KAMAN CORP
Form 10-Q
November 02, 2011

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

FORM 10-Q

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

For the quarterly period ended September 30, 2011

Or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to ______

Commission File Number: 0-1093

KAMAN CORPORATION

(Exact name of registrant as specified in its charter)

Connecticut (State or other jurisdiction of incorporation or organization)	06-0613548 (I.R.S. Employer Identification No.)

1332 Blue Hills Avenue
Bloomfield, Connecticut 06002
(Address of principal executive offices) (Zip Code)
(860) 243-7100
(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 by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).
Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of “large accelerated filer,” “accelerated filer” and “smaller reporting company” in Rule 12b-2 of the Exchange Act.

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨ Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).
Yes ¨ No x

At October 28, 2011, there were 26,209,307 shares of Common Stock outstanding.

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Item 1. Financial Statements
CONDENSED CONSOLIDATED BALANCE SHEETS
KAMAN CORPORATION AND SUBSIDIARIES
(In thousands, except share and per share amounts) (Unaudited)

	September 30, 2011	December 31, 2010
Assets		
Current assets:		
Cash and cash equivalents	$15,220	$32,232
Accounts receivable, net	193,442	173,620
Inventories	327,564	316,899
Deferred income taxes	25,310	26,357
Income tax receivable	—	2,420
Other current assets	26,740	33,425
Total current assets	588,276	584,953
Property, plant and equipment, net of accumulated depreciation of $139,844 and $130,685, respectively	97,152	89,719
Goodwill	124,384	114,818
Other intangibles assets, net	50,400	49,428
Deferred income taxes	27,291	33,740
Other assets	18,692	23,099
Total assets	$906,195	$895,757
Liabilities and Shareholders' Equity		
Current liabilities:		
Notes payable	$1,410	$2,980
Current portion of long-term debt	5,000	5,000
Accounts payable – trade	109,240	95,416
Accrued salaries and wages	34,943	31,730
Current portion of amount due to Commonwealth of Australia	6,116	24,399
Other accruals and payables	58,130	61,676
Income taxes payable	1,511	644
Total current liabilities	216,350	221,845
Long-term debt, excluding current portion	143,323	140,443
Deferred income taxes	6,997	7,556
Underfunded pension	83,589	98,624
Due to Commonwealth of Australia, excluding current portion	6,191	13,102
Other long-term liabilities	50,333	51,517
Commitments and contingencies		
Shareholders' equity:		
Preferred stock, $1 par value, 200,000 shares authorized; none outstanding	—	—
Common stock, $1 par value, 50,000,000 shares authorized, voting, 26,457,300 and 26,091,067 shares issued, respectively	26,457	26,091
Additional paid-in capital	107,616	97,903
Retained earnings	353,656	325,844
Accumulated other comprehensive income (loss)	(84,077)	(86,300)
Less 181,279 and 64,949 shares of common stock, respectively, held in treasury, at cost	(4,240)	(868)
Total shareholders' equity	399,412	362,670

Total liabilities and shareholders’ equity	$906,195	$895,757

See accompanying notes to the condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
KAMAN CORPORATION AND SUBSIDIARIES
(In thousands, except per share amounts) (Unaudited)

	For the Three Months Ended		For the Nine Months Ended	
	September 30, 2011	October 1, 2010	September 30, 2011	October 1, 2010
Net sales	$356,520	$359,545	$1,119,429	$953,404
Cost of sales	255,219	265,782	807,681	703,626
Gross profit	101,301	93,763	311,748	249,778
Selling, general and administrative expenses	80,945	74,166	244,672	215,018
Net (gain)/loss on sale of assets	14	5	50	(515)
Operating income	20,342	19,592	67,026	35,275
Interest expense (income), net	2,733	(3,529)	8,624	862
Other (income) expense, net	(176)	(24)	(590)	(691)
Earnings before income taxes	17,785	23,145	58,992	35,104
Income tax expense	5,426	7,320	19,626	11,476
Net earnings	$12,359	$15,825	$39,366	$23,628
Net earnings per share:				
Basic net earnings per share	$0.47	$0.61	$1.50	$0.91
Diluted net earnings per share	$0.47	$0.61	$1.48	$0.91
Average shares outstanding:				
Basic	26,339	25,956	26,250	25,904
Diluted	26,561	26,104	26,530	26,071
Dividends declared per share	$0.16	$0.14	$0.44	$0.42

See accompanying notes to the condensed consolidated financial statements.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
KAMAN CORPORATION AND SUBSIDIARIES
(In thousands) (Unaudited)

	For the Nine Months Ended September 30, 2011	October 1, 2010
Cash flows from operating activities:		
Net earnings	$39,366	$23,628
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Depreciation and amortization	16,562	15,267
Change in allowance for doubtful accounts	98	501
Accretion of convertible notes discount	1,230	—
Net (gain) loss on sale of assets	50	(515)
(Gain) on amount due to Commonwealth of Australia, net of gain (loss) on derivative instruments	(123)	(690)
Stock compensation expense	5,720	3,567
Excess tax (benefit) from share-based compensation arrangements	(742)	(214)
Deferred income taxes	4,634	2,247
Changes in assets and liabilities, excluding effects of acquisitions/divestures:		
Accounts receivable	(18,342)	(24,111)
Inventories	(9,563)	(10,690)
Income tax receivable	(2,420)	(1,401)
Other current assets	13,353	649
Accounts payable - trade	3,880	11,659
Accrued contract losses	(31)	3,400
Advances on contracts	453	1,042
Accrued expenses and payables	(22,176)	9,898
Income taxes payable	854	(4,948)
Pension liabilities	(12,890)	(3,121)
Other long-term liabilities	(4,416)	952
Net cash provided by (used in) operating activities	15,497	27,120
Cash flows from investing activities:		
Proceeds from sale of assets	242	1,087
Expenditures for property, plant & equipment	(19,416)	(14,505)
Acquisition of businesses including earn out adjustments, net of cash received	(12,965)	(52,073)
Other, net	252	286
Cash provided by (used in) investing activities	(31,887)	(65,205)
Cash flows from financing activities:		
Net borrowings (repayments) under revolving credit agreements	4,490	45,629
Debt repayment	(3,750)	(3,750)
Net change in book overdraft	9,239	3,013
Proceeds from exercise of employee stock options and employee purchases of stock	4,537	1,817
Purchase of treasury stock	(3,372)	—
Dividends paid	(10,998)	(10,864)

