1,794
	75,116	74,417
Cost of sales	41,369	42,249
Cost of services	13,523	13,024
Selling, general, and administrative expenses	17,256	13,465
	72,148	68,738
	2,968	5,679
Other income, net	(124)	120
	2,844	5,799
Interest expense	4,215	4,049

Earnings (loss) before income taxes	(1,371)	1,750
Income tax benefit (provision)	3,964	(957)
Net earnings	$ 2,593	$ 793

The accompanying notes are an integral part of the financial statements.

TALLEY MANUFACTURING AND TECHNOLOGY, INC.
Consolidated Statement of Cash Flows
(thousands)

	Three Months Ended March 31, 1994	1993
Cash and cash equivalents at beginning of period	$ 6,417	$10,118
Cash flows from operating activities:		
Net earnings	2,593	793
Adjustments to reconcile net income to cash flows from operating activities:		
Change in deferred income taxes	(5,604)	87
Depreciation and amortization	2,397	2,593
Gain on sale of property and equipment	(4)	(77)
Other	(17)	321
Changes in assets and liabilities, net of effects from acquired businesses:		
(Increase) decrease in accounts receivable	5,550	(3,497)
Decrease in inventories	973	2,084
(Increase) decrease in prepaids	250	(301)
Decrease in accounts payable	(1,684)	(2,646)
Increase in accrued expenses	4,290	763
Other, net	(217)	1,022
Cash flows from operating activities	8,527	1,142
Cash flows from investing activities:		
Purchases of property and equipment	(875)	(773)
Proceeds from sale of property and equipment	8	101

Cash flows from investing activities	(867)	(672)
Cash flows from financing activities:		
Decrease in investment by Parent	-	(2,677)
Increase in investment by Parent	1,508	4,389
Repayment of long term-debt	(96,649)	(25,982)
Proceeds from new long-term debt	85,057	25,756
Cash flows from financing activities	(10,084)	1,486
Net increase (decrease) in cash and cash equivalents	(2,424)	1,956
Total cash and cash equivalents at March 31,	$ 3,993	$12,074

The accompanying notes are an integral part of the financial statements.

<TABLE>
<CAPTION>

TALLEY MANUFACTURING AND TECHNOLOGY, INC.
Consolidated Statement of Changes in Stockholder's Equity
For the Three Months Ended March 31, 1994 and 1993
(thousands)

<S>	Preferred Stock <C>	Common Stock <C>	Capital in Excess of Par Value <C>	Retained Earnings <C>
BALANCE AT DECEMBER 31, 1992	$ -	$ -	$10,948	$ -
Net earnings			793	
Amounts from Parent			1,628	
Decrease in guaranteed debt of ESOP			84	
BALANCE AT MARCH 31, 1993	$ -	$ -	$13,453	$ -
BALANCE AT DECEMBER 31, 1993	$ -	$ 1	$15,753	$ 3,018
Net earnings				2,593
Contribution from Parent			1,508	
BALANCE AT MARCH 31, 1994	$ -	$ 1	$17,261	$ 5,611

</TABLE>

The accompanying notes are an integral part of the financial statements.

TALLEY MANUFACTURING AND TECHNOLOGY, INC.

Note 1 - General

In July 1993, Talley Manufacturing and Technology, Inc. (the Company), a wholly owned subsidiary of Talley Industries, Inc., ("Talley") was formed with the issuance of 1,000 shares of common stock. The formation of the Company was in anticipation of an offering, in October, 1993, of Senior Notes by the Company and Senior Discount Debentures by Talley. The Senior Notes are guaranteed by substantially all of the Company's subsidiaries (the "Subsidiary Guarantors"). Concurrently with the issuance of these securities, Talley contributed the capital stock of its operating subsidiaries (other than its real estate subsidiaries) to the Company, which also assumed a substantial portion of Talley's indebtedness and liabilities. At the same time, the Company entered into a new credit facility with certain institutional lenders which is also guaranteed by the Subsidiary Guarantors. The net proceeds from the Senior Notes, the Senior Discount Debentures and the new credit facility were used to repay substantially all of the indebtedness of the Company and its subsidiaries, including the indebtedness assumed from Talley, and substantially all of the indebtedness remaining with Talley.

Upon completion of the reorganization of entities under the common control of Talley described above and the new financing, the Company is a holding company which owns all of the capital stock of the operating subsidiaries of Talley (other than the real estate subsidiaries). Accordingly, all corporate costs, assets and liabilities are included in the Company's financial statements and interest expense includes the interest on indebtedness of the operating subsidiaries and all indebtedness assumed by the Company in connection with the reorganization. In connection with the reorganization, Talley and the Company entered into a tax sharing agreement and a cost sharing agreement which require the Company to reimburse Talley for certain ongoing general and administrative expenses which will be incurred by Talley and to make certain tax payments to Talley.

