

EASTERN CO  
Form 10-Q  
October 28, 2008

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

**FORM 10-Q**

(Mark One)

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED September 27, 2008**

**OR**

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

**Commission File Number:** 0599

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

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

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

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

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

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Edgar Filing: EASTERN CO - Form 10-Q

Yes  No

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

Large accelerated filer

Accelerated filer

Non-accelerated filer  (Do not check if a smaller reporting company)

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

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

| <u>Class</u>               | <u>Outstanding as of September 27, 2008</u> |
|----------------------------|---|
| Common Stock, No par value | 5,958,314                                   |

- 1 -

---

## PART 1 FINANCIAL INFORMATION

## ITEM 1 FINANCIAL STATEMENTS

## THE EASTERN COMPANY AND SUBSIDIARIES

## CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

|   | September 27,<br>2008 |   | December 29,<br>2007  |
|---|-----------------------|---|-----------------------|
| <b>ASSETS</b>   |                       |   |                       |
| <b>Current Assets</b>   |                       |   |                       |
| Cash and cash equivalents   | \$ 9,184,034          |   | \$ 8,209,722          |
| Accounts receivable, less allowances: \$339,000 - 2008; \$342,000 - 2007          | 21,884,932            |   | 18,993,934            |
| Inventories   | 29,499,583            |   | 30,490,696            |
| Prepaid expenses and other assets   | 2,888,386             |   | 2,872,910             |
| Recoverable taxes receivable  | -                     |   | 1,428,569             |
| Deferred income taxes   | 1,256,780             |   | 1,256,780             |
| <b>Total Current Assets</b>   | <b>64,713,715</b>     |   | <b>63,252,611</b>     |
| <br>  |                       |   |                       |
| <b>Property, Plant and Equipment</b>  | <b>49,724,215</b>     |   | 47,983,565            |
| <b>Accumulated depreciation</b>   | <b>(25,195,474)</b>   | ) | (22,749,351)          |
|   | <b>24,528,741</b>     |   | 25,234,214            |
| <br>  |                       |   |                       |
| <b>Goodwill</b>   | <b>13,883,070</b>     |   | 13,955,608            |
| <b>Trademarks</b>   | <b>143,818</b>        |   | 135,473               |
| <b>Patents, technology, and other intangibles net of accumulated amortization</b> | <b>3,744,076</b>      |   | 3,981,338             |
| <b>Prepaid pension cost</b>   | <b>1,860,291</b>      |   | 1,792,657             |
|   | <b>19,631,255</b>     |   | 19,865,076            |
| <b>TOTAL ASSETS</b>   | <b>\$ 108,873,711</b> |   | <b>\$ 108,351,901</b> |



| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>                              | <b>September 27,<br/>2008</b> | <b>December 29,<br/>2007</b> |
|---|-------------------------------|------------------------------|
| <b>Current Liabilities</b>  |                               |                              |
| Accounts payable  | \$ 8,806,189                  | \$ 8,183,408                 |
| Accrued compensation  | 2,070,349                     | 2,571,970                    |
| Other accrued expenses  | 855,879                       | 2,345,091                    |
| Current portion of long-term debt                                       | 3,021,378                     | 3,123,742                    |
| <b>Total Current Liabilities</b>  | <b>14,753,795</b>             | <b>16,224,211</b>            |
| <br>  |                               |                              |
| <b>Deferred income taxes</b>  | <b>2,463,669</b>              | <b>2,390,882</b>             |
| <b>Other long-term liabilities</b>                                      | <b>1,645,304</b>              | <b>1,620,311</b>             |
| <b>Long-term debt, less current portion</b>                             | <b>12,142,857</b>             | <b>14,383,060</b>            |
| <b>Accrued postretirement benefits</b>                                  | <b>899,264</b>                | <b>1,111,234</b>             |
| <b>Accrued pension cost</b>   | <b>1,877,916</b>              | <b>1,226,994</b>             |
| <b>Interest rate swap obligation</b>                                    | <b>535,625</b>                | <b>577,941</b>               |
| <b>Minority interest</b>  | <b>111,948</b>                | <b>-</b>                     |
| <br>  |                               |                              |
| <b>Shareholders Equity</b>  |                               |                              |
| Preferred Stock, no par value: Authorized and unissued 2,000,000 shares |                               |                              |
| Common Stock, no par value: Authorized: 50,000,000 shares               |                               |                              |
| Issued: 8,530,853 shares in 2008 and 8,354,978 shares in 2007           | <b>24,162,719</b>             | 22,173,795                   |
| Treasury Stock: 2,572,539 shares in 2008 and 2,545,379 shares in 2007   | <b>(17,368,172)</b>           | (16,967,562)                 |
| Retained earnings   | <b>68,297,665</b>             | 66,262,566                   |
| <br>  |                               |                              |
| Accumulated other comprehensive income (loss):                          |                               |                              |
| Foreign currency translation  | <b>2,273,781</b>              | 2,400,268                    |
| Unrecognized net pension and postretirement benefit costs, net of tax   | <b>(2,580,106)</b>            | (2,682,183)                  |
| Derivative financial instruments, net of taxes                          | <b>(342,554)</b>              | (369,616)                    |
| Accumulated other comprehensive loss                                    | <b>(648,879)</b>              | (651,531)                    |
| <b>Total Shareholders Equity</b>  | <b>74,443,333</b>             | <b>70,817,268</b>            |
| <b>TOTAL LIABILITIES AND SHAREHOLDERS EQUITY</b>                        | <b>\$ 108,873,711</b>         | <b>\$ 108,351,901</b>        |

See accompanying notes.

## THE EASTERN COMPANY AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

|   | Nine Months Ended     |                       | Three Months Ended    |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
| <b>Net sales</b>  | <b>\$ 103,568,528</b> | \$ 122,520,357        | <b>\$ 34,550,899</b>  | \$ 36,027,712         |
| Cost of products sold                                   | (84,486,176 )         | (93,359,015 )         | (29,104,229 )         | (29,038,496 )         |
| Gross margin  | <b>19,082,352</b>     | 29,161,342            | <b>5,446,670</b>      | 6,989,216             |
| Selling and administrative expenses                     | (13,607,617 )         | (14,708,553 )         | (4,379,689 )          | (4,796,997 )          |
| Operating profit  | <b>5,474,735</b>      | 14,452,789            | <b>1,066,981</b>      | 2,192,219             |
| Interest expense  | (810,472 )            | (985,423 )            | (265,720 )            | (292,962 )            |
| Other income  | <b>29,782</b>         | 152,933               | <b>3,960</b>          | 62,971                |
| <b>Income before income taxes and minority interest</b> | <b>4,694,045</b>      | 13,620,299            | <b>805,221</b>        | 1,962,228             |
| Income taxes  | <b>1,270,678</b>      | 4,427,063             | (56,768 )             | 255,586               |
| <b>Income before minority interest</b>                  | <b>3,423,367</b>      | 9,193,236             | <b>861,989</b>        | 1,706,642             |
| <b>Minority interest</b>                                | <b>13,052</b>         | -                     | <b>13,052</b>         | -                     |
| <b>Net income</b>                                       | <b>\$ 3,436,419</b>   | \$ 9,193,236          | <b>\$ 875,041</b>     | \$ 1,706,642          |
| <b>Earnings per Share:</b>                              |                       |                       |                       |                       |
| Basic   | <b>\$ .59</b>         | \$ 1.64               | <b>\$ .15</b>         | \$ .30                |
| Diluted   | <b>\$ .56</b>         | \$ 1.54               | <b>\$ .14</b>         | \$ .29                |
| <b>Cash dividends per share:</b>                        | <b>\$ .24</b>         | \$ .24                | <b>\$ .08</b>         | \$ .08                |

See accompanying notes.