Debt issuance costs	(715)	(2,321)
Windfall tax benefit	742	214
Other	(636)	(362)
Cash provided by (used in) financing activities	(463)	33,376
Net increase (decrease) in cash and cash equivalents	(16,853)	(4,709)
Effect of exchange rate changes on cash and cash equivalents	(159)	(1,352)
Cash and cash equivalents at beginning of period	32,232	18,007
Cash and cash equivalents at end of period	$15,220	$11,946

See accompanying notes to the condensed consolidated financial statements.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the three months and nine months ended September 30, 2011 and October 1, 2010
(Unaudited)

1. BASIS OF PRESENTATION

The December 31, 2010 condensed consolidated balance sheet amounts have been derived from the previously audited consolidated balance sheet of Kaman Corporation and subsidiaries (collectively, the "Company"). In the opinion of management, the remainder of the condensed financial information reflects all adjustments necessary for a fair presentation of the Company's financial position, results of operations and cash flows for the interim periods presented. All such adjustments are of a normal recurring nature, unless otherwise disclosed in this report. Certain amounts in the prior period condensed consolidated financial statements have been reclassified to conform to current presentation. The statements should be read in conjunction with the consolidated financial statements and notes included in the Company's Form 10-K for the year ended December 31, 2010. The results of operations for the interim periods presented are not necessarily indicative of trends or of results to be expected for the entire year.

The Company has a calendar year-end; however, its first three fiscal quarters follow a 13-week convention, with each quarter ending on a Friday. The third quarter for 2011 and 2010 ended on September 30, 2011 and October 1, 2010, respectively.

2. RECENT ACCOUNTING STANDARDS

In September 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-08, "Intangibles - Goodwill and Other (ASC Topic 350) - Testing Goodwill for Impairment." ASU No. 2011-08 intends to simplify goodwill impairment testing by permitting assessment of qualitative factors to determine whether events and circumstances lead to the conclusion that it is necessary to perform the two-step goodwill impairment test currently required under ASC 350, Intangibles - Goodwill and Other. The amendments are effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. Early adoption is permitted, including for annual and interim goodwill impairment tests performed as of a date after September 15, 2011, if an entity's financial statements for the most recent annual or interim period have not yet been issued. The Company plans to adopt this guidance early and apply its provisions for its annual impairment test for 2011. The Company does not expect that the adoption of this guidance will have a significant impact on its Consolidated Financial Statements.

In June 2011, the FASB issued ASU No. 2011-05, "Comprehensive Income (ASC Topic 220) - Presentation of Comprehensive Income." ASU No. 2011-05 eliminates the option to present the components of other comprehensive income as part of the statement of equity and requires an entity to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. The amendments are effective retrospectively for fiscal years, and interim periods within those years, beginning after December 15, 2011. The guidance requires changes in presentation only and will have no significant impact on the Company's Consolidated Financial Statements.

In May 2011, the FASB issued ASU No. 2011-04, "Fair Value Measurement (ASC Topic 820) - Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRS." ASU No. 2011-04 amends current fair value measurement and disclosure guidance to include increased transparency around valuation inputs and investment categorization. The changes are effective prospectively for interim and annual periods beginning after December 15, 2011. The Company does not expect that the adoption of this guidance will have a significant impact on its Consolidated Financial Statements.

3. ADDITIONAL CASH FLOW INFORMATION

Cash payments for interest were $6.8 million and $5.9 million for the nine months ended September 30, 2011, and October 1, 2010, respectively. Cash payments for income taxes, net of refunds, for the same periods were $10.9 million and $14.0 million, respectively.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the three months and nine months ended September 30, 2011 and October 1, 2010
(Unaudited)

4. ACCQUISITIONS

On September 2, 2011, the Company acquired Target Electronic Supply ("Target") for $14.2 million, inclusive of working capital adjustments and contingent consideration. Target, founded in 1978, has become part of the Company's Industrial Distribution segment. Target is a leading motion control distributor in the New England area with locations in Massachusetts, Connecticut and New Hampshire.

The acquisition was accounted for as a purchase transaction. The value of the assets acquired and liabilities assumed were recorded based on their fair value at the date of acquisition. The fair value of assets acquired and liability assumed are as follows (in thousands):

Cash	$20	
Accounts receivable	1,583	
Inventories	1,822	
Property, plant and equipment	88	
Other tangible assets	20	
Goodwill	8,451	
Other intangible assets	2,980	
Other liabilities	(710	)
Total of net assets acquired	14,254	
Less cash received	(20	)
Plus debt assumed	—	
Total consideration	$14,234	

The Company has paid $10.6 million of the total consideration of $14.2 million through September 30, 2011. The remaining $3.6 million represents the contingent consideration and working capital adjustment holdback. The Company recorded a $3.4 million contingent consideration liability, which is based on the attainment of certain gross profit targets by the acquired business through 2014. The total possible undiscounted payments could range from zero to $4.0 million. The goodwill is tax deductible (excluding the portion relating to the contingent consideration liability, which is not deductible until paid). The goodwill is the result of expected synergies from combining the operations of the acquired business with the Company's operations and intangible assets that do not qualify for separate recognition, such as an assembled workforce. There is $1.1 million of revenue from this acquisition included in the Condensed Consolidated Statement of Operations for the three months and nine months ended September 30, 2011.

