DUCOMMUN INC /DE/
Form 10-Q
October 31, 2006
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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, 2006

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 1-8174

DUCOMMUN INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware **(State or other jurisdiction of incorporation or organization)**	**95-0693330** **(I.R.S. Employer Identification No.)**
23301 Wilmington Avenue, Carson, California **(Address of principal executive offices)**	**90745-6209** **(Zip Code)**

(310) 513-7280

(Registrant s telephone number, including area code)

(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. Yes x 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 x Non accelerated filer ¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. As of October 25, 2006, there were outstanding 10,242,996 shares of common stock.

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DUCOMMUN INCORPORATED

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

DUCOMMUN INCORPORATED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	(Unaudited) September 30, 2006	December 31, 2005
Assets		
Current Assets:		
Cash and cash equivalents	$ 2,618	$ 19,221
Accounts receivable (less allowance for doubtful accounts of $288 and $244)	40,242	32,890
Unbilled receivables	4,611	
Inventories	65,950	53,299
Deferred income taxes	7,516	6,048
Prepaid income taxes		56
Other current assets	5,485	4,464
Total Current Assets	126,422	115,978
Property and Equipment, Net	53,822	52,481
Goodwill, Net	108,066	57,201
Other Intangible Assets, Net	10,741	
Other Assets	1,757	2,309
	$ 300,808	$ 227,969
Liabilities and Shareholders Equity		
Current Liabilities:		
Current portion of long-term debt	$ 1,253	$
Accounts payable	26,851	17,787
Accrued liabilities	38,869	33,879
Total Current Liabilities	66,973	51,666
Long-Term Debt, Less Current Portion	43,850	
Deferred Income Taxes	6,279	5,752
Other Long-Term Liabilities	2,700	2,700
Total Liabilities	119,802	60,118
Commitments and Contingencies		
Shareholders Equity:		
Common stock $.01 par value; authorized 35,000,000 shares; issued 10,234,996 shares in 2006 and 10,108,996 shares in 2005	102	101
Additional paid-in capital	45,112	41,987
Retained earnings	138,492	128,463
Accumulated other comprehensive loss	(2,700)	(2,700)

Total Shareholders Equity	181,006	167,851
	$ 300,808	$ 227,969

See accompanying notes to consolidated financial statements.

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DUCOMMUN INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

(Unaudited)

	For Three Months Ended September 30, 2006	October 1, 2005
Net Sales	$ 81,557	$ 63,008
Operating Costs and Expenses:		
Cost of goods sold	64,612	49,958
Selling, general and administrative expenses	10,374	7,555
Total Operating Costs and Expenses	74,986	57,513
Operating Income	6,571	5,495
Interest (Expense)/Income, Net	(704)	407
Income Before Taxes	5,867	5,902
Income Tax Expense, Net	(1,768)	(1,587)
Net Income	$ 4,099	$ 4,315
Earnings Per Share:		
Basic earnings per share	$ .40	$ .43
Diluted earnings per share	$ .40	$ .42
Weighted Average Number of Common Shares Outstanding:		
Basic	10,231	10,069
Diluted	10,292	10,222

See accompanying notes to consolidated financial statements.

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DUCOMMUN INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

(Unaudited)

	For Nine Months Ended	
	September 30, 2006	**October 1, 2005**
Net Sales	$ 231,195	$ 188,818
Operating Costs and Expenses:		
Cost of goods sold	184,508	150,041
Selling, general and administrative expenses	29,609	22,195
Total Operating Costs and Expenses	214,117	172,236
Operating Income	17,078	16,582
Interest (Expense)/Income, Net	(1,868)	322
Income Before Taxes	15,210	16,904
Income Tax Expense, Net	(5,181)	(4,433)
Net Income	$ 10,029	$ 12,471
Earnings Per Share:		
Basic earnings per share	$ .98	$ 1.24
Diluted earnings per share	$ .97	$ 1.22
Weighted Average Number of Common Shares Outstanding:		
Basic	10,195	10,058
Diluted	10,287	10,190

See accompanying notes to consolidated financial statements.