## THE EASTERN COMPANY AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

|  | Nine Months Ended     |                       | Three Months Ended    |                       |
|--|-----------------------|-----------------------|-----------------------|-----------------------|
|  | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
| Net income   | <b>\$ 3,436,419</b>   | \$ 9,193,236          | <b>\$ 875,041</b>     | \$ 1,706,642          |
| Other comprehensive income:  |                       |                       |                       |                       |
| Change in foreign currency translation                               | (126,487 )            | 1,402,130             | (336,732 )            | 543,948               |
| Change in pension and postretirement benefit costs, net of taxes of: |                       |                       |                       |                       |

**2008 \$57,534 and \$19,178, respectively**

|  |                |           |               |            |
|--|----------------|-----------|---------------|------------|
| 2007 \$105,788 and \$35,581, respectively                                  | <b>102,077</b> | 183,566   | <b>34,026</b> | 61,740     |
| Change in fair value of derivative financial instruments, net of taxes of: | <b>27,062</b>  | (79,335 ) | <b>1,561</b>  | (199,868 ) |

**2008 \$15,254 and \$881, respectively**

Edgar Filing: EASTERN CO - Form 10-Q

2007 (\$46,701) and (\$115,183), respectively

|                      |                     |               |                   |              |
|----------------------|---------------------|---------------|-------------------|--------------|
|                      | <b>2,652</b>        | 1,506,361     | <b>(301,145)</b>  | 405,820      |
| Comprehensive income | <b>\$ 3,439,071</b> | \$ 10,699,597 | <b>\$ 573,896</b> | \$ 2,112,462 |

*See accompanying notes.*

- 4 -

---

## THE EASTERN COMPANY AND SUBSIDIARIES

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

|   | Nine Months Ended<br>September 27, 2008 | September 29, 2007  |
|---|---|---------------------|
| <b>Operating Activities</b>   |   |                     |
| Net income  | \$ 3,436,419                            | \$ 9,193,236        |
| Adjustments to reconcile net income to net cash provided by operating activities: |   |                     |
| Depreciation and amortization   | 3,004,113                               | 3,384,316           |
| Provision for doubtful accounts   | -                                       | 33,075              |
| Loss on sale of equipment and other assets  | 771                                     | 9,997               |
| Issuance of Common Stock for directors' fees                                      | 27,840                                  | 39,884              |
| Minority interest   | (13,052)                                | -                   |
| Changes in operating assets and liabilities:                                      |   |                     |
| Accounts receivable   | (2,912,006)                             | 3,429,937           |
| Inventories   | 978,417                                 | (38,620)            |
| Prepaid expenses and other  | 1,214,722                               | (149,578)           |
| Prepaid pension cost  | 785,170                                 | (1,067,512)         |
| Other assets  | (111,362)                               | (166,120)           |
| Accounts payable  | 557,621                                 | (4,632,587)         |
| Accrued compensation  | (504,217)                               | (707,479)           |
| Other accrued expenses  | (1,457,975)                             | (2,491,632)         |
| <b>Net cash provided by operating activities</b>                                  | <b>5,006,461</b>                        | <b>6,836,917</b>    |
| <b>Investing Activities</b>   |   |                     |
| Purchases of property, plant and equipment  | (1,730,843)                             | (2,039,394)         |
| Proceeds from sale of equipment and other assets                                  | -                                       | 23,350              |
| Business acquisition  | (128,325)                               | -                   |
| <b>Net cash used in investing activities</b>                                      | <b>(1,859,168)</b>                      | <b>(2,016,044)</b>  |
| <b>Financing Activities</b>   |   |                     |
| Principal payments on long-term debt  | (2,342,568)                             | (2,332,844)         |
| Proceeds from sales of Common Stock   | 1,651,558                               | 1,966,728           |
| Tax benefit from exercise of incentive stock options                              | 309,526                                 | 1,373,253           |
| Purchases of Common Stock for treasury  | (400,610)                               | (223,085)           |
| Dividends paid  | (1,401,320)                             | (1,341,929)         |
| <b>Net cash used in financing activities</b>                                      | <b>(2,183,414)</b>                      | <b>(557,877)</b>    |
| <b>Effect of exchange rate changes on cash</b>                                    | <b>10,433</b>                           | <b>245,609</b>      |
| <b>Net change in cash and cash equivalents</b>                                    | <b>974,312</b>                          | <b>4,508,605</b>    |
| Cash and cash equivalents at beginning of period                                  | 8,209,722                               | 3,101,458           |
| <b>Cash and cash equivalents at end of period</b>                                 | <b>\$ 9,184,034</b>                     | <b>\$ 7,610,063</b> |

See accompanying notes.





THE EASTERN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

September 27, 2008

**Note A Basis of Presentation**

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by generally accepted accounting principles in the United States for complete financial statements. Refer to the Company's consolidated financial statements and notes thereto included in its Form 10-K for the year ended December 29, 2007 for additional information.

On August 13, 2008, the Company entered into a joint venture agreement to further develop existing technology for use in the Security Products segment. The joint venture is currently not material to the consolidated financial statements of the Company. The Company's 80% ownership of this joint venture has been consolidated into its financial statements with the remaining 20% ownership accounted for as a minority interest therein.

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

The condensed consolidated balance sheet as of December 29, 2007 has been derived from the audited consolidated balance sheet at that date.

**Note B Earnings Per Share**

The denominators used in the earnings per share computations follow:

|  | <b>Nine Months Ended<br/>September 27, 2008</b> | <b>September 29,<br/>2007</b> | <b>Three Months Ended<br/>September 27,<br/>2008</b> | <b>September 29, 2007</b> |
|--|---|-------------------------------|--|---------------------------|
| <b>Basic:</b>                              |   |                               |  |                           |
| Weighted average shares outstanding        | <b>5,842,948</b>                                | 5,589,905                     | <b>5,881,284</b>                                     | 5,669,274                 |
| <b>Diluted:</b>                            |   |                               |  |                           |
| Weighted average shares outstanding        | <b>5,842,948</b>                                | 5,589,905                     | <b>5,881,284</b>                                     | 5,669,274                 |
| Dilutive stock options                     | <b>323,901</b>                                  | 384,329                       | <b>307,865</b>                                       | 273,255                   |
| Denominator for diluted earnings per share | <b>6,166,849</b>                                | 5,974,234                     | <b>6,189,149</b>                                     | 5,942,529                 |

**Note C Inventories**

The components of inventories follow:

|   | <b>September 27, 2008</b> | <b>December 29, 2007</b> |
|---|---------------------------|--------------------------|
| <b>Raw material and component parts</b> | <b>\$ 8,171,385</b>       | <b>\$ 8,435,858</b>      |
| <b>Work in process</b>                  | <b>8,200,884</b>          | <b>8,482,427</b>         |
| <b>Finished goods</b>                   | <b>13,127,314</b>         | <b>13,572,411</b>        |
|   | <b>\$ 29,499,583</b>      | <b>\$ 30,490,696</b>     |

- 6 -

---

**Note D Segment Information**

Segment financial information follows:

|   | Nine Months Ended     |                       | Three Months Ended    |                       |
|---|-----------------------|-----------------------|-----------------------|-----------------------|
|   | September 27,<br>2008 | September 29,<br>2007 | September 27,<br>2008 | September 29,<br>2007 |
| <b>Revenues:</b>  |                       |                       |                       |                       |
| <b>Sales to unaffiliated customers:</b>                 |                       |                       |                       |                       |
| <b>Industrial Hardware</b>                              | \$ 45,267,247         | \$ 66,015,019         | \$ 14,906,407         | \$ 16,662,475         |
| <b>Security Products</b>                                | 43,506,017            | 46,127,092            | 14,376,300            | 16,180,366            |
| <b>Metal Products</b>                                   | 14,795,264            | 10,378,246            | 5,268,192             | 3,184,871             |
|   | \$ 103,568,528        | \$ 122,520,357        | \$ 34,550,899         | \$ 36,027,712         |
| <b>Income before income taxes:</b>                      |                       |                       |                       |                       |
| <b>Industrial Hardware</b>                              | \$ 3,386,086          | \$ 11,932,596         | \$ 834,262            | \$ 798,509            |
| <b>Security Products</b>                                | 3,448,918             | 4,056,059             | 1,179,552             | 1,662,688             |
| <b>Metal Products</b>                                   | (1,360,269)           | (1,535,866)           | (946,833)             | (268,978)             |
| <b>Operating Profit</b>                                 | 5,474,735             | 14,452,789            | 1,066,981             | 2,192,219             |
| <b>Interest expense</b>                                 | (810,472)             | (985,423)             | (265,720)             | (292,962)             |
| <b>Other income</b>                                     | 29,782                | 152,933               | 3,960                 | 62,971                |
| <b>Income before income taxes and minority interest</b> | \$ 4,694,045          | \$ 13,620,299         | \$ 805,221            | \$ 1,962,228          |