The fair value of the identifiable intangible assets of $3.0 million, consisting of trade names and customer relationships, was determined using the income approach. Specifically, the relief-from-royalty method was utilized for the trade names and the discounted cash flows method was utilized for the customer relationships. The trade names, $0.1 million, are being amortized over a period of 3 years, and the customer relationships, $2.9 million, are being amortized over a period of 8 years, the estimated lives of the assets.

During the second quarter, the Company acquired a distribution business comprised of two locations for a purchase price of $0.9 million that has been merged into our existing distribution operations.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
For the three months and nine months ended September 30, 2011 and October 1, 2010
(Unaudited)

5. ACCOUNTS RECEIVABLE, NET

Accounts receivable consist of the following (in thousands):

	September 30, 2011	December 31, 2010
Trade receivables	$120,147	$102,679
U.S. Government contracts:		
Billed	28,524	37,278
Costs and accrued profit – not billed	3,085	7,521
Commercial and other government contracts:		
Billed	45,233	29,973
Costs and accrued profit – not billed	375	—
Less allowance for doubtful accounts	(3,922)	(3,831)
Accounts receivable, net	$193,442	$173,620

Accounts receivable, net includes amounts for matters such as contract changes, negotiated settlements and claims for unanticipated contract costs, which totaled $0.2 million and $0.5 million at September 30, 2011 and December 31, 2010, respectively. The Company records revenue associated with these matters only when recovery can be estimated reliably and realization is probable.

6. FAIR VALUE MEASUREMENTS

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants at the measurement date.

The Company uses a three-level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy requires us to maximize the use of observable inputs and minimize the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1 — Quoted prices in active markets for identical assets or liabilities.
- Level 2 — Observable inputs other than quoted prices included in Level 1, such as quoted prices for markets that are not active or other inputs that are observable or can be corroborated by observable market data.
- Level 3 — Unobservable inputs that are supported by little or no market activity and are significant to the fair value of the assets or liabilities. This includes certain pricing models, discounted cash flow methodologies and similar techniques that use significant unobservable inputs.

The table below segregates all financial assets and liabilities that are measured at fair value on a recurring basis (at least annually) into the most appropriate level within the fair value hierarchy based on the inputs used to determine their fair value at the measurement date (in thousands):

	Carrying Value at	Quoted prices in active markets	Significant other observable	Significant unobservable

	September 30, 2011	(Level 1)	inputs (Level 2)	inputs (Level 3)
Derivative instruments	$2,971	$—	$2,971	$—
Total Assets	$2,971	$—	$2,971	$—
Derivative instruments	$203	$—	$203	$—
Contingent consideration	3,355	—	—	3,355
Total Liabilities	$3,558	$—	$203	$3,355

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6. FAIR VALUE MEASUREMENTS (CONTINUED)

	Total Carrying Value at December 31, 2010	Quoted prices in active markets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)
Derivative instruments	$12,623	$—	$12,623	$—
Total Assets	$12,623	$—	$12,623	$—
Derivative instruments	$806	$—	$806	$—
Total Liabilities	$806	$—	$806	$—

The Company's derivative instruments are limited to foreign exchange contracts and interest rate swaps that are measured at fair value using observable market inputs such as forward rates and our counterparties' credit risks. Based on these inputs, the derivative instruments are classified within Level 2 of the valuation hierarchy and have been included in other current assets, other assets and other long-term liabilities on the Condensed Consolidated Balance Sheets at September 30, 2011 and December 31, 2010. Based on the continued ability to trade and enter into forward contracts and interest rate swaps, we consider the markets for our derivative instruments to be active.

The Company evaluated the credit risk associated with the counterparties to these derivative instruments and determined that, as of September 30, 2011, such credit risks have not had an adverse impact on the fair value of these instruments.

The Company's contingent consideration liability of $3.4 million is associated with the acquisition of Target. This liability was measured at fair value based on the potential payments of the liability associated with the unobservable input of the estimated post-acquisition financial results of Target through 2014 and, therefore, is a Level 3 liability. See Note 4, Acquisitions, for further discussion of this acquisition. There was no change in the estimated fair value from the acquisition date through September 30, 2011.

7. DERIVATIVE FINANCIAL INSTRUMENTS

The Company is exposed to certain risks relating to its ongoing business operations, including market risks relating to fluctuations in foreign currency exchange rates and interest rates. Derivative financial instruments are recognized on the consolidated balance sheets as either assets or liabilities and are measured at fair value. Changes in the fair values of derivatives are recorded each period in earnings or accumulated other comprehensive income, depending on whether a derivative is effective as part of a hedged transaction. Gains and losses on derivative instruments reported in accumulated other comprehensive income are subsequently included in earnings in the periods in which earnings are affected by the hedged item. The Company does not use derivative instruments for speculative purposes.

Derivatives Designated as Cash Flow Hedges

The Company's Term Loan Credit Agreement ("Term Loan") contains floating rate obligations and is subject to interest rate fluctuations. During 2009, the Company entered into interest rate swap agreements for the purposes of hedging the eight quarterly variable-rate interest payments on its Term Loan due in 2010 and 2011. These interest rate swap agreements are designated as cash flow hedges. They are intended to manage interest rate risk associated with the Company's variable-rate borrowings and minimize the impact of interest rate fluctuations on the Company's earnings and cash flows attributable to changes in LIBOR rates. The Company will include in earnings amounts currently included in accumulated other comprehensive income upon payment of its last remaining quarterly variable-rate interest payment.