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DUCOMMUN INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	For Nine Months Ended September 30, 2006	For Nine Months Ended October 1, 2005
Cash Flows from Operating Activities:		
Net Income	$ 10,029	$ 12,471
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation	6,131	5,652
Amortization of other intangible assets	999	
Deferred income tax (benefit)/provision	(941)	2,454
Excess tax benefit from stock-based compensation	(182)	
Income tax benefit from stock-based compensation	501	177
Stock-based compensation expense	1,067	
Recovery of doubtful accounts	(15)	(110)
Gain on sale of assets	(36)	(13)
Net (recovery of)/provision for warranty reserves	(23)	108
Net reduction of contract cost overruns	(257)	(574)
Changes in Assets and Liabilities Net of Effects from Acquisitions:		
Accounts receivable - (increase)	(856)	(6,882)
Unbilled receivables - (increase)	(2,052)	
Inventories - (increase)	(10,784)	(588)
Prepaid income taxes - decrease	56	272
Other assets - (increase)	(186)	(570)
Accounts payable - increase	7,781	2,092
Accrued and other liabilities - (decrease)/increase	(408)	3,375
Net Cash Provided by Operating Activities	10,824	17,864
Cash Flows from Investing Activities:		
Purchase of Property and Equipment	(6,851)	(3,229)
Proceeds from Sale of Assets	179	18
Acquisition of Businesses, Net of Cash Acquired	(60,495)	
Net Cash Used in Investing Activities	(67,167)	(3,211)
Cash Flows from Financing Activities:		
Net Borrowings/(Repayment) of Long-Term Debt	38,000	(1,200)
Net Cash Effect of Exercise Related to Stock Options	1,558	247
Excess Tax Benefit from Stock-Based Compensation	182	
Net Cash Provided by/(Used in) Financing Activities	39,740	(953)
Net (Decrease)/Increase in Cash and Cash Equivalents	(16,603)	13,700
Cash and Cash Equivalents at Beginning of Period	19,221	158
Cash and Cash Equivalents at End of Period	$ 2,618	$ 13,858

Supplemental Disclosures of Cash Flow Information:		
Interest Paid	$ 1,654	$ 32
Taxes Paid	$ 4,930	$ 2,237

See accompanying notes to consolidated financial statements.

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DUCOMMUN INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Basis of Presentation

The consolidated balance sheet is unaudited as of September 30, 2006 and the consolidated statements of income and the consolidated statements of cash flows are unaudited for the three months and nine months ended September 30, 2006 and October 1, 2005. The consolidated financial statements include the accounts of Ducommun Incorporated and its subsidiaries (Ducommun or the Company), after eliminating inter-company balances and transactions. The interim financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are, in the opinion of the Company, necessary for a fair presentation of the results for the interim periods presented. The financial information included in this Form 10-Q should be read in conjunction with the Company s consolidated financial statements and related notes thereto included in the Form 10-K for the year ended December 31, 2005. The results of operations for the three months and nine months ended September 30, 2006 are not necessarily indicative of the results to be expected for the full year ending December 31, 2006.

Note 2. Changes in Significant Accounting Policies

Ducommun operates in two business segments. Ducommun AeroStructures, Inc. (DAS), engineers and manufactures aerospace structural components and subassemblies. Ducommun Technologies, Inc. (DTI), designs, engineers and manufactures electromechanical components and subsystems, and through its Miltec Corporation (Miltec) subsidiary, provides engineering, technical and program management services (including design, development, integration and test of prototype products) principally for the aerospace and military markets. The significant accounting policies of the Company and its two business segments are the same except as described below.

Revenue Recognition

Except for the Company s Miltec subsidiary, the Company recognizes revenue when persuasive evidence of an arrangement exists, the price is fixed or determinable, collection is reasonably assured and delivery of products has occurred or services have been rendered. Revenue from products sold under long-term contracts is recognized by the Company on the same basis as other sale transactions. The Company recognizes revenue on the sale of services (including prototype products) by its Miltec

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subsidiary based on the type of contract: time and materials, cost-plus reimbursement and firm-fixed price. Revenue is recognized by Miltec (i) on time and materials contracts as time is spent at hourly rates, which are negotiated with customers, plus the cost of any allowable materials and out-of-pocket expenses, (ii) on cost-plus reimbursement contracts based on direct and indirect costs incurred plus a negotiated profit calculated as a percentage of cost, a fixed amount or a performance-based award fee, and (iii) on fixed-price contracts on the percentage-of-completion method measured by the percentage of costs incurred to estimated total costs.