**Note E Recent Accounting Pronouncements**

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements*, ( SFAS 157 ). SFAS 157 defines fair value, establishes a framework for measuring the fair value of assets and liabilities, and expands disclosure requirements regarding the fair value measurement. SFAS 157 does not expand the use of fair value measurements. This statement, as issued, is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years. FASB Staff Position (FSP) FAS No. 157-2 was issued in February 2008 and deferred the effective date of SFAS 157 for non-financial assets and liabilities to fiscal years beginning after November 2008. As such, the Company adopted SFAS 157 as of December 30, 2007 for financial assets and liabilities only. There was no material impact on the Company's consolidated financial statements. As of September 27, 2008, the Company's financial liability subject to SFAS 157 consisted of an interest rate swap agreement (included in Interest rate swap obligation on the consolidated balance sheets). The Company determined fair value for the derivative liability based on third party valuation models (i.e. Level 2 as defined under SFAS 157). The Company does not have any financial assets subject to SFAS 157. The Company does not believe that the adoption of SFAS 157 to non-financial assets and liabilities will have a material impact on its consolidated financial statements.

In February 2007, the FASB issued SFAS 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115* ( SFAS 159 ). SFAS 159 expands the use of fair value accounting but does not affect existing standards which require assets or liabilities to be carried at fair value. The objective of SFAS 159 is to improve financial reporting by providing companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Under SFAS 159, a company may elect to use fair value to measure eligible items at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Eligible items include, but are limited to, accounts receivable, accounts payable, and issued debt. If elected, SFAS 159 is effective for fiscal years beginning after November 15, 2007. The Company has not elected to measure any additional assets or liabilities at fair value that are not

already measured at fair value under existing standards.

- 7 -

---

## Edgar Filing: EASTERN CO - Form 10-Q

In December 2007, the FASB issued SFAS No. 141 (revised 2007), *Business Combinations* ( SFAS No. 141(R) ), which replaces SFAS No. 141. This standard significantly changes the principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. The statement also provides guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. This statement is effective prospectively, except for certain retrospective adjustments to deferred tax balances, for fiscal years beginning after December 15, 2008. The Company has not determined the impact, if any, of the adoption of SFAS No. 141(R).

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements – an amendment of ARB No. 51*, ( SFAS No. 160 ). SFAS 160 clarifies the classification of noncontrolling interests in consolidated balance sheets and reporting transactions between the reporting entity and holders of noncontrolling interests. Under this statement, noncontrolling interests are considered equity and reported as an element of consolidated equity. Further, net income encompasses all consolidated subsidiaries with disclosure of the attribution of net income between controlling and noncontrolling interests. SFAS No. 160 is effective prospectively for fiscal years beginning after December 15, 2008. The Company has not determined the impact, if any, of the adoption of SFAS No. 160.

In March 2008, the FASB issued SFAS No. 161, *Disclosures About Derivative Instruments and Hedging Activities – an amendment of FASB Statement No. 133* ( SFAS No. 161 ), which expands the disclosure requirements in SFAS 133 about an entity's derivative instruments and hedging activities. SFAS No. 161 expands the disclosure provisions to apply to all entities with derivative instruments subject to SFAS No. 133 and its related interpretations. The provisions also apply to related hedged items, bifurcated derivatives, and nonderivative instruments that are designated and qualify as hedging instruments. Entities with instruments subject to SFAS No. 161 must provide more robust qualitative disclosures and expanded quantitative disclosures. Such disclosures, as well as existing SFAS No. 133 required disclosures, generally will need to be presented for every annual and interim reporting period. SFAS No. 161 is effective for fiscal years and interim periods beginning after November 15, 2008. The Company has not determined the impact, if any, of the adoption of SFAS No. 161.

In April 2008, the FASB issued FSP SFAS No. 142-3, *Determination of the Useful Life of Intangible Assets* ( FSP SFAS No. 142-3 ). FSP SFAS No. 142-3 amends the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset under SFAS No. 142, *Goodwill and Other Intangible Assets* ( SFAS No. 142 ). The intent of FSP SFAS No. 142-3 is to improve the consistency between the useful life of a recognized intangible asset under SFAS No. 142 and the period of expected cash flows used to measure the fair value of the asset under SFAS No. 141(R) and other applicable accounting literature. FSP SFAS No. 142-3 is effective for financial statements issued for fiscal years beginning after December 15, 2008 and must be applied prospectively to intangible assets acquired after the effective date. The Company has not determined the impact, if any, of the adoption of FSP SFAS No. 142-3.

In May 2008, the FASB issued SFAS No. 162, *Hierarchy of Generally Accepted Accounting Principles* ( SFAS No. 162 ). This statement is intended to improve financial reporting by identifying a consistent framework, or hierarchy, for selecting accounting principles to be used in preparing financial statements of nongovernmental entities that are presented in conformity with GAAP. This statement will be effective 60 days following the U.S. Securities and Exchange Commission's approval of the Public Company Accounting Oversight Board amendment to AU Section 411, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*. The Company has not determined the impact, if any, of the adoption of SFAS No. 162.

In June 2008, the FASB issued Staff Position ("FSP") Emerging Issue Task Force ("EITF") Issue No. 03-6-1, *Determining Whether Instruments Granted in Share-Based Payment Transactions Are Participating Securities* ("FSP EITF 03-6-1"). FSP EITF 03-6-1 provides that invested share-based payment awards that contain non-forfeitable rights to dividends or dividend equivalents (whether paid or unpaid) are participating securities and shall be included in the computation of earnings per share pursuant to the two-class method. FSP EITF 03-6-1 is effective for fiscal years beginning after December 15, 2008. Upon adoption, a company is required to retrospectively adjust its earnings per share data, including any amounts related to interim periods, summaries of earnings and selected financial data, to conform to the provisions of FSP EITF 03-6-1. The Company has not determined the impact, if any, of the adoption of FSP EITF 03-6-1.



**Note F Debt**

The interest rates on the term and the revolving credit portions of the Loan Agreement vary. The interest rates may vary based on the LIBOR rate plus a margin spread of 1.0% to 1.65% for the term portion and 1.0% to 1.6% for the revolving credit portion. The margin rate spread is based on operating results calculated on a rolling-four-quarter basis. The Company may also borrow funds at the lender's prime rate. On September 27, 2008, the interest rate on the term portion of the Loan Agreement was 4.04%. The Company did not utilize the revolving loan during the third quarter or the first nine months of 2008.

**Note G Goodwill**

The following is a roll-forward of goodwill from year-end 2007 to the end of the third quarter 2008:

|                       | <b>Industrial<br/>Hardware<br/>Segment</b> | <b>Security<br/>Products<br/>Segment</b> | <b>Metal<br/>Products<br/>Segment</b> | <b>Total</b>         |
|-----------------------|--|--|---------------------------------------|----------------------|
| Beginning balance     | \$ 2,121,792                               | \$ 11,833,816                            | \$                                    | \$ 13,955,608        |
| Foreign exchange      | (72,538 )                                  |  |                                       | (72,538 )            |
| <b>Ending balance</b> | <b>\$ 2,049,254</b>                        | <b>\$ 11,833,816</b>                     | <b>\$</b>                             | <b>\$ 13,883,070</b> |

**Note H Intangibles**

Patents are recorded at cost and are amortized using the straight-line method over the lives of the patents. Technology and licenses are recorded at cost and are generally amortized on a straight-line basis over periods ranging from 5 to 17 years. Non-compete agreements and customer relationships are being amortized using the straight-line method over a period of 5 years. Trademarks are not amortized as their lives are deemed to be indefinite.