The financial statements of the Company have been prepared using the historical amounts included in the Talley Industries, Inc. and subsidiaries consolidated financial statements giving effect to the reorganization described above. Although the Subsidiary Guarantors guaranteed the Senior Notes, separate financial statements of the Subsidiary Guarantors are not included because the Subsidiary Guarantors are jointly and severally liable with the Company under the Senior Notes, the aggregate assets, liabilities, earnings and equity of the Subsidiary Guarantors are substantially equivalent to the assets, liabilities, earnings and equity of the Company on a consolidated basis, and separate financial statements and other disclosures concerning the Subsidiary Guarantors would not be material to investors. In addition, with the exception of the net assets of the real estate operations and certain debt and related interest expense, the consolidated financial statements of Talley are substantially identical to those of the Company.

Although the financial statements of the Company separately report its assets, liabilities (including contingent liabilities) and stockholder's equity, legal title to such assets and legal responsibility for such liabilities was not affected by such attribution during periods prior to the reorganization. Accordingly, the Talley consolidated financial statements and related notes should be read in connection with these financial statements.

In the opinion of the Company, the accompanying unaudited consolidated financial statements contain all adjustments (consisting of only normal recurring accruals) necessary to present fairly the financial position as of March 31, 1994 and December 31, 1993 and the results of operations for the three-month periods ended March 31, 1994 and 1993, and cash flows and changes in stockholder's equity for the three-month periods ended March 31, 1994 and 1993. Such results, however, may not be indicative of the results for the full year.

Note 2 - Inventories

Inventories are summarized as follows (in thousands):

	March 31, 1994	December 31, 1993
Raw materials and supplies	$11,778	$10,293
Work-in-process	8,695	9,584
Finished goods	26,542	26,470
Inventories applicable to government contracts	16,801	18,461
	$63,816	$64,808

Note 3 - Earnings Per Share

Talley Manufacturing and Technology, Inc. is a wholly owned subsidiary of Talley Industries, Inc.; accordingly, earnings per share information is not presented.

Note 4 - Sale of Subsidiaries

In July 1993 the Company completed the sale of the net assets of its precision potentiometer business for a cash purchase price of $2.8 million, which approximated the book value of the net assets sold. Sales and pretax earnings of the business sold for the six months ended June 30, 1993 were $2.3 million and $.4 million, respectively.

Note 5 - Income Tax Benefit

Pursuant to recent legislation passed in the State of Arizona regarding the rules for filing consolidated state income tax returns, the Company has reversed $5.6 million of state income tax accruals to reflect the change in the law. The new law is retroactive to the beginning of 1986.

TALLEY MANUFACTURING AND TECHNOLOGY, INC.

Management's Discussion and Analysis
of Financial Condition and Results of Operations

The following table summarizes the Company's consolidated revenue and earnings (loss), by segment for the periods shown:

(Dollars in Thousands)	Three Months Ended March 31, 1994	1993
REVENUES:		
Government Products and Services	$36,258	$39,426
Airbag Royalty	3,896	1,722
Industrial Products	29,200	26,089
Specialty Products	5,762	7,180
	$75,116	$74,417
OPERATING INCOME:		
Government Products and Services	$ 4,186	$ 5,684
Airbag Royalty	3,896	1,722
Industrial Products	720	537
Specialty Products	610	773
Total operating income	9,412	8,716
Corporate expense	(6,584)	(3,036)
Non-segment interest income	16	119
Interest expense	(4,215)	(4,049)
Earnings (loss) before income taxes	$(1,371)	$ 1,750

Revenues for the three-month period ended March 31, 1994 increased $.7 million from $74.4 million to $75.1 million, compared with the corresponding period in the prior year. The slight increase in the three-month comparison is primarily the result of increasing revenue in the Airbag Royalties segment and the Steel Operations, offset by decreased revenue in the Government Products and Services segment due to scheduled price reductions under certain extended range munitions contracts and the timing of completion and shipments under other contracts. The pretax loss for the three months ended March 31, 1994 was $1.4 million compared with $1.8 million pretax earnings in the first three months of the previous year. The loss in the first quarter of 1994 includes a $4.5 million provision for litigation costs related to resolution of claims in connection with the airbag royalties being received from the licensee. Net income was $2.6 million for the first quarter of 1994, which reflects a tax benefit resulting from reversal of state income tax accruals of $5.6 million, pursuant to a retroactive change in tax laws in the State of Arizona.