Goodwill

The Company s business acquisitions have resulted in goodwill. Goodwill is not amortized but is subject to impairment tests on an annual basis in the fourth quarter and between annual tests, in certain circumstances, when events indicate an impairment may have occurred. Goodwill is tested for impairment utilizing a two-step method. In the first step, the Company determines the fair value of the reporting unit using expected future discounted cash flows and other market valuation approaches, requiring management to make estimates and assumptions about the reporting unit s future prospects. If the net book value of the reporting unit exceeds the fair value, the Company would then perform the second step of the impairment test which requires fair valuation of all the reporting unit s assets and liabilities in a manner similar to a purchase price allocation, with any residual fair value being allocated to goodwill. This residual fair value of goodwill is then compared to the carrying amount to determine impairment. An impairment charge will be recognized only when the implied fair value of a reporting unit, including goodwill, is less than its carrying amount.

Other Intangible Assets

The Company amortizes purchased other intangible assets with finite lives using the straight-line method over the estimated economic lives of the assets, ranging from one to fourteen years. The value of other intangibles acquired through business combinations has been estimated using present value techniques which involve estimates of future cash flows. Actual results could vary, potentially resulting in impairment charges.

Accounting for Stock-Based Compensation

Effective January 1, 2006, the Company began recognizing compensation expense for share-based payment transactions in the financial statements at their fair value. The expense is measured at the grant date, based on the calculated fair value of the share-based award, and is recognized over the requisite service period (generally the vesting period of the equity award). Prior to January 1, 2006, the Company accounted for share-based compensation based upon the intrinsic value of options at the grant date. The transition to fair value was accounted for using the modified prospective method. Therefore, financial statement amounts for prior periods presented in this Form 10-Q have not been restated to reflect the fair value method of recognizing compensation cost relating to stock options.

Prior to January 1, 2006, the Company presented all benefits of tax deductions resulting from the exercise of share-based compensation as operating cash flows in the statements of cash flows. Prospectively, the benefits of tax deductions in excess of the compensation cost recognized for stock options (excess tax benefits) are classified as financing cash flows. Excess tax benefits reflected as a financing cash inflow totaled $182,000 during the first nine months ended September 30, 2006. Income tax benefits reflected as an operating cash inflow totaled $319,000 during the first nine months ended September 30, 2006.

Earnings Per Share

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding in each period. Diluted earnings per share is computed by dividing income available to common shareholders plus income associated with dilutive securities by the weighted average number of common shares outstanding plus any potential dilutive shares that could be issued if exercised or converted into common stock in each period. For the three months ended September 30, 2006 and October 1, 2005, income available to common shareholders was $4,099,000 and $4,315,000, respectively. The weighted average number of common shares outstanding for the three months ended September 30, 2006 and October 1, 2005 were 10,231,000 and 10,069,000, respectively; the dilutive shares associated with stock options were 61,000 and 153,000, respectively. For the nine months ended September 30, 2006 and October 1, 2005, income available to common shareholders was $10,029,000 and $12,471,000, respectively. The weighted average number of common shares outstanding for the nine months ended September 30, 2006 and October 1, 2005 were 10,195,000 and 10,058,000; and the dilutive shares associated with stock options were 92,000 and 133,000, respectively. For the three months ended September 30, 2006 and October 1, 2005 the number of shares not included in the calculations because the impact would have been antidilutive was 632,000 and 48,000, respectively; and for the nine months ended September 30, 2006 and October 1, 2005 the number of shares not included in the calculation because the impact would have been antidilutive was 523,000 and 246,000, respectively.

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Comprehensive Income

Certain items such as foreign currency translation adjustments, unrealized gains and losses on certain investments in debt and equity securities and minimum pension liability adjustments are presented as separate components of shareholders equity. The current period change in these items is defined as other comprehensive income and separately reported in the financial statements. Accumulated other comprehensive loss, as reflected in the Consolidated Balance Sheets under the equity section, is comprised of a minimum pension liability adjustment of $2,700,000, net of tax, at September 30, 2006 and December 31, 2005.

Recent Accounting Pronouncements

On September 15, 2006, the Financial Accounting Standards Board (FASB or the Board) issued FASB Statement No. 157, *Fair Value Measurements (SFAS No. 157)*, which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles (GAAP). As a result of SFAS No. 157 there is now a common definition of fair value to be used throughout GAAP. The FASB believes that the new standard will make the measurement of fair value more consistent and comparable and improve disclosures about those measures. Companies will need to adopt SFAS No. 157 for financial statements issued for fiscal years beginning after November 15, 2007.