The gross carrying amount and accumulated amortization of amortizable intangible assets:

|                           | <b>Industrial<br/>Hardware<br/>Segment</b> | <b>Security<br/>Products<br/>Segment</b> | <b>Metal<br/>Products<br/>Segment</b> | <b>Total</b> | <b>Weighted-Average<br/>Amortization Period<br/>(Years)</b> |
|---------------------------|--|--|---------------------------------------|--------------|---|
| <b>2008 Gross Amount:</b> |  |  |                                       |              |   |
| Patents and developed     |  |  |                                       |              |   |
| technology                | \$ 2,730,439                               | \$ 1,111,638                             | \$ 82,747                             | \$ 3,924,824 | <b>15.8</b>   |
| Customer relationships    | 45,825                                     | 1,921,811                                | -                                     | 1,967,636    | <b>5.0</b>  |
| Non-compete agreements    | 30,000                                     | 90,735                                   | -                                     | 120,735      | <b>5.0</b>  |



Edgar Filing: EASTERN CO - Form 10-Q

|                         |              |              |           |              |             |
|-------------------------|--------------|--------------|-----------|--------------|-------------|
| Other                   | -            | 128,941      | -         | 128,941      | <b>5.0</b>  |
| Total Gross Intangibles | \$ 2,806,264 | \$ 3,253,125 | \$ 82,747 | \$ 6,142,136 | <b>11.7</b> |

**2008 Accumulated**

**Amortization:**

Patents and developed

|                          |              |              |           |              |
|--------------------------|--------------|--------------|-----------|--------------|
| technology               | \$ 1,151,178 | \$ 319,698   | \$ 71,114 | \$ 1,541,990 |
| Customer relationships   | 6,874        | 765,345      | -         | 772,219      |
| Non-compete agreements   | 4,500        | 65,462       | -         | 69,962       |
| Other                    | -            | 13,889       | -         | 13,889       |
| Accumulated Amortization | \$ 1,162,552 | \$ 1,164,394 | \$ 71,114 | \$ 2,398,060 |

**Net September 27, 2008 per  
Balance Sheet**

|  |                     |                     |                  |                     |
|--|---------------------|---------------------|------------------|---------------------|
|  | <b>\$ 1,643,712</b> | <b>\$ 2,088,731</b> | <b>\$ 11,633</b> | <b>\$ 3,744,076</b> |
|--|---------------------|---------------------|------------------|---------------------|

- 9 -

Edgar Filing: EASTERN CO - Form 10-Q

|  | <b>Industrial</b>   | <b>Security</b>     | <b>Metal</b>     |                     |                            |
|--|---------------------|---------------------|------------------|---------------------|----------------------------|
|  | <b>Hardware</b>     | <b>Products</b>     | <b>Products</b>  |                     | <b>Weighted-Average</b>    |
|  | <b>Segment</b>      | <b>Segment</b>      | <b>Segment</b>   | <b>Total</b>        | <b>Amortization Period</b> |
|  |                     |                     |                  |                     | <b>(Years)</b>             |
| <b>2007 Gross Amount:</b>                      |                     |                     |                  |                     |                            |
| Patents and developed                          |                     |                     |                  |                     |                            |
| technology                                     | \$ 2,738,893        | \$ 1,088,592        | \$ 82,747        | \$ 3,910,232        | <b>15.7</b>                |
| Customer relationships                         | -                   | 1,921,811           | -                | 1,921,811           | <b>5.0</b>                 |
| Non-compete agreements                         | -                   | 90,735              | -                | 90,735              | <b>5.0</b>                 |
| Other  | -                   | 3,941               | -                | 3,941               | <b>-</b>                   |
| Total Gross Intangibles                        | \$ 2,738,893        | \$ 3,105,079        | \$ 82,747        | \$ 5,926,719        | <b>11.8</b>                |
| <b>2007 Accumulated</b>                        |                     |                     |                  |                     |                            |
| <b>Amortization:</b>                           |                     |                     |                  |                     |                            |
| Patents and developed                          |                     |                     |                  |                     |                            |
| technology                                     | \$ 1,077,608        | \$ 263,255          | \$ 67,501        | \$ 1,408,364        |                            |
| Customer relationships                         | -                   | 477,495             | -                | 477,495             |                            |
| Non-compete agreements                         | -                   | 59,522              | -                | 59,522              |                            |
| Accumulated Amortization                       | \$ 1,077,608        | \$ 800,272          | \$ 67,501        | \$ 1,945,381        |                            |
| <b>Net December 29, 2007 per Balance Sheet</b> |                     |                     |                  |                     |                            |
|  | <b>\$ 1,661,285</b> | <b>\$ 2,304,807</b> | <b>\$ 15,246</b> | <b>\$ 3,981,338</b> |                            |

**Note I Retirement Benefit Plans**

The Company has non-contributory defined benefit pension plans covering certain U.S. employees. Plan benefits are generally based upon age at retirement, years of service and, for its salaried plan, the level of compensation. The Company also sponsors unfunded nonqualified supplemental retirement plans that provide certain current and former officers with benefits in excess of limits imposed by federal tax law. The measurement date for the obligations disclosed below is September 30 of each year. The Company will adopt the measurement date provision of SFAS No. 158, Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans an amendment of FASB Statements No. 87, 88, 106, and 132(R), in 2008, which will require the Company to measure the funded status of the plans as of January 3, 2009, the end of the Company's fiscal 2008. The Company has not determined the impact this change will have on its financial statements.

The Company also provides health care and life insurance for retired salaried employees in the United States who meet specific eligibility requirements.

Significant disclosures relating to these benefit plans for the third quarter and first nine months of Fiscal 2008 and 2007 follow:

| <b>Pension Benefits</b>  |                  | <b>Three Months Ended</b> |                  |
|--------------------------|------------------|---------------------------|------------------|
| <b>Nine Months Ended</b> |                  | <b>Sept. 27,</b>          | <b>Sept. 29,</b> |
| <b>Sept. 27,</b>         | <b>Sept. 29,</b> | <b>Sept. 27,</b>          | <b>Sept. 29,</b> |
| <b>2008</b>              | <b>2007</b>      | <b>2008</b>               | <b>2007</b>      |

Edgar Filing: EASTERN CO - Form 10-Q

|                                       |                     |              |                   |            |
|---------------------------------------|---------------------|--------------|-------------------|------------|
| Service cost                          | <b>\$ 1,365,117</b> | \$ 1,328,344 | <b>\$ 455,039</b> | \$ 442,781 |
| Interest cost                         | <b>1,976,007</b>    | 1,861,500    | <b>658,669</b>    | 620,500    |
| Expected return on plan assets        | <b>(2,734,557 )</b> | (2,465,153 ) | <b>(911,519 )</b> | (821,717 ) |
| Amortization of prior service cost    | <b>153,087</b>      | 61,344       | <b>51,029</b>     | 20,448     |
| Amortization of transition obligation | -                   | (8,886 )     | -                 | (2,962 )   |
| Amortization of the net loss          | <b>48,795</b>       | 267,798      | <b>16,265</b>     | 89,266     |
| Net periodic benefit cost             | <b>\$ 808,449</b>   | \$ 1,044,947 | <b>\$ 269,483</b> | \$ 348,316 |

- 10 -

---

|                                    | <b>Postretirement Benefits</b> |                  | <b>Three Months Ended</b> |                 |
|------------------------------------|--------------------------------|------------------|---------------------------|-----------------|
|                                    | <b>Nine Months Ended</b>       |                  | <b>Sept 27,</b>           |                 |
|                                    | <b>Sept. 27,</b>               | <b>Sept. 29,</b> | <b>Sept 27,</b>           | <b>Sept 29,</b> |
|                                    | <b>2008</b>                    | <b>2007</b>      | <b>2008</b>               | <b>2007</b>     |
| Service cost                       | \$ 93,799                      | \$ 83,375        | \$ 31,267                 | \$ 30,839       |
| Interest cost                      | 91,425                         | 96,320           | 30,475                    | 34,820          |
| Expected return on plan assets     | (66,376 )                      | (66,635 )        | (22,125 )                 | (28,333 )       |
| Amortization of prior service cost | (17,576 )                      | (17,900 )        | (5,858 )                  | (5,956 )        |
| Amortization of the net gain       | (24,695 )                      | (13,001 )        | (8,232 )                  | (3,475 )        |
| Net periodic benefit cost          | \$ 76,577                      | \$ 82,159        | \$ 25,527                 | \$ 27,895       |

The Company's funding policy with respect to its qualified plans is to contribute at least the minimum amount required by applicable laws and regulations. In 2008, the Company is required to contribute \$317,000 into its hourly pension plans and \$161,000 into its postretirement plan. As of September 27, 2008, the Company has made contributions totaling \$263,000 to the hourly pension plans and \$119,000 to its postretirement plan and will make the remaining contributions as required during the remainder of the year.