The Company holds foreign exchange contracts designed to hedge forecasted transactions denominated in foreign currencies and to minimize the impact of foreign currency fluctuations on the Company's earnings and cash flows. Some of these contracts were designated as cash flow hedges. The Company will include in earnings amounts currently included in accumulated other comprehensive income upon recognition of cost of sales related to the underlying transactions.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
For the three months and nine months ended September 30, 2011 and October 1, 2010
(Unaudited)

7. DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

Derivatives Designated as Cash Flow Hedges – Continued

The following table shows the fair value of derivative instruments designated as cash flow hedging instruments (in thousands):

	Balance Sheet Location	Fair Value September 30, 2011	December 31, 2010	Notional Amount
Derivative Liabilities				
Interest rate swap contracts	Other liabilities	$203	$806	$40,000
Total		$203	$806	

The following table shows the gain or (loss) recognized in other comprehensive income for derivatives designated as cash flow hedges (in thousands):

	For the three months ended		For the nine months ended	
	September 30, 2011	October 1, 2010	September 30, 2011	October 1, 2010
Interest rate swap contracts	$(3)	$(181)	$(51)	$(774)
Total	$(3)	$(181)	$(51)	$(774)

During the three months and nine months ended September 30, 2011, the loss reclassified to earnings from other comprehensive income for derivative instruments designated as cash flow hedges was $0.2 million and $0.7 million, respectively. During the three months and nine months ended October 1, 2010, the loss reclassified to earnings from other comprehensive income for derivative instruments designated as cash flow hedges was $0.1 million and $0.4 million, respectively. Over the next twelve months, the Company expects to reclassify $0.1 million to earnings from other comprehensive income for derivative instruments designated as cash flow hedges.

During the three months and nine months ended September 30, 2011 and October 1, 2010, no amounts were recorded for the ineffective portion of derivative instruments designated as cash flow hedges.

Derivatives Not Designated as Hedging Instruments

The following table shows the fair value of derivative instruments not designated as hedging instruments (in thousands):

	Balance Sheet Location	Fair Value September 30, 2011	December 31, 2010	Notional Amount
Derivative Assets				
Foreign exchange contracts	Other current assets	$—	$10	0 / 350 Euro

Foreign exchange contracts	Other current assets / Other assets	2,899	12,613	9,816 / 36,516 Australian Dollars
Foreign exchange contracts	Other current assets / Other assets	72	—	$5,418 / $0
Total		$2,971	$12,623	

On February 12, 2009, the Company dedesignated the forward contract it had entered into to hedge $36.5 million (AUD) of its $39.5 million (AUD) future minimum required payments to the Commonwealth of Australia. Payments of $26.8 million (AUD), of the $36.5 million (AUD) hedged liability, were made through September 30, 2011. At September 30, 2011, the U.S. dollar value of the remaining $9.8 million (AUD) hedged liability was $9.5 million.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
For the three months and nine months ended September 30, 2011 and October 1, 2010
(Unaudited)

7. DERIVATIVE FINANCIAL INSTRUMENTS (CONTINUED)

Derivatives Not Designated as Hedging Instruments – Continued

The following table shows the location and amount of the gain (loss) recognized on the Condensed Consolidated Statements of Operations for derivatives not designated as hedge instruments (in thousands):

	Statement of Operations Location	For the three months ended September 30, 2011	For the three months ended October 1, 2010	For the nine months ended September 30, 2011	For the nine months ended October 1, 2010
Derivative Assets					
Foreign exchange contracts	Other expense, net	$—	$—	$—	$5
Foreign exchange contracts (a)	Other expense, net	(835)	4,698	(110)	3,415
Foreign exchange contracts	Other expense, net	—	—	—	(55)
Foreign exchange contracts	Other expense, net	—	16	—	16
Foreign exchange contracts	Other expense, net	71	—	71	—
Total		$(764)	$4,714	$—$(39)	$3,381
Derivative Liabilities					
Foreign exchange contracts	Other expense, net	$—	$—	$(2)	$(61)
Total		$—	$—	$(2)	$(61)

(a) For the three months and nine months ended September 30, 2011, the Company recorded income of $1.1 million and $0.8 million, respectively, in other (income) expense, net related to the change in the value of the previously hedged $36.5 million (AUD) payable. For the three months and nine months ended October 1, 2010, the Company recorded expense of $4.7 million and $2.7 million, respectively, in other (income) expense, net related to the change in the value of the previously hedged $36.5 million (AUD) payable.

Hedges of a Net Investment in Foreign Operations

The Company did not reclassify any amounts related to hedges of a net investment in foreign operations from other comprehensive income to earnings during the three months and nine months ended September 30, 2011 or October 1, 2010. Over the next twelve months, the Company does not expect to reclassify any amounts related to the Euro note from other comprehensive income to earnings.

8. INVENTORIES

Inventories consist of the following (in thousands):

	September 30, 2011	December 31, 2010
Merchandise for resale	$115,691	$113,841
Contracts and other work in process	199,070	184,210

Finished goods	12,803	18,848
Total	$327,564	$316,899

Inventories include amounts associated with matters such as contract changes, negotiated settlements and claims for unanticipated contract costs, which totaled $9.9 million and $10.4 million at September 30, 2011 and December 31, 2010, respectively. Of the inventory associated with claims, $3.2 million relates to the FMU-143 matter. See Note 11, Commitments and Contingencies, for further discussion of this matter. The Company records costs associated with these matters in inventory only when recovery can be estimated reliably and realization is probable.