On October 3, 2006, the FASB issued FASB Statement No. 158, *Employers Accounting for Defined Benefit Pension and Other Postretirement Plans and amendment of FASB Statement No. 87, 88, 106, and 132(R.) (SFAS No. 158).* This Statement requires an employer that is a business entity and sponsors one or more single-employer defined benefit plans to recognize the funded status of a benefit measured as the difference between plan assets at fair value (with limited exceptions) and the benefit obligation in its statement of financial position. SFAS No. 158 also requires employers to recognize as a component of other comprehensive income, net of tax, the gains or losses and prior service costs or credits that arise during the period but are not recognized as components of net periodic benefit cost pursuant to FASB Statement No. 87, *Employers Accounting for Pensions, or No. 106, Employers Accounting for Postretirement Benefits Other Than Pensions*.

On September 13, 2006, the Securities Exchange Commission (SEC) released the Staff Accounting Bulletin No. 108 (SAB No. 108). For a number of years, the SEC staff has expressed concern over the diversity of practice surrounding how public companies (and their auditors) quantify financial statement misstatements. SAB No. 108 addresses the diversity in quantification practices with respect to annual financial statements. The interpretations in SAB No. 108 express the staff s views regarding the process of quantifying financial statement misstatement.

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In July 2006, the FASB issued Final Interpretation No. 48 (FIN No. 48), *Accounting for Uncertainty in Income Taxes*, an interpretation of SFAS No. 109. FIN No. 48 clarifies the accounting for income taxes by prescribing the minimum recognition threshold a tax position is required to meet before being recognized in the financial statements. FIN No. 48 also provides guidance on derecognition, measurement, classification, interest and penalties, accounting in interim periods, disclosure and transition. In addition, FIN No. 48 excludes income taxes from the scope of SFAS No. 5, *Accounting for Contingencies*. FIN No. 48 is effective for fiscal years beginning after December 15, 2006. Differences between the amounts recognized in the consolidated balance sheets prior to the adoption of FIN No. 48 and the amounts reported after adoption will be accounted for as a cumulative-effect adjustment recorded to the beginning balance of retained earnings. The Company is currently evaluating the effect that the adoption of FIN No. 48 will have on its results of operations and financial position.

In February 2006, the FASB issued Statement of Financial Accounting Standards No. 155, Accounting for Certain Hybrid Financial Instruments (SFAS No. 155). SFAS No. 155 amends SFAS No. 133 Accounting for Derivative Instruments and Hedging Activities (SFAS No. 133), and SFAS No. 140 Accounting for Transfers and Servicing of Financial Assets and Extinguishments of Liabilities (SFAS No. 140) and addresses the application of SFAS No. 133 to beneficial interests in securitized financial assets. SFAS No. 155 establishes a requirement to evaluate interests in securitized financial assets to identify interests that are freestanding derivatives or that are hybrid financial instruments that contain an embedded derivative requiring bifurcation. Additionally, SFAS No. 155 permits fair value measurement for any hybrid financial instrument that contains an embedded derivative that otherwise would require bifurcation. SFAS No. 155 is effective for financial instruments acquired or issued after January 1, 2007. The adoption of SFAS No. 155 is not expected to have a material effect on the Company s consolidated financial position and results of operations.

In November 2005, FASB issued FASB Staff Position (FSP) FAS 115-1 and FAS 124-1, *The Meaning of Other-Than-Temporary Impairment and Its Application to Certain Investments.* This FSP addresses the determination as to when an investment is considered impaired, whether that impairment is other than temporary, and the measurement of an impairment loss. The FSP also includes accounting considerations subsequent to the recognition of other-than-temporary impairment and requires certain disclosures about unrealized losses that have not been recognized as other-than-impairments. The guidance in this FSP is applicable to reporting periods beginning after December 15, 2005. The adoption of this FSP did not have a material effect on the Company s consolidated financial position and results of operations.

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In October 2005, the FASB announced that FSP No. 13-1, Accounting for Rental Costs Incurred during a Construction Period. This Position states that rental costs incurred during and after a construction period are for the right to control the use of a leased asset during and after construction of a leased asset, and that there is no distinction between the right to use a leased asset during the construction period and the right to use that asset after the construction period. This Position requires that rental costs associated with ground or building operating leases that are incurred during a construction period be recognized as rental expense, included in income from continuing operations. The Company adopted FSP No. 13-1 in January 2006. The adoption of FSP No. 13-1 did not have a material impact on the Company s consolidated financial position and results of operations or cash flows.

In May 2005, FASB issued Statement of the Financial Accounting Standards No. 154, Accounting Changes and Error Corrections a replacement of APB Opinion No. 20 and FASB Statement No. 3. This Statement requires the retrospective application to prior periods financial statements of changes in accounting principle, unless it is impracticable to determine either the period-specific effects or the cumulative effect of the change.