The Company has a contributory savings plan under Section 401(k) of the Internal Revenue Code covering substantially all U.S. non-union employees. The plan allows participants to make voluntary contributions of up to 100% of their annual compensation on a pretax basis, subject to IRS limitations. The plan provides for contributions by the Company at its discretion. The Company made contributions of \$42,864 and \$136,706 in the third quarter and first nine months of 2008, respectively, and \$41,715 and \$130,054 in the third quarter and first nine months of 2007, respectively.

#### **Note J - Stock Based Compensation and Stock Options**

The Company has stock option plans for officers, other key employees, and non-employee directors: the 1989, 1995, 1997 and 2000 plans. Options granted under the 1989 plan and incentive stock options granted under the 1995 and 2000 plans must have exercise prices that are not less than 100% of the fair market value of the stock on the dates the options are granted. Restricted stock awards may also be granted to participants under the 1995 and 2000 plans with restrictions determined by the Compensation Committee of the Company's Board of Directors. Under the 1995, 1997, and 2000 plans, nonqualified stock options granted to participants will have exercise prices determined by the Compensation Committee of the Company's Board of Directors. No options or restricted stock were granted in 2008 or 2007.

As of September 27, 2008, there were 367,500 shares available for future grant under the above noted 2000 plan and there were no shares available for grant from the 1997, 1995 and 1989 plans. As of September 27, 2008, there were 828,000 shares of common stock reserved under all option plans for future issuance.

|   | <b>Nine Months Ended</b>  |  | <b>Year Ended</b>        |  |
|---|---------------------------|--|--------------------------|--|
|   | <b>September 27, 2008</b> |  | <b>December 29, 2007</b> |  |
|   | <b>Shares</b>             | <b>Weighted -<br/>Average Exercise<br/>Price</b> | <b>Shares</b>            | <b>Weighted -<br/>Average<br/>Exercise Price</b> |
| <b>Outstanding at beginning of period</b> | 663,000                   | \$ 10.099  | 1,002,750                | \$ 9.233   |
| <b>Granted</b>                            |                           |  |                          |  |

Edgar Filing: EASTERN CO - Form 10-Q

|                                     |                 |          |        |                 |               |
|-------------------------------------|-----------------|----------|--------|-----------------|---------------|
| <b>Expired</b>                      | <b>(28,394</b>  | <b>)</b> | 9.330  |                 |               |
| <b>Exercised</b>                    | <b>(174,106</b> | <b>)</b> | 9.486  | <b>(339,750</b> | <b>)</b>      |
| <b>Outstanding at end of period</b> | <b>460,500</b>  |          | 10.378 | <b>663,000</b>  | <b>7.544</b>  |
|                                     |                 |          |        |                 | <b>10.099</b> |

- 11 -

---

**Options Outstanding and Exercisable**

| <b>Range of Exercise Prices</b> |         | <b>Outstanding as of September 27, 2008</b> | <b>Weighted Average Remaining Contractual Life</b> |  | <b>Weighted Average Exercise Price</b> |
|---------------------------------|---------|---|--|--|--|
|                                 |         |   |  |  |  |
| \$ 9.33                         | \$10.20 | 386,250                                     | 1.7  |  | \$9.823                                |
| \$12.33                         | \$13.58 | 74,250                                      | 4.9  |  | 13.264                                 |
|                                 |         | 460,500                                     | 2.2  |  | 10.378                                 |

At September 27, 2008, outstanding and exercisable options had an intrinsic value of \$1,506,623. The total intrinsic value of stock options exercised in the first nine months of 2008 was \$919,664. For the nine month periods ended September 27, 2008 and September 29, 2007, the Company recognized tax benefits of \$309,526 and \$1,373,253, respectively, resulting from the exercise of non-qualified stock options and the disqualification of incentive stock options that were exercised and sold prior to the required holding period.

**Note K Income Taxes**

The Company files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2004 and non-U.S. income tax examinations by tax authorities prior to 2001.

The total amount of unrecognized tax benefits could increase or decrease within the next twelve months for a number of reasons, including the closure of federal, state and foreign tax years by expiration of the statute of limitations and the recognition and measurement considerations under FASB Interpretation No. 48 (FIN 48A) *Accounting for Uncertainty in Income Taxes and interpretation of FASB Statement No. 109*. During the quarter ended September 27, 2008, the total amount of unrecognized tax benefits decreased by approximately \$216,000 (plus an additional \$36,000 of interest costs) related to the lapsing of the statute of limitations. The Company believes that it is reasonably possible that approximately \$215,000 of unrecognized tax benefits primarily related to the earnings of its Hong Kong subsidiary will be recognized over the next twelve months.

**Note L Business Acquisitions**

Effective January 11, 2008 the Company acquired certain assets from Auto-Vehicle Parts Company that included a certain product line owned by one of its divisions, the F.A. Neider Company (Neider). Neider produces the footman loop products, or strap fasteners, which are used to fasten straps, traps, tools, and cargo to a vehicle, container, or trailer. Neider manufactures footman loops used in the following markets: military, aerospace, service body, and trailer. The footman loop product line was integrated into the Company's Industrial Hardware segment. The cost of the Neider acquisition was \$128,325, inclusive of transaction costs.

The above acquisition has been accounted for using the purchase method. The acquired business is included in the consolidated operating results of the Company from the date of acquisition.

Neither the actual results nor the pro forma effects of the acquisition of Neider are material to the Company's financial statements.

- 12 -

---

**Note M Stock Rights**

On July 23, 2008, the Company adopted a new stock rights plan to replace the plan that expired on July 22, 2008. At the plan's inception on July 23, 2008, there were 5,837,184 stock rights outstanding under the plan. Each right may be exercised to purchase one share of the Company's common stock at an exercise price of \$80.00, subject to adjustment to prevent dilution.

The rights generally become exercisable ten days after an individual or group acquires 10% or more of the Company's outstanding common stock, or after the commencement or announcement of an offer to acquire 10% or more of the Company's common stock. The stock rights, which do not have voting privileges, expire on July 23, 2018, and may be redeemed by the Company at a price of \$0.01 per right at any time prior to their expiration at the discretion of the Board of Directors. In the event that the Company were acquired in a merger or other business combination transaction, provision shall be made so that each holder of a right shall have the right to receive, upon exercise of the right at its then current exercise price, that number of shares of common stock of the surviving company which at the time of such transaction would have a market value of two times the exercise price of the right.



**ITEM 2 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

The following discussion is intended to highlight significant changes in the Company's financial position and results of operations for the thirty-nine weeks ended September 27, 2008. The interim financial statements and this Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Consolidated Financial Statements and Notes thereto for the fiscal year ended December 29, 2007 and the related Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 29, 2007.