Earnings from both the Airbag Royalty segment and the Industrial Products segment improved compared with the prior year. Royalties in the Airbag Royalty segment increased by $2.2 million from $1.7 million in the first three months of 1993 to $3.9 million for the first three months of 1994, while earnings from the Industrial segment improved $.2 million. Earnings from the Government Products and Services segment and the Specialty Products segment for the first three months of 1994, when compared with the first three months of 1993, were $1.5 million and $.2 million lower, respectively.

The gross profit percentage, excluding airbag royalties, of 22.8%, for the three months ended March 31, 1994 was down from the gross profit percentage of 24.0% for the comparable period in 1993. The decrease from the prior year is due to the mix of contracts.

Government Products and Services. Revenue and earnings in the first quarter of 1994 decreased $3.2 million and $1.5 million, respectively, when compared with the same period in the prior year. These decreases are primarily due to a scheduled pricing reduction under the extended range munitions program following the recovery of the Company's investment in a new production facility, and also due to the timing of completion and shipments under other contracts. Revenue and earnings from the Company's architectural and engineering services company are approximately equal to the comparable period in the prior year.

Airbag Royalties. Revenue from airbag royalties increased from $1.7 million in the first three months of 1993 to $3.9 million in the first three months of 1994. This increase was due to an increase in airbags manufactured and sold. (Also see "Other Matters" as a separate caption within Management's Discussion and Analysis of Financial Condition and Results of Operations)

Industrial Products. In the first three months of 1994 Industrial Products sales and earnings increased $3.1 million and $.2 million, respectively, when compared with the first three months of 1993. Increases in sales resulted from improvement in orders for stainless steel bars and rods and increased demand for ceramic insulators products due to harsh winter weather conditions and improved market share. The improvement in earnings resulted from the sales increases and cost reduction and streamlining efforts at the Company's steel and ceramic insulator operations. These increases partially were offset by lower welder products sales and earnings.

Specialty Products. During the first three months of 1994, sales for the Specialty Products segment decreased 19.7%, from $7.2 million to $5.8 million, while earnings decreased slightly from $.8 million to $.6 million, when compared with the same period in 1993. The decrease in sales and earnings when compared to the prior year is a result of the timing of sales, which are expected to improve during the remainder of 1994.

Other. Interest expense in the first three months of 1994 increased to $4.2 million, from $4.0 million in the comparable period in 1993, mainly due to a major portion of the Company's debt being refinanced from variable rates to higher fixed rates. Corporate overhead increased from $3.0 million to $6.6 million over the comparable period in 1993 due to a $4.5 million provision for litigation costs related to resolution of claims in connection with airbag royalties being received from the licensee. Income tax benefit for the first three months of 1994 was $4.0 million compared to a tax provision of $1.0 million in the comparable period in 1993. The net income tax benefit in 1994 is the result of a favorable state tax legislation which resulted in a $5.6 million reversal of taxes previously accrued.

Financial Condition, Liquidity and Capital Resources

At March 31, 1994, the Company had $4.0 million in cash and cash equivalents and net working capital of $70.1 million. Cash flow from operating activities for the three months ended March 31, 1994 was $8.5 million, generally the result of the Company's successful efforts toward collection of trade receivables. Cash generated from operations during the first three months of 1993 was $1.1 million. Cash used for investing activities during the three months ended March 31, 1994 was $.9 million for capital expenditures. Cash used in financing activities of $10.1 million reflects a reduction in debt from cash generated from operations and from cash available at the beginning of the year.

The Company, along with its parent, Talley Industries, Inc. ("Talley"), in October 1993, completed a major refinancing program. This refinancing program included an offering of $185 million of debt securities, consisting of $70 million gross proceeds of senior discount debentures due 2005, issued by Talley to yield 12.25% and $115 million of senior notes due 2003, with an interest rate of 10.75% issued by the Company, which was newly formed to hold the stock of all the operating subsidiaries of Talley (except for the subsidiaries holding Talley's real estate operations). In connection with this refinancing, the Company obtained a secured credit facility with institutional lenders, of which approximately $48 million was initially borrowed in connection with the refinancing discussed above. Borrowings under the secured credit facility may not exceed the collateral base as defined in the governing credit agreement. The facility consists of a five-year revolving credit facility of up to $40 million and a five-year $20 million term loan facility. At March 31, 1994 availability under the facility, based primarily on inventory and receivable levels, was $54.6 million, of which $36.8 million was borrowed. Upon the occurrence of certain specified events, at any time following the third anniversary of the secured credit facility, the agent thereunder may elect to terminate the facility.