In November 2004, Statement of Financial Accounting Standards No. 151, Inventory Costs, an Amendment of ARB No. 43, Chapter 4 (SFAS No. 151), was issued. The amendments made by SFAS No. 151 clarify that abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) should be recognized as current-period charges and require the allocation of fixed production overheads to inventory based on the normal capacity of the production facilities. The Company adopted SFAS No. 151 in January 2006. The adoption of SFAS No. 151 did not have a material impact on the Company s consolidated financial position and results of operations.

Use of Estimates

Certain amounts and disclosures included in the consolidated financial statements required management to make estimates and judgments that affect the amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. These estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

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Note 3. Acquisitions

On January 6, 2006, the Company acquired Miltec Corporation (Miltec) a privately-owned company based in Huntsville, Alabama for $47,107,000 (including assumed indebtedness and excluding acquisition costs) plus contingent payments not to exceed $3,000,000. Miltec provides engineering, technical and program management services (including design, development, integration and test of prototype products) principally for aerospace and military markets. The acquisition was accounted for under the purchase method of accounting. The cost of the acquisition was allocated on the basis of the estimated fair value of the assets acquired and liabilities assumed. The acquisition was funded from internally generated cash, notes to the sellers, and borrowings of approximately $24,000,000 under the Company s credit agreement. The operating results for this acquisition have been included in the consolidated statements of income since the date of the acquisition.

On May 10, 2006, the Company acquired WiseWave Technologies, Inc. (WiseWave), a privately-owned company based in Torrance, California for $7,000,000 (including assumed indebtedness and excluding acquisition costs) plus contingent payments not to exceed $500,000. WiseWave manufactures microwave and millimeterwave products for both aerospace and non-aerospace applications. The acquisition was accounted for under the purchase method of accounting. The cost of the acquisition was allocated on the basis of the estimated fair value of the assets acquired and liabilities assumed. The acquisition was funded from notes to the sellers, and borrowings of approximately $5,100,000 under the Company s credit agreement. The operating results for this acquisition have been included in the consolidated statements of income since the date of the acquisition.

On September 1, 2006, the Company acquired CMP Display Systems, Inc. (CMP), a privately-owned company based in Newbury Park, California for $14,000,000 (including assumed indebtedness and excluding acquisition costs). CMP manufactures incandescent, electroluminescent and LED edge lit panels and assemblies for the aerospace and defense industries. The acquisition was accounted for under the purchase method of accounting. The cost of the acquisition was allocated on the basis of the estimated fair value of the assets acquired and liabilities assumed. The acquisition was funded from notes to the sellers, and borrowings of approximately $10,800,000 under the Company s credit agreement. The operating results for this acquisition have been included in the consolidated statements of income since the date of the acquisition

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The following table presents unaudited pro forma consolidated operating results for the Company for the three months and nine months ended October 1, 2005 as if the Miltec acquisition had occurred as of the beginning of the periods presented. Pro forma results for the three months and nine months ended October 1, 2005, assuming the acquisition of WiseWave and CMP at the beginning of the period, would not have been materially different from the Company s historical results for the periods presented.

(In thousands, except per share amounts)	Three Months Ended October 1, 2005	Nine Months Ended October 1, 2005
Net sales	$ 71,977	$ 220,851
Net earnings	3,136	10,401
Basic earnings per share	0.31	1.03
Diluted earnings per share	0.31	1.02

The table below summarizes the preliminary purchase price allocation for Miltec, WiseWave and CMP at the date of acquisitions. The allocations are incomplete as they do not reflect any fair value adjustments for CMP. The CMP purchase price allocation and portions of the Miltec and WiseWave purchase price allocations will be finalized during the fourth quarter of 2006.

(In thousands)	
Tangible assets, exclusive of cash	$ 11,954
Intangible assets	11,740
Goodwill	50,865
Liabilities assumed	(14,064)
Cost of acquisition, net of cash acquired	$ 60,495

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Note 4. Inventories

Inventories consist of the following:

	(In thousands)	
	September 30, 2006	December 31, 2005
Raw materials and supplies	$ 24,950	$ 17,388
Work in process	50,313	43,417
Finished goods	1,410	685
	76,673	61,490
Less progress payments	10,723	8,191
Total	$ 65,950	$ 53,299

Note 5. Property and Equipment

Property and equipment consist of the following:

	(In thousands)	
	September 30, 2006	December 31, 2005
Land	$ 11,333	$ 11,333
Buildings and improvements	29,751	28,931
Machinery and equipment	74,237	73,480
Furniture and equipment	15,903	14,209
Construction in progress	5,474	1,989
	136,698	129,942
Less accumulated depreciation and amortization	82,876	77,461
Total	$ 53,822	$ 52,481

Depreciation expense was $2,077,000 and $1,793,000 for the three months ended September 30, 2006 and October 1, 2005, respectively; and $6,131,000 and $5,652,000 for the nine months ended September 30, 2006 and October 1, 2005, respectively.