Certain statements set forth in this discussion and analysis of financial condition and results of operations are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. They use such words as may, will, expect, believe, plan and other similar terminology. These statements reflect management's current expectations regarding future events and operating performance and speak only as of the date of this release. These forward-looking statements involve a number of risks and uncertainties, and actual future results and trends may differ materially depending on a variety of factors, including changing customer preferences, lack of success of new products, loss of customers, competition, increased raw material prices, problems associated with foreign sourcing of parts and products, changes within our industry segments and in the overall economy, litigation and legislation. In addition, terrorist threats and the possible responses by the U.S. government, the effects on consumer demand, the financial markets, the travel industry, the trucking industry and other conditions increase the uncertainty inherent in forward-looking statements. Forward-looking statements reflect the expectations of the Company at the time they are made, and investors should rely on them only as expressions of opinion about what may happen in the future and only at the time they are made. The Company undertakes no obligation to update any forward-looking statement. Although the Company believes it has an appropriate business strategy and the resources necessary for its operations, future revenue and margin trends cannot be reliably predicted and the Company may alter its business strategies to address changing conditions.

In addition, the Company makes estimates and assumptions that may materially affect reported amounts and disclosures. These relate to valuation allowances for accounts receivable and for excess and obsolete inventories, accruals for pensions and other postretirement benefits (including forecasted future cost increases and returns on plan assets), provisions for depreciation (estimating useful lives), uncertain tax positions, and, on occasion, accruals for contingent losses.

## **Overview**

During the third quarter of 2008, the Company experienced a 4% decrease in sales when compared to the third quarter of 2007. In the third quarter of 2008 Industrial Hardware sales decreased 11%, Security Products sales decreased 11% and Metal Products experienced a 65% increase in sales compared to the prior year period. The decreases in the Industrial Hardware and Security Products segments were due to decreases in sales volume of existing products in many of the markets we serve. The increase in the Metals Products segment was due to a combination of increased sales volume of existing products, price increases to customers and sales from the introduction of new products.

For the three months ended September 27, 2008, gross margin as a percentage of sales was 15% compared to 19% in the comparable period of 2007. The decrease in the gross margin was primarily the result of higher manufacturing costs related to raw materials, utilities, maintenance and repair, research and development.

The 16% decrease in sales in the first nine months of 2008 compared to the prior year reflects the inclusion of \$18.1 million in 2007 for the completion of one-time orders to produce door latching components for a military project to up-armor existing Humvees. Excluding the sales resulting from the military contract and despite the slow down in the economy, sales of all our core business units decreased less than 1% in the first nine months of 2008. Sales decreased in the Industrial Hardware segment by 31% in the first nine months of 2008 compared to the 2007 period, reflecting the \$18.1 million military sales completed in the 2007 period. In addition, the Security Products segment experienced a 6% decrease, due to lower sales volume of existing products, and the Metal Products segment experienced a 43% increase in sales compared to the

Edgar Filing: EASTERN CO - Form 10-Q

prior year period, due to a combination of increased sales volume of existing products, price increases to customers and sales from the introduction of new products.

- 14 -

---

## Edgar Filing: EASTERN CO - Form 10-Q

Gross margin as a percentage of sales for the nine months ended September 27, 2008 was 18% compared to 24% in the comparable period a year ago. Higher sales volume in the first nine months of 2007, particularly the door latching components for the military project to up-armor existing Humvees which was completed in the first quarter of 2007, resulted in better utilization of our production capacity mainly in the Industrial Hardware segment and was the primary reason for the higher gross margin in the 2007 period. Additionally, gross margin was reduced by increased manufacturing costs for raw materials, utilities, maintenance and repair, research and development.

Raw material prices have continued to increase during the third quarter of 2008, primarily for hot and cold rolled steel, scrap iron and plastic resin. The Company is recovering these increases from our customers, wherever possible. Currently, there is no indication that the Company will not be able to obtain supplies of all the materials that it requires. Raw material costs will continue to have a negative impact on gross margins unless prices for raw materials stabilize.

Cash flow from operations in the first nine months of 2008 has declined compared to the same period in 2007, reflecting the higher sales volume from the military up-armor project which benefited the prior year period. The Company's line of credit, along with controlling discretionary expenditures, should provide sufficient cash flow to enable the Company to meet all its existing obligations.

A more detailed analysis of the Company's results of operations and financial condition follows:

### Results of Operations

The following table shows, for the periods indicated, selected line items from the condensed consolidated statements of income as a percentage of net sales, by segment:

#### Three Months Ended September 27, 2008

|                                    | Industrial<br>Hardware | Security<br>Products | Metal<br>Products | Total  |
|------------------------------------|------------------------|----------------------|-------------------|--------|
| Net sales                          | 100.0%                 | 100.0%               | 100.0%            | 100.0% |
| Cost of products sold              | 81.9%                  | 76.9%                | 110.9%            | 84.2%  |
| Gross margin                       | 18.1%                  | 23.1%                | -10.9%            | 15.8%  |
| Selling and administrative expense | 12.5%                  | 14.9%                | 7.1%              | 12.7%  |
| Operating profit                   | 5.6%                   | 8.2%                 | -18.0%            | 3.1%   |

#### Three Months Ended September 29, 2007

|                       | Industrial<br>Hardware | Security<br>Products | Metal<br>Products | Total  |
|-----------------------|------------------------|----------------------|-------------------|--------|
| Net sales             | 100.0%                 | 100.0%               | 100.0%            | 100.0% |
| Cost of products sold | 81.6%                  | 76.2%                | 97.8%             | 80.6%  |

Edgar Filing: EASTERN CO - Form 10-Q

|   |       |       |       |       |
|---|-------|-------|-------|-------|
| <b>Gross margin</b>                       | 18.4% | 23.8% | 2.2%  | 19.4% |
| <b>Selling and administrative expense</b> | 13.6% | 13.6% | 10.7% | 13.3% |
| <b>Operating profit</b>                   | 4.8%  | 10.2% | -8.5% | 6.1%  |

- 15 -

---

## Edgar Filing: EASTERN CO - Form 10-Q

The following table shows the amount of change for the third quarter of 2008 compared to the third quarter of 2007 in sales, cost of products sold, gross margin, selling and administrative expenses and operating profit, by segment (dollars in thousands):

|  | <b>Industrial<br/>Hardware</b> | <b>Security<br/>Products</b> | <b>Metal<br/>Products</b> | <b>Total</b>      |
|--|--------------------------------|------------------------------|---------------------------|-------------------|
| <b>Net sales</b>                           | <b>\$ (1,756)</b>              | <b>\$ (1,804)</b>            | <b>\$ 2,083</b>           | <b>\$ (1,477)</b> |
| <b>Volume</b>                              | -17.2%                         | -14.3%                       | 50.5%                     | -10.7%            |
| <b>Prices</b>                              | 2.5%                           | 2.1%                         | 10.6%                     | 3.8%              |
| <b>New products</b>                        | <u>4.2%</u>                    | <u>1.1%</u>                  | <u>4.3%</u>               | <u>2.8%</u>       |
|  | -10.5%                         | -11.1%                       | 65.4%                     | -4.1%             |
| <b>Cost of products sold</b>               | <b>\$ (1,393)</b>              | <b>\$ (1,270)</b>            | <b>\$ 2,728</b>           | <b>\$ 65</b>      |
|  | -10.2%                         | -10.3%                       | 87.6%                     | 0.2%              |
| <b>Gross margin</b>                        | <b>\$ (363)</b>                | <b>\$ (534)</b>              | <b>\$ (645)</b>           | <b>\$(1,542)</b>  |
|  | -11.9%                         | -13.9%                       | -907.4%                   | -22.1%            |
| <b>Selling and administrative expenses</b> | <b>\$ (399)</b>                | <b>\$ (51)</b>               | <b>\$ 33</b>              | <b>\$ (417)</b>   |
|  | -17.6%                         | -2.3%                        | 9.7%                      | -8.7%             |
| <b>Operating profit</b>                    | <b>\$ 36</b>                   | <b>\$ (483)</b>              | <b>\$ (678)</b>           | <b>\$(1,125)</b>  |
|  | 4.5%                           | -29.1%                       | -252.0%                   | -51.3%            |