K-MAX® inventory of $19.7 million and $23.7 million as of September 30, 2011 and December 31, 2010, respectively, is included in other work in process and finished goods. The decrease in this balance reflects inventory being used on our contract for K-MAX® unmanned aircraft systems. Management believes that a significant portion of this K-MAX inventory will be sold after September 30, 2012, based upon the anticipation of supporting the fleet for the foreseeable future.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
For the three months and nine months ended September 30, 2011 and October 1, 2010
(Unaudited)

8. INVENTORIES (CONTINUED)

SH-2G(I), formerly SH-2G(A), inventory of $52.7 million and $53.7 million at September 30, 2011 and December 31, 2010, respectively, is included in contracts and other work in process inventory. Management believes that a significant portion of this inventory will be sold after September 30, 2012, based upon the time needed to market the aircraft and prepare them for sale.

9. ENVIRONMENTAL COSTS

The following table displays the activity and balances associated with accruals related to environmental costs included in other accruals and payables and other long-term liabilities (in thousands):

Balance at December 31, 2010	$15,012
Additions to accrual	540
Payments	(1,116)
Changes in foreign currency	11
Balance at September 30, 2011	$14,447

For further discussion of these matters see Note 11, Commitments and Contingencies.

10. PENSION PLANS

Components of net pension cost for the Qualified Pension Plan and Supplemental Employees’ Retirement Plan (SERP) are as follows (in thousands):

	Qualified Pension Plan		SERP	
	For the three months ended		For the three months ended	
	September 30, 2011	October 1, 2010	September 30, 2011	October 1, 2010
Service cost for benefits earned	$3,021	$2,752	$90	$98
Interest cost on projected benefit obligation	7,082	7,185	129	188
Expected return on plan assets	(8,581)	(7,987)	—	—
Effect of curtailment	—	—	—	737
Net amortization and deferral	1,695	554	38	105
Net pension cost	$3,217	$2,504	$257	$1,128

	Qualified Pension Plan		SERP	
	For the nine months ended		For the nine months ended	
	September 30, 2011	October 1, 2010	September 30, 2011	October 1, 2010
Service cost for benefits earned	$9,061	$8,774	$270	$278
Interest cost on projected benefit obligation	21,244	21,920	387	592

Expected return on plan assets	(25,741)	(24,038)	—	—
Effect of curtailment	—	221	560	737
Net amortization and deferral	5,086	2,109	114	232
Net pension cost	$9,650	$8,986	$1,331	$1,839

The Company has contributed $19.6 million to the Qualified Pension Plan for the 2011 plan year, $13.8 million of which was voluntary. The Company does not expect to make any further contributions to the Qualified Pension Plan during 2011. The Company expects to contribute $4.4 million to the SERP for the 2011 plan year, $4.3 million of which was contributed during the first nine months of 2011. For the 2010 plan year, the Company made contributions of $35.7 million to the qualified plan and $3.4 million to the SERP.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
For the three months and nine months ended September 30, 2011 and October 1, 2010
(Unaudited)

11. COMMITMENTS AND CONTINGENCIES

Legal Matters

FMU-143

As reported previously, the Company is involved in various litigation concerning its prior FMU-143 program at the Aerospace segment’s Orlando facility (“Orlando Facility”). The suits involve (a) a civil action brought by the U.S. Government (“USG”) under the False Claims Act in federal district court in Orlando alleging that the Company knowingly substituted the wrong version of the bellows motor into some FMU-143 lots, for which the current damages claim is approximately $6 million and (b) various claims and counterclaims before the Armed Services Board of Contract Appeals (the “Board”) concerning performance under the program, with the USG alleging that the Company owes the USG over $15 million and the Company claiming that the USG owes it over $8 million. During the third quarter, the parties began substantive settlement discussions to resolve these suits and those discussions continue. If a settlement is reached upon terms satisfactory to both parties, the Company could pay the USG up to $5.0 million. In addition, there would be no admission of liability in either matter, which is consistent with management's view of its legal liability. Although a settlement is reasonably possible, no amount has been accrued for these matters as of September 30, 2011 due to the substantive nature of the non-financial settlement terms under discussion, including the USG approval process that must be followed for both the False Claim Act and Board matter. In the meantime, the trial originally scheduled for October 2011 in the False Claims Act matter has been postponed and the Board proceedings have been stayed.

If the settlement were to occur, the Company has net assets of $2.2 million, primarily inventory, related to the counterclaim against the USG that would be at risk. Should the settlement terms be resolved to the satisfaction of both parties, the Company will evaluate the recoverability of these assets and record an impairment charge, if necessary.

Wichita Subpoena Matter

A grand jury subpoena has been issued out of the U.S. District Court for the District of Kansas to Kaman Composites-Wichita, in connection with a government investigation relating to record keeping associated with the manufacture of certain composite parts. Management is cooperating with the government's investigation and believes that it has fully complied with all legal obligations in connection with the manufacture of the parts in question. At September 30, 2011, the Company had no amount accrued for this matter, as it is unable to estimate the amount of costs, if any, that might be incurred in connection with the resolution of this matter at this time. The Company believes that the likelihood of an adverse outcome to this matter is remote.

Other Matters

Revenue Sharing Agreement with the Commonwealth of Australia

Pursuant to the terms of its revenue sharing agreement with the Commonwealth of Australia, the Company will share all proceeds from the resale of the SH-2G(I), formerly SH-2G(A), aircraft, spare parts, and equipment with the Commonwealth on a predetermined basis, and a minimum of at least $39.5 million (AUD) must be paid to the Commonwealth regardless of sales. Cumulative payments of $26.8 million (AUD) have been made through September 30, 2011. Additional payments of $6.4 million (AUD) each must be paid in March of 2012 and 2013 to the extent that cumulative payments have not yet reached $33.1 million (AUD) and $39.5 million (AUD) as of such dates, respectively.