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Note 6. Goodwill and Other Intangible Assets

The values of goodwill and other intangibles at September 30, 2006 are subject to change based upon the completion of our purchase price allocations. The carrying amount of goodwill for the three months and nine months ended September 30, 2006 is as follows:

		(In thousands)	
	Ducommun AeroStructures, Inc.	Ducommun Technologies, Inc.	Total Ducommun
Balance at December 31, 2005	$ 36,785	$ 20,416	$ 57,201
Goodwill additions due to acquisitions		50,865	50,865
Balance at September 30, 2006	$ 36,785	$ 71,281	$ 108,066

Other intangible assets at September 30, 2006 consist of backlog, trade names, customer relations and non-compete agreements in connection with the Miltec and WiseWave acquisitions, and are amortized on the straight-line method over periods ranging from one to fourteen years. The fair value of other intangible assets was determined by management with the assistance of an independent valuation expert.

The carrying amount of other intangible assets as of September 30, 2006 and December 31, 2005 are as follows:

	(In thousands)					
	Ducommun Technologies, Inc.					
	September 30, 2006			December 31, 2005		
	Gross	Accumulated Amortization	Net Carrying Value	Gross	Accumulated Amortization	Net Carrying Value
Other intangible assets	$ 11,740	$ (999)	$ 10,741	$	$	$

Amortization expense of other intangible assets was $366,000 and $999,000 for the three month and nine month periods ended September 30, 2006.

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Note 7. Long-Term Debt

Long-term debt is summarized as follows:

	(In thousands) September 30, 2006	December 31, 2005
Bank credit agreement	$ 38,000	$
Notes and other obligations for acquisitions	7,103	
Total debt	45,103	
Less current portion	1,253	
Total long-term debt	$ 43,850	$

The Company has entered into an Amended and Restated Credit Agreement with Bank of America, N.A., as Administrative Agent, Wachovia Bank, National Association, as Syndication Agent, and other lenders named therein (the Credit Agreement). The Credit Agreement provides for an unsecured revolving credit line of $75,000,000 maturing on April 7, 2010. Interest is payable monthly on the outstanding borrowings at Bank of America s prime rate (8.25% per annum at September 30, 2006) plus a spread (0% to 0.50% per annum based on the leverage ratio of the Company) or, at the election of the Company, for terms of up to six months at the LIBOR rate plus a spread (1.00% to 1.75% per annum depending on the leverage ratio of the Company). The Credit Agreement includes minimum fixed charge coverage, maximum leverage and minimum net worth covenants, an unused commitment fee (0.25% to 0.40% per annum depending on the leverage ratio of the Company), and limitations on future dispositions of property, repurchases of common stock, dividends, outside indebtedness, and acquisitions.

On January 6, 2006, the Company acquired Miltec Corporation. The purchase price included an unsecured three-year note payable to the owners, with principal payments of $353,000 in 2007 and $1,000,000 a year in 2008 and 2009, respectively, with interest at 5.00% per annum.

On May 10, 2006, the Company acquired WiseWave Technologies, Inc. The purchase price included an interest free $750,000 payment obligation (in five equal annual installments of $150,000), for a non-competition agreement and an unsecured $1,000,000 note payable in 2009 with interest at 5.00% per annum.

On September 1, 2006, the Company acquired CMP Display Systems, Inc. The purchase price included an unsecured $3,000,000 note payable (in four equal annual installments of $750,000) with interest at 6.00% per annum.

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The weighted average interest rate on borrowings outstanding was 6.31% at September 30, 2006. There were no borrowings as of October 1, 2005.

The carrying amount of long-term debt approximates fair value based on the terms of the related debt, recent transactions and estimates using interest rates currently available to the Company for debt with similar terms and remaining maturities.