The following table shows, for the periods indicated, selected line items from the condensed consolidated statements of income as a percentage of net sales, by segment:

### Nine Months Ended September 27, 2008

|   | <b>Industrial<br/>Hardware</b> | <b>Security<br/>Products</b> | <b>Metal<br/>Products</b> | <b>Total</b> |
|---|--------------------------------|------------------------------|---------------------------|--------------|
| <b>Net sales</b>                          | 100.0%                         | 100.0%                       | 100.0%                    | 100.0%       |
| <b>Cost of products sold</b>              | 79.4%                          | 77.1%                        | 101.4%                    | 81.6%        |
| <b>Gross margin</b>                       | 20.6%                          | 22.9%                        | -1.4%                     | 18.4%        |
| <b>Selling and administrative expense</b> | 13.1%                          | 15.0%                        | 7.8%                      | 13.1%        |
| <b>Operating profit</b>                   | 7.5%                           | 7.9%                         | -9.2%                     | 5.3%         |

### Nine Months Ended September 29, 2007

|                              | <b>Industrial<br/>Hardware</b> | <b>Security<br/>Products</b> | <b>Metal<br/>Products</b> | <b>Total</b> |
|------------------------------|--------------------------------|------------------------------|---------------------------|--------------|
| <b>Net sales</b>             | 100.0%                         | 100.0%                       | 100.0%                    | 100.0%       |
| <b>Cost of products sold</b> | 71.0%                          | 77.1%                        | 105.3%                    | 76.2%        |
| <b>Gross margin</b>          | 29.0%                          | 22.9%                        | -5.3%                     | 23.8%        |

Edgar Filing: EASTERN CO - Form 10-Q

|   |       |       |        |       |
|---|-------|-------|--------|-------|
| <b>Selling and administrative expense</b> | 10.9% | 14.1% | 9.5%   | 12.0% |
| <b>Operating profit</b>                   | 18.1% | 8.8%  | -14.8% | 11.8% |

- 16 -

---

## Edgar Filing: EASTERN CO - Form 10-Q

The following table shows the amount of change for the first nine months of 2008 compared to the first nine months of 2007 in sales, cost of products sold, gross margin, selling and administrative expenses and operating profit, by segment (dollars in thousands):

|  | <b>Industrial<br/>Hardware</b> | <b>Security<br/>Products</b> | <b>Metal<br/>Products</b> | <b>Total</b>       |
|--|--------------------------------|------------------------------|---------------------------|--------------------|
| <b>Net sales</b>                           | <b>\$ (20,748)</b>             | <b>\$(2,621)</b>             | <b>\$ 4,417</b>           | <b>\$ (18,952)</b> |
| <b>Volume</b>                              | -36.0%                         | -7.7%                        | 22.7%                     | -20.7%             |
| <b>Prices</b>                              | 0.8%                           | 0.8%                         | 16.5%                     | 2.4%               |
| <b>New products</b>                        | <u>3.8%</u>                    | <u>1.2%</u>                  | <u>3.4%</u>               | <u>2.8%</u>        |
|  | -31.4%                         | -5.7%                        | 42.6%                     | -15.5%             |
| <b>Cost of products sold</b>               | <b>\$ (10,919)</b>             | <b>\$(2,034)</b>             | <b>\$ 4,080</b>           | <b>\$ (8,873)</b>  |
|  | -23.3%                         | -5.7%                        | 37.3%                     | -9.5%              |
| <b>Gross margin</b>                        | <b>\$ (9,829)</b>              | <b>\$(587)</b>               | <b>\$ 337</b>             | <b>\$(10,079)</b>  |
|  | -51.4%                         | -5.5%                        | 61.4%                     | -34.6%             |
| <b>Selling and administrative expenses</b> | <b>\$ (1,283)</b>              | <b>\$ 21</b>                 | <b>\$ 161</b>             | <b>\$ (1,101)</b>  |
|  | -17.8%                         | 0.3%                         | 16.4%                     | -7.5%              |
| <b>Operating profit</b>                    | <b>\$ (8,546)</b>              | <b>\$(608)</b>               | <b>\$ 176</b>             | <b>\$ (8,978)</b>  |
|  | -71.6%                         | -15.0%                       | 11.4%                     | -62.1%             |

### Industrial Hardware Segment

**Net sales** in the Industrial Hardware segment were down 11% in the third quarter of 2008 and down 31% in the first nine months compared to the prior year periods. The decrease in sales in the third quarter was the result of a decrease in sales of products to the vehicular industry in 2008 compared to the same period in 2007. The decrease in sales in the first nine months of 2008 compared to the prior year period was due to the fulfillment of orders to produce door latching components for a military project to up-armor existing Humvees in the 2007 period. Excluding the sales from the military contract in the Industrial Hardware segment, sales of our core business units in this segment decreased 4% in the first nine months of 2008. This decrease was due to lower sales volume of sleeper cabs and other products for the Class 8 truck market compared to the prior year, the impact of which was reduced by sales generated from the introduction of new products for the various markets we serve. New product introductions included a center case kit, a handle rescue wrench, inside handle assembly and a padlock t-handle assembly for the military market; a water resistant 3 t-handle for the distribution market; a multi-stage rotary for the truck accessory market; honeycomb core electronic panels for the high-tech market; and various honeycomb panels and enclosures for the transportation market. The Industrial Hardware segment continues to develop new products and gain orders for military hardware and latching systems, with various current orders totaling over \$11 million scheduled to begin shipping during the fourth quarter of 2008 and continue through 2009. The Class 8 truck market is not predicted to improve until at least the third quarter of 2009.

**Cost of products sold** for the Industrial Hardware segment decreased 10% in the third quarter and 23% in the first nine months of 2008 compared to the prior year periods. The decrease in the third quarter of 2008 was due to low sales volume in the 2008 period. The decrease in the first nine months of 2008 compared to the prior year was the result of the fulfillment of orders to produce door latching components for a military project to up-armor existing Humvees which was completed during the first quarter of 2007.

**Gross margin** as a percent of net sales was comparable at 18% in the third quarter of both 2008 and 2007. Gross margin decreased from 29% to 21% in the first nine months of 2008 compared to the prior year period as a direct result of the significant decrease in sales volume, primarily the fulfillment of orders to produce door latching components for a military project to up-armor existing Humvees which was completed during the first quarter of 2007, resulting in more efficient utilization of our existing facilities in that earlier period.





**Selling and administrative expenses** decreased 18% for both the third quarter and first nine months of 2008 compared to the prior year periods primarily due to decreases in payroll and payroll related charges and corporate allocations.

## Security Products Segment

**Net sales** in the Security Products segment decreased 11% in the third quarter and 6% in the first nine months of 2008 compared to the 2007 periods. The decrease in sales in both the third quarter and first nine months of 2008 in the Security Products segment is mainly the result of lower sales volume of existing products to many of the markets this segment serves. The decrease was lessened by sales of new products focused on lock products such as a wing knob lock with a flip-up cover for the truck accessory market; variations of the SearchAlert™ for the luggage market; backplates, a clamp set, trim mold and turn signal stalks for motorcycles; as well as various other items for the many markets we service.

**Cost of products sold** for the Security Products segment was down 10% in the third quarter and 6% in the first nine months of 2008 compared to the same periods in 2007. The decrease in cost of products sold was primarily due to the decrease in sales volume and the mix of products sold compared to the prior year periods. This segment experienced costs increases for raw materials, utilities and research and development.

**Gross margin** as a percentage of sales in both the third quarter and first nine months were comparable at approximately 23% for all periods.

**Selling and administrative expenses** decreased 2% in the third quarter of 2008 compared to the prior year period. The decrease in the third quarter of 2008 compared to the prior year quarter was due to a reduction in travel expenses and corporate allocations. Selling and administrative expenses were comparable in the first nine months of 2008 and 2007.