To secure these payments, the Company has provided the Commonwealth with a $12.7 million (AUD) unconditional letter of credit as of September 30, 2011, which is being reduced as such payments are made. As of September 30, 2011, the U.S. dollar value of the remaining $12.7 million (AUD) required payment was $12.3 million, of which $6.1 million is due no later than March 2012. In late 2008, the Company entered into foreign currency exchange contracts that limit the foreign currency risks associated with these required payments. These contracts will enable the Company to purchase $9.8 million (AUD) for $6.3 million. See Note 7, Derivative Financial Instruments, for further discussion of these instruments.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
For the three months and nine months ended September 30, 2011 and October 1, 2010
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11. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Other Matters - Continued

40 mm

The Orlando facility is one of five defendants in a qui tam suit under the False Claims Act brought by John D. King, a former employee of one of the other defendants. The case, United States ex rel. King v. DSE, Inc., et al., No. 9:08-cv-02416 (M.D. Fla.), is currently pending in the U.S. District Court for the Middle District of Florida. The United States Department of Justice has declined to intervene in the suit, and the case is being brought by Mr. King. The suit alleges that the Orlando facility knowingly submitted false claims or made false statements in connection with its work on 40 mm grenade programs. Management believes that it has fully complied with its legal obligations in connection with this program. At September 30, 2011, the Company had no amount accrued for this matter, as it is unable to estimate the amount of costs, if any, that might be incurred in connection with the resolution of this matter at this time. The Company believes that the likelihood of an adverse outcome to this matter is remote.

Moosup

The Connecticut Department of Environmental Protection (“CTDEP”) has given the Company approval for reclassification of groundwater in the vicinity of the Moosup, CT facility consistent with the character of the area. This facility is currently being held for disposal. The Company has completed the process of connecting neighboring properties to public drinking water in accordance with such approval and in coordination with the CTDEP and local authorities. Site characterization of the environmental condition of the property, which began in 2008, is continuing and is anticipated to be completed by the end of 2011.

The total anticipated cost of the environmental remediation activities associated with the Moosup property is $4.2 million, all of which has been accrued. The total amount paid to date in connection with these environmental remediation activities is $2.0 million. A portion ($0.4 million) of the accrual related to this property is included in other accruals and payables and the balance is included in other long-term liabilities. The remaining balance of the accrual reflects the total anticipated cost of completing these environmental remediation activities. Although it is reasonably possible that additional costs will be paid in connection with the resolution of this matter, the Company is unable to estimate the amount of such additional costs, if any, at this time.

New Hartford

In connection with the sale of the Music segment in 2007, the Company assumed responsibility for meeting certain requirements of the Connecticut Transfer Act (the “Transfer Act”) that applied to the transfer of the New Hartford, Connecticut, facility leased by that segment for guitar manufacturing purposes (“Ovation”). Under the Transfer Act, those responsibilities essentially consist of assessing the site's environmental conditions and remediating environmental impairments, if any, caused by Ovation's operations prior to the sale. The site is a multi-tenant industrial park, in which Ovation and other unrelated entities leased space. The environmental assessment process, which began in 2008, is still in process.

The Company's estimate of its portion of the cost to assess the environmental conditions and remediate this site is $2.2 million, unchanged from previously reported estimates, all of which has been accrued. The total amount paid to date in connection with these environmental remediation activities is $0.5 million. A portion ($0.5 million) of the accrual related to this property is included in other accruals and payables and the balance is included in other long-term liabilities. The remaining balance of the accrual reflects the total anticipated cost of completing these environmental remediation activities. Although it is reasonably possible that additional costs will be paid in connection with the resolution of this matter, the Company is unable to estimate the amount of such additional costs, if any, at this time.

11. COMMITMENTS AND CONTINGENCIES (CONTINUED)

Other Matters - Continued

Bloomfield

In connection with the 2008 purchase of the portion of the Bloomfield campus that Kaman Aerospace Corporation had leased from NAVAIR, the Company assumed responsibility for environmental remediation at the facility as may be required under the Transfer Act and continues the effort to define the scope of the remediation that will be required by the CTDEP. The assumed environmental liability of $10.3 million was determined by taking the undiscounted estimated remediation liability of $20.8 million and discounting it at a rate of 8%. This remediation process will take many years to complete. The total amount paid to date in connection with these environmental remediation activities is $3.7 million. A portion ($2.4 million) of the accrual related to this property is included in other accruals and payables and the balance is included in other long-term liabilities. Although it is reasonably possible that additional costs will be paid in connection with the resolution of this matter, the Company is unable to estimate the amount of such additional costs, if any, at this time.

United Kingdom

In connection with the purchase of Kaman U.K. Composites ("U.K. Composites"), the Company accrued, at the time of acquisition, £1.6 million for environmental compliance at the facilities. The remaining balance of the accrual at September 30, 2011 was £0.9 million, with £0.5 million having been paid to date in connection with these environmental remediation activities and £0.2 million released to income. The U.S. dollar equivalent of the remaining environmental compliance liability as of September 30, 2011, is $2.5 million, which is included in other accruals and payables. The Company continues to assess the work that may be required, which may result in a change to this accrual. Although it is reasonably possible that additional costs will be paid in connection with the resolution of this matter, the Company is unable to estimate the amount of such additional costs, if any, at this time.