Note 8. Accrued Liabilities

Accrued liabilities consist of the following:

	(In thousands)	
	September 30, 2006	**December 31, 2005**
Accrued compensation	$ 18,673	$ 15,452
Accrued income tax and sales tax	6,082	4,869
Provision for environmental costs	5,028	4,724
Accrued insurance costs	2,057	2,615
Provision for contract cost overruns	2,029	2,286
Customer deposits	1,113	1,553
Accrued warranty reserves	98	122
Other	3,789	2,258
Total	$ 38,869	$ 33,879

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Note 9. Stock Options

The Company has three stock option or incentive plans. Stock awards may be made to directors, officers and key employees under the stock plans on terms determined by the Compensation Committee of the Board of Directors or, with respect to directors, on terms determined by the Board of Directors. Stock options have been and may be granted to directors, officers and key employees under the stock plans at prices not less than 100% of the market value on the date of grant, and expire not more than ten years from the date of grant. The option price and number of shares are subject to adjustment under certain dilutive circumstances.

The Company s transition to fair value accounting for stock-based compensation resulted in expense recognition in 2006 consisting of all awards granted prior to, but not yet vested as of December 31, 2005, and all awards granted after December 31, 2005 based on the grant-date fair value estimated using a Black-Scholes valuation model. The Company recognizes compensation expense, net of an estimated forfeiture rate, on a straight-line basis over the requisite service period of the award. The Company has two identified award populations, one with an option vesting term of four years and the other with an option vesting term of one year. The Company estimated the forfeiture rate based on its historic experience.

The Company also examined its historic pattern of option exercises in an effort to determine if there were any discernable activity patterns based on certain employee populations. The table below presents the weighted average expected life in months of the two identified employee populations. The expected life computation is based on historic exercise patterns and post-vesting termination behavior within each of the two populations identified. The risk-free interest rate for periods within the contractual life of the award is based on the U.S. Treasury yield curve in effect at the time of grant. The expected volatility is derived from historical volatility of the Company s common stock.

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The fair value of each share-based payment award was estimated using the following assumptions and weighted average fair values as follows:

	Stock Options [1] Three Months Ended		Stock Options [1] Nine Months Ended	
	Sept. 30, 2006	Oct. 1, 2005	Sept. 30, 2006	Oct. 1, 2005
Weighted average fair value of grants	N/A	$ 9.84	$ 8.71	$ 8.13
Risk-free interest rate	N/A	4.59%	5.08%	4.36%
Dividend yield	N/A	0.00%	0.00%	0.00%
Expected volatility	N/A	56.00%	44.56%	54.11%
Expected life in months	N/A	48	55	48

[1] The fair value calculation was based on stock options granted during the period.

Option activity under the option plans as of September 30, 2006 and changes during the nine months ended September 30, 2006 were as follows:

	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at December 31, 2005	845,213	$ 16.81		
Granted	218,000	20.07		
Exercised	(160,988)	14.45		
Expired or canceled	(32,000)	17.44		
Outstanding at September 30, 2006	870,225	$ 18.04	4.79	$ 6,349,916
Exercisable at September 30, 2006	374,000	$ 17.03	3.68	$ 3,525,870
Available for grant	43,300			

The aggregate intrinsic value in the table above represents the difference between the closing price of the Company s common stock price on the last trading day of the third quarter of 2006 and the exercise prices of outstanding stock options, multiplied by the number of in-the-money stock options as of the same date. The aggregate intrinsic value represents the total amount before tax withholdings, that

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would have been received by stock option holders if they had all exercised the stock options on September 30, 2006. The aggregate intrinsic value of stock options exercised for the three months ended September 30, 2006 and October 1, 2005 was $23,000 and $331,000, respectively; and for the nine months ended September 30, 2006 and October 1, 2005 was $1,254,000 and $506,000, respectively. Total fair value of options vested and expensed was $285,000 and $1,067,000, before tax benefits, for the three months and nine months ended September 30, 2006, respectively.

As of September 30, 2006, total unrecognized compensation cost (before tax benefits) related to stock options of $3,266,266 is expected to be recognized over a weighted-average period of 2.5 years.

Cash received from option exercises for the nine months ended September 30, 2006 and October 1, 2005 was $1,558,000 and $662,000, respectively. The actual tax benefit realized for the tax deductions from option exercises of the share-based payment awards totaled $501,000 and $177,000 for the nine months ended September 30, 2006 and October 1, 2005, respectively.