The proceeds from the offerings described above and the initial borrowings under the secured credit facility refinanced substantially all of the debt of the Company and Talley. The Company anticipates that the new capital structure will support the long-term growth of its core businesses and permit the implementation of its strategy to use the portion of airbag royalties retained by the Company (after certain permitted distributions to Talley) and other available cash flow to reduce its total indebtedness.

The Company is permitted (and intends) to distribute cash to its parent, Talley, for specified purposes and under certain other circumstances. These distributions will be made using funds available from operations and the secured credit facility. The payments include (but are not limited to) certain airbag royalties in excess of $10 million in any year (or in excess of such greater amount as would be required for the Company to meet a specified fixed charge coverage ratio) which will be used to redeem the Senior Discount Debentures issued by Talley and an annual distribution of up to $1.3 million ($1.7 million for the period from the issue date of the new indebtedness through December 31, 1994) for a period of five years to fund certain carrying and other costs associated with Talley's real estate operations. The Company may also redeem $8.0 million in preferred stock of the Company purchased by Talley from proceeds of the recent refinancing. In addition, the Company is a party to a cost sharing agreement and a tax sharing agreement which will require the Company to reimburse Talley for certain ongoing general and administrative expenses and to make certain tax payments to Talley.

The Company believes that the combination of cash flow from operations, funds available under the credit facility described above (or any successor facility) and increasing revenue from airbag royalties (to the extent retained by the Company as described above) will provide sufficient liquidity to meet its working capital, debt service and other capital requirements and to meet its other ongoing business needs over the next five years.

Other Matters

As more fully explained in the Commitments and Contingencies note to the December 31, 1993 Consolidated Financial Statements, litigation between the Company and TRW, Inc. (TRW), the buyer of the Company's airbag business and licensee of the Company's technology related thereto, has been pending since 1989. In mid-February 1994 TRW filed a new declaratory judgment action asserting claims already made in the existing action and further claiming the Company, through the actions of a subsidiary, breached a non-compete provision of the Asset Purchase Agreement by rendering services to competitors of TRW, and requesting among other things a court order that a contemporaneous notice and

a $26.5 million one-time payment that TRW sent to the Company was valid, entitling it to terminate that airbag royalty and obtain a paid up license to use the Company's airbag technology. On March 1, the Company answered TRW's complaint and also filed counterclaims alleging that TRW had wrongfully terminated the license agreement, had intentionally interfered with Talley's business relationships and had failed to exert reasonable efforts to exploit the exclusive license granted to TRW by the Company.

On March 14, 1994 the Company filed a Motion for an Order requiring TRW to make payment of all quarterly royalties until the lawsuit is finally resolved. The Company sought the Order to avoid the potential harm from cash flow interruption and/or potential loan covenant defaults caused by TRW's failure to pay scheduled royalty payments. A three day hearing on the Company's Motion was completed on May 3, 1994. The Company expects a ruling from the Court on this Motion in the near future. Without regard to how the Court rules on the Motion, the Company intends to ask the Court for an early hearing on the merits of TRW's attempted termination of royalty payments. The Company believes that a final hearing will show that TRW's claims are without merit and that the Court will enter a final Order confirming the Company's right to continue receiving royalty payments.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

As more fully explained in the Commitments and Contingencies note to the December 31, 1993 Consolidated Financial Statements, litigation between the Company and TRW, Inc. (TRW), the buyer of the Company's airbag business and licensee of the Company's technology related thereto, has been pending since 1989. In mid-February 1994 TRW filed a new declaratory judgment action asserting claims already made in the existing action and further claiming the Company, through the actions of a subsidiary, breached a non-compete provision of the Asset Purchase Agreement by rendering services to competitors of TRW, and requesting among other things a court order that a contemporaneous notice and a $26.5 million one-time payment that TRW sent to the Company was valid, entitling it to terminate that airbag royalty and obtain a paid up license to use the Company's airbag technology. On March 1, the Company answered TRW's complaint and also filed counterclaims alleging that TRW had wrongfully terminated the license agreement, had intentionally interfered with Talley's business relationships and had failed to exert reasonable efforts to exploit the exclusive license granted to TRW by the Company.

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Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits: None

(b) Reports on Form 8-K:

There were no reports on Form 8-K filed for the three months ended March 31, 1994.

SIGNATURES

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

TALLEY MANUFACTURING AND
TECHNOLOGY, INC.
(Registrant)

Date: May 12, 1994

By Kenneth May
Kenneth May
Vice President, Controller
Principal Accounting
Officer

Date: May 12, 1994

By Mark S. Dickerson
Mark S. Dickerson
Vice President, General
Counsel and Secretary