12. DEBT

Revolving Credit and Term Loan Agreements

In June 2011, the Company amended its $275.0 million Amended and Restated Revolving Credit Agreement and its Second Amended and Restated Term Loan Credit Agreement. These amendments allowed the Company to reduce the interest rate for these facilities to LIBOR plus 137.5 basis points compared to an interest rate of LIBOR plus 200.0 basis points prior to the amendments. In addition, the Company amended the required quarterly commitment fees on the unused revolving loan commitment amount from 0.35% to 0.50% per annum to 0.225% to 0.35% per annum, and the fees for outstanding letters of credit from 2.00% to 3.00% to 1.375% to 2.25%, based on the leverage ratio as defined in the agreements. These amendments did not result in any other changes to these facilities.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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13. COMPUTATION OF EARNINGS PER SHARE

The computation of basic earnings per share is based on net earnings divided by the weighted average number of shares of common stock outstanding for each period. The computation of diluted earnings per share includes the common stock equivalency of convertible debt and dilutive option awards granted to employees under the Stock Incentive Plan.

	For the three months ended		For the nine months ended	
	September 30, 2011	October 1, 2010	September 30, 2011	October 1, 2010
	(in thousands, except per share amounts)			
Net earnings	$12,359	$15,825	$39,366	$23,628
Basic:				
Weighted average shares outstanding	26,339	25,956	26,250	25,904
Basic earnings per share	$0.47	$0.61	$1.50	$0.91
Diluted:				
Weighted average shares outstanding	26,339	25,956	26,250	25,904
Weighted average shares issuable on exercise of dilutive stock options	222	148	238	167
Weighted average shares issuable on exercise of convertible notes	—	—	42	—
Weighted average diluted shares outstanding	26,561	26,104	26,530	26,071
Diluted earnings per share	$0.47	$0.61	$1.48	$0.91

Excluded from the diluted earnings per share calculation for the three months and nine months ended September 30, 2011, respectively, are 165,482 and 233,965 anti-dilutive option awards granted to employees. Excluded from the diluted earnings per share calculation for the three months and nine months ended October 1, 2010, respectively, are 519,625 and 519,903 anti-dilutive option awards granted to employees.

In November 2010, the Company issued Convertible Notes due on November 15, 2017 in the aggregate principal amount of $115.0 million. No shares were issuable under the Convertible Notes as the exercise price for the Convertible Notes was greater than the average share price for the three-month period. Shares issuable under the Convertible Notes that were dilutive during the nine-month period have been included in the calculation of earnings per share for the nine months ended September 30, 2011. Excluded from the diluted earnings per share calculation for the three months and nine months ended September 30, 2011 are 3,386,739 shares issuable under the warrants with a strike price of $44.40 sold in connection with the Company’s convertible note offering as they would be anti-dilutive.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
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14. SHARE-BASED ARRANGEMENTS

Stock Plan Activity

The following table summarizes share-based compensation expense recorded during each period presented (in thousands):

	For the three months ended		For the nine months ended	
	September 30, 2011	October 1, 2010	September 30, 2011	October 1, 2010
Stock options	$351	$280	$1,385	$1,136
Restricted stock awards	627	491	3,912	2,181
Stock appreciation rights	—	72	179	46
Employee stock purchase plan	87	70	244	204
Total share-based compensation	$1,065	$913	$5,720	$3,567

Stock option activity was as follows:

	For the three months ended September 30, 2011		For the nine months ended September 30, 2011	
	Stock Options	Weighted-average exercise price	Stock Options	Weighted-average exercise price
Stock options outstanding at beginning of period	1,001,005	$ 23.29	985,079	$ 20.81
Granted	—	—	183,815	31.78
Exercised	(2,026)	18.33	(159,151)	17.96
Forfeited or expired	—	—	(10,764)	19.61
Stock options outstanding at September 30, 2011	998,979	$ 23.30	998,979	$ 23.30

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model. The following table indicates the weighted-average assumptions used in estimating fair value:

	For the three months ended		For the nine months ended	
	September 30, 2011	October 1, 2010	September 30, 2011	October 1, 2010
Expected option term	—	—	6.5 years	6.5 years
Expected volatility	— %	— %	43.9 %	46.1 %
Risk-free interest rate	— %	— %	2.9 %	3.2 %
Expected dividend yield	— %	— %	2.2 %	3.3 %
Per share fair value of options granted	$—	$—	$12.05	$9.28

There were no stock options granted during the three months ended September 30, 2011 and October 1, 2010.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
For the three months and nine months ended September 30, 2011 and October 1, 2010
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14. SHARE-BASED ARRANGEMENTS (CONTINUED)

Stock Plan Activity - Continued

Restricted Stock activity was as follows:

	For the three months ended September 30, 2011		For the nine months ended September 30, 2011	
	Restricted Stock Awards	Weighted-average grant date fair value	Restricted Stock Awards	Weighted-average grant date fair value
Restricted Stock outstanding at beginning of period	337,919	$ 25.73	287,761	$ 22.84
Granted	—	—	170,934	31.94
Vested	(11,100)	30.27	(130,494)	27.89
Forfeited or expired	—	—	(1,382)	24.56
Restricted Stock outstanding at September 30, 2011	326,819	$ 25.58	326,819	$ 25.58

Stock Appreciation Rights ("SARs") activity was as follows:

	For the three months ended September 30, 2011		For the nine months ended September 30, 2011	
	Stock Appreciation Rights (SARs)	Weighted-average exercise price	Stock Appreciation Rights (SARs)	Weighted-average exercise price
SARs outstanding at beginning of period	—	$ —	21,700	$ 10.66
Granted	—	—	—	—
Exercised	—	—	(21,700)	10.66
Forfeited or expired	—	—	—	—
SARs outstanding at September 30, 2011	—	$ —	—	$ —

The Company made payments of $0.6 million to settle stock appreciation rights (at intrinsic value) during the nine months ended September 30, 2011. No cash was paid to settle stock appreciation rights during the three months ended September 30, 2011. No cash was paid to settle stock appreciation rights during the three months and nine months ended October 1, 2010.

15. GOODWILL AND OTHER INTANGIBLE ASSETS, NET

Goodwill

The following table sets forth the change in the carrying amount of goodwill for each segment and for the Company:

In thousands	Industrial Distribution	Aerospace	Total
Gross balance at December 31, 2010	$39,868	$89,131	$128,999
Accumulated impairment	—	(14,181)	(14,181)
Net balance at December 31, 2010	39,868	74,950	114,818
Additions	8,974	637	9,611
Exchange rate changes	(87)	42	(45)
Net balance at September 30, 2011	$48,755	$75,629	$124,384

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
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15. GOODWILL AND OTHER INTANGIBLE ASSETS, NET (CONTINUED)

Goodwill - Continued

The additions to the goodwill balance relate to the Industrial Distribution segment's two acquisitions during 2011 and earn out payments made to the former owners of one of the Aerospace segment's earlier acquisitions. The two Industrial Distribution acquisitions were the acquisition of Target, discussed in Note 4, Acquisitions, and a distribution business comprised of two locations for a purchase price of $0.9 million. Both have been merged into the Company's existing distribution operations.

Other Intangible Assets

Other intangible assets consisted of:

		At September 30, 2011		At December 31, 2010	
	Amortization Period	Gross Amount	Accumulated Amortization	Gross Amount	Accumulated Amortization
In thousands					
Customer lists / relationships	8-21 years	$55,262	$(7,853)	$50,798	$(5,135)
Trademarks / trade names	3-7 years	1,474	(625)	1,396	(403)
Patents	17 years	636	(463)	657	(442)
Non-compete agreements and other	1-9 years	3,980	(2,011)	3,902	(1,345)
Total		$61,352	$(10,952)	$56,753	$(7,325)

The increase in the intangible asset balance relates primarily to the Industrial Distribution acquisitions mentioned above, payments made by the Company's Aerospace segment in accordance with an exclusive teaming arrangement and fluctuations in foreign currency exchange rates.

In order to determine the useful life of the customer lists/relationships acquired in 2011, the Company considered numerous factors, most importantly the industry considerations associated with the acquired entity. The Company determined the amortization period for the customer lists/relationships intangible assets for its Industrial Distribution acquisitions in 2011 based primarily on an analysis of their historical customer sales attrition information.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
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16. SEGMENT INFORMATION

The Company is organized based upon the nature of its products and services, and is composed of two operating segments each overseen by a segment manager. These segments are reflective of how the Company's Chief Executive Officer, who is its Chief Operating Decision Maker ("CODM"), reviews operating results for the purposes of allocating resources and assessing performance. The Company has not aggregated operating segments for purposes of identifying reportable segments.

In thousands	For the three months ended September 30, 2011	October 1, 2010	For the nine months ended September 30, 2011	October 1, 2010
Net sales:				
Industrial Distribution	$239,132	$223,127	$717,309	$613,310
Aerospace	117,388	136,418	402,120	340,094
Net sales	$356,520	$359,545	$1,119,429	$953,404
Operating income:				
Industrial Distribution	$11,869	$8,494	$35,853	$21,019
Aerospace	18,694	19,017	61,515	40,764
Net gain (loss) on sale of assets	(14)	(5)	(50)	515
Corporate expense	(10,207)	(7,914)	(30,292)	(27,023)
Operating income	20,342	19,592	67,026	35,275
Interest expense, net	2,733	(3,529)	8,624	862
Other income, net	(176)	(24)	(590)	(691)
Earnings before income taxes	17,785	23,145	58,992	35,104
Income tax expense	5,426	7,320	19,626	11,476
Net earnings	$12,359	$15,825	$39,366	$23,628

Included in Corporate expense for the three months and nine months ended September 30, 2011 is $0.3 million and $0.4 million, respectively of costs incurred in connection with acquisitions. Included in Corporate expense for the nine months ended October 1, 2010 is $1.1 million of costs incurred in connection with acquisitions.

17. SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME

Changes in shareholders' equity for the nine months ended September 30, 2011, were as follows (in thousands):

Balance at December 31, 2010	$362,670
Net earnings	39,366
Change in pension & post-retirement benefit plan liabilities, net	3,231
Foreign currency translation adjustment, net	(1,386)
Unrealized gain (loss) on derivative instruments, net	378
Dividends declared	(11,555)
Employee stock plans and related tax benefit	4,539

Purchase of treasury shares	(3,372)
Share-based compensation activity	5,541
Balance at September 30, 2011	$399,412

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (CONTINUED)
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17. SHAREHOLDERS' EQUITY AND COMPREHENSIVE INCOME (CONTINUED)

Comprehensive income (loss) is shown below (in thousands):

	For the three months ended	
	September 30, 2011	October 1, 2010
Net earnings	$12,359	$15,825
Change in pension and post-retirement benefit plan liabilities, net of tax of expense of $660 and $250, respectively	1,077	408
Foreign currency translation adjustment	(6,088)	5,286
Unrealized gain (loss) on derivative instruments, net of tax expense of $81 and tax benefit of $14, respectively	135	(23)
Comprehensive income	$7,483	$21,496

	For the nine months ended	
	September 30, 2011	October 1, 2010
Net earnings	$39,366	$23,628
Change in pension and post-retirement benefit plan liabilities,		