Nonvested stock options at December 31, 2005 and changes during the nine months ended September 30, 2006 were as follows:

	Number of shares	Weighted - Average Grant Date Fair Value Per Share
Nonvested at December 31, 2005	493,588	$ 8.10
Granted	218,000	8.71
Vested	(185,863)	8.00
Forfeited	(29,500)	8.32
Nonvested at September 30, 2006	496,225	$ 8.39

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The pro forma table below reflects net earnings and basic and diluted net earnings per share for the three and nine months ended October 1, 2005, had the Company applied the fair value recognition provisions as follows:

	(In thousands)	
	Three Months Ended October 1, 2005	Nine Months Ended October 1, 2005
Net income, as reported	$ 4,315	$ 12,471
Less: Stock-based compensation expense determined under the fair value based method for all awards, net of related tax effects	(288)	(826)
Pro forma net income	$ 4,027	$ 11,645
Earnings per common share:		
As reported:		
Basic	$ .43	$ 1.24
Diluted	.42	1.22
Pro forma:		
Basic	$ .40	$ 1.16
Diluted	.39	1.14

As a result of fair value accounting for stock-based compensation, the impact to the Consolidated Condensed Financial Statement for the nine months ended September 30, 2006 for income before income taxes and net income was $1,067,000 and $704,000 lower, respectively, than if we had continued to account for stock-based compensation based upon grant date intrinsic value. The impact on basic and diluted earnings per share for the three months and nine months ended September 30, 2006 was $0.02 per share and $0.07 per share, respectively.

Note 10. Employee Benefit Plans

The Company has three unfunded supplemental retirement plans. The first plan was suspended in 1986, but continues to cover certain former executives. The second plan was suspended in 1997, but continues to cover certain current and retired directors. The third plan covers one former executive. The accumulated benefit obligations under the plan at September 30, 2006 and December 31, 2005 were $2,156,000 and $1,900,000, respectively, which are included in accrued liabilities.

The Company sponsors, for all its employees, two 401(k) defined contribution plans. The first plan covers all employees, other than employees at the Company s Miltec subsidiary, and allows the employees to make annual voluntary contributions not to exceed the lesser of an amount equal to 25% of their compensation or limits established by the Internal Revenue Code. Under this plan the Company generally provides a match equal to 50% of the employee s contributions up to the first 4% of compensation, except for union employees who are not eligible to receive the match. The second plan

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covers only the employees at the Company s Miltec subsidiary and allows the employees to make annual voluntary contributions not to exceed the lesser of an amount equal to 100% of their compensation or limits established by the Internal Revenue Code. Under this plan, Miltec generally (i) provides a match equal to 100% of the employee s contributions up to the first 5% of compensation, (ii) contributes 3% of an employee s compensation annually, and (iii) contributes, at the Company s discretion, 0% to 7% of an employee s compensation annually. The Company s provision for matching and profit sharing contributions for the three months ended September 30, 2006 and October 1, 2005 was approximately $685,000 and $170,000, respectively. The Company s provision for matching and profit sharing contributions for the nine months ended September 30, 2006 and October 1, 2005 was approximately $2,193,000 and $522,000, respectively.

On December 31, 2004, the Company terminated health care benefits for certain retired employees. In connection with the termination, in January 2005, the Company distributed lump sum payments to the eligible retirees in the aggregate amount of $277,000.

The Company has a defined benefit pension plan covering certain hourly employees of a subsidiary. Pension plan benefits are generally determined on the basis of the retiree s age and length of service. Assets of the defined benefit plan are composed primarily of fixed income and equity securities.

The components of net periodic pension cost for the defined benefit pension plan are as follows:

	(In thousands)			
	Three Months Ended		Nine Months Ended	
	September 30, 2006	October 1, 2005	September 30, 2006	October 1, 2005
Service cost	$ 170	$	$ 510	$
Interest cost	174	8	522	23
Expected return on plan assets	(211)		(633)	
Amortization of actuarial loss	51		153	
	$ 184	$ 8	$ 552	$ 23

On December 31, 2005, the Company s annual measurement date, and September 30, 2006, the accumulated benefit obligation exceeded the fair value of the pension plan assets. The Company recognized an additional minimum pension liability at September 30, 2006 and December 31, 2005 of $2,700,000, net of tax, which decreased shareholders equity and is included in other long-term liabilities. This charge to shareholders equity represents a net loss not yet recognized as pension expense. This charge did not affect reported earnings, and could reverse if either interest rates increase or market performance and plan returns improve or contributions cause the pension plan to return to fully funded status. There were no charges during the quarters ended September 30, 2006 and October 1, 2005.

The Company s funding policy is to contribute cash to its pension plan so that the minimum contribution requirements established by government funding and taxing authorities are met. The Company does not expect to make a contribution to the pension plan in 2006.

Note 11. Indemnifications and Warranty Liability

Indemnifications

The Company has made guarantees