## Metal Products Segment

**Net sales** in the Metal Products segment were up 65% in the third quarter and 43% in the first nine months of 2008 as compared to the prior year periods. Sales of mining products were up 49% in the third quarter and 45% in the first nine months of 2008 compared to the prior year periods. Sales of contract castings increased 48% in the third quarter and 17% in the first nine months of 2008 from the prior year levels. New product sales included a cablehead and a crater head used in underground mining. The recently announced closing of a major competitor may create additional opportunities to increase sales volume.

**Cost of products sold** increased 88% in the third quarter and 37% in the first nine months of 2008 compared to the same periods in 2007. The major factor driving the increase in cost of products sold is the increased cost of scrap metal, the main ingredient used in the making of malleable and ductile iron. The increase in cost of products sold was also affected by the mix of products produced, utility costs, supplies and tools, equipment maintenance and payroll and payroll related charges as compared to the prior year periods.

**Gross margin** as a percentage of net sales decreased from 2% to -11% in the third quarter of 2008 and improved from -5% to -1% for the first nine months of 2008 compared to the 2007 periods. The decrease in the third quarter is primarily due to higher manufacturing costs in the 2008 period. The improvement in the first nine months is primarily due to increased sales volume of existing products, the mix of products produced and price increases to our customers.

**Selling and administrative expenses** were up 10% in the third quarter and 16% in the first nine months of 2008 compared to the same periods in 2007. The increases were due to increases in payroll and payroll related charges and higher sales commissions resulting from the higher sales volume, as well as corporate allocations.

- 18 -

---

## Other Items

**Interest expense** decreased 9% in the third quarter and 18% in the first nine months of 2008 compared to the prior year periods due to the lower debt balances and lower interest rates. The prior year nine month period reflected borrowings under the revolving credit portion of the loan agreement used to fund interim working capital needs in the 2007 period for the aforementioned military contract.

**Other income** decreased 94% in the quarter and 81% from the first nine months of 2007 to 2008 due to lower interest income from the Company's cash management program and lower interest rates in 2008.

**Income taxes** reflected the change in the earnings level. The effective tax rate in the third quarter of 2008 was -7% compared to 13% in the third quarter of 2007. The effective tax rate for the first nine months of 2008 was 27% compared to 33% in the first nine months of 2007. The lower effective rates in the third quarter of both 2008 and 2007 resulted from favorable tax provision adjustments. Without these adjustments, effective tax rates for all periods presented would have been in the range of 33% to 36%.

## Liquidity and Sources of Capital

The Company generated \$5.0 million from operations for the first nine months of 2008 compared to \$6.8 million for the same period in 2007. The change in cash flows was primarily the result of changes in the level of sales related to the Company's military contract, which was completed in the first quarter of 2007, and the associated timing differences for collections of accounts receivable and payments of liabilities and changes in inventories. Cash flow from operations coupled with cash on hand at the beginning of the year were sufficient to fund capital expenditures, debt service, incentive payments, contributions to the Company's pension plans, and dividend payments. The Company did not utilize its revolving line of credit during the third quarter or first nine months of 2008. During the first nine months of 2007, the maximum balance outstanding on the line of credit was approximately \$5.3 million; however, the line was completely re-paid at the end of the first quarter of 2007 and was not utilized during the remainder of that year.

Additions to property, plant and equipment were \$1.7 million during the first nine months of 2008 versus \$2.0 million for the comparable period in the prior year. Total capital expenditures for 2008 are expected to be in the range of \$2.5 million to \$3.0 million. There are no outstanding commitments for these estimated capital expenditures.

Total inventories as of September 27, 2008 were \$29.5 million, compared to \$30.5 million at year-end 2007. The inventory turnover ratio of 3.9 turns at the end of the third quarter was comparable to the year-end 2007 ratio of 3.9 turns, but slightly lower than the 4.4 turns in the third quarter of 2007. Accounts receivable increased by \$2.9 million from year end and increased \$198,000 from the third quarter of Fiscal 2007. The average days sales in accounts receivable for the third quarter of 2008 at 58 days was comparable to the third quarter of 2007 at 55 days, but increased from year end 2007 at 44 days. The increase was due to a slowdown of collections in the Industrial Hardware and Metal Products segments. The Company is confident that these receivables will ultimately be collected.

Cash flow from operating activities and funds available under the revolving credit portion of the Company's loan agreement are expected to be sufficient to cover future foreseeable working capital requirements.

## ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk from what was reported in the 2007 Annual Report on Form 10-K.

- 19 -

---

## **ITEM 4 CONTROLS AND PROCEDURES**

### Evaluation of Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer ( CEO ) and Chief Financial Officer ( CFO ), of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

The Company believes that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. The Company's disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives, and the CEO and CFO have concluded that these controls and procedures are effective at the reasonable assurance level.

### Changes in Internal Controls

During the period covered by this report, there have been no significant changes in the Company's internal control over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, the Company's internal controls.

## **PART II OTHER INFORMATION**

### **ITEM 1 LEGAL PROCEEDINGS**

The Company is currently undergoing investigation by the U.S. Department of Environmental Protection and N.Y. Department of Environmental Conservation for various anonymous complaints regarding its metal castings facility. The Company recorded a contingent liability of \$250,000 in December 2007 for settlement of this matter. Based on current information available, the Company believes this matter will be settled for \$250,000 during 2008. The liability has been reduced by approximately \$154,000 that has been spent through the first nine months of 2008 toward remedies required under the settlement agreement.

There are no other legal proceedings, other than ordinary routine litigation incidental to the Company's business, to which either the Company or any of its subsidiaries is a party or to which any of their property is the subject.

### **ITEM 1A RISK FACTORS**

## Edgar Filing: EASTERN CO - Form 10-Q

There have been no material changes in risk factors from what was reported in the 2007 Annual Report on Form 10-K.

### ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There have been no sales of unregistered securities by the Company during the period covered by this report.

#### Issuer Purchases of Equity Securities

| Period                       | (a) Total Number of Shares Purchased | (b) Average Price Paid per Share | (c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs | (d) Maximum Number that May Yet Be Purchased Under the Plans or Programs |
|------------------------------|--------------------------------------|----------------------------------|--|--|
| June 29 August 2, 2008       | -                                    | -                                | -  | -  |
| August 3 August 30, 2008     | 27,160                               | \$14.75                          | -  | -  |
| August 31 September 27, 2008 | -                                    | -                                | -  | -  |
| Total                        | 27,160                               | \$14.75                          | -  | -  |

The Company does not have any share repurchase plans or programs. The figures shown in the table above are for shares delivered to the Company to exercise stock options.

**ITEM 3 DEFAULTS UPON SENIOR SECURITIES**

None

**ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS**

See the information set forth in Part II, Item 4 of the Form 10-Q of the Company for the quarterly period ended March 29, 2008.

**ITEM 5 OTHER INFORMATION**

None

**ITEM 6 EXHIBITS**

31) Certifications required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32) Certifications pursuant to Rule 13a-14(b) and 18 USC 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99(1)) The Registrant's Annual Report on Form 10-K for the fiscal year ended December 29, 2007 is incorporated herein by reference.

99(2)) Form 8-K filed on April 22, 2008 setting forth the press release reporting the Company's earnings for the quarter ended March 29, 2008 is incorporated herein by reference.

99(3)) Form 8-K filed on June 23, 2008 setting forth the Company's 2008 Rights Agreement is incorporated herein by reference.

99(4)) Form 8-K filed on July 9, 2008 setting forth the Company's loss of an Emeritus Director is incorporated herein by reference.

99(5)) Form 8-K filed on July 23, 2008 setting forth the press release reporting the Company's earnings for the quarter ended June 28, 2008 is incorporated herein by reference.

Edgar Filing: EASTERN CO - Form 10-Q

99(6)) Form 8-K filed on October 22, 2008 setting forth the press release reporting the Company's earnings for the quarter ended September 27, 2008 is incorporated herein by reference.

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.

**THE EASTERN COMPANY**  
(Registrant)

DATE: October 28, 2008

/s/Leonard F. Leganza  
Leonard F. Leganza

Chairman, President and Chief Executive Officer

DATE: October 28, 2008

/s/John L. Sullivan III  
John L. Sullivan III

Vice President and Chief Financial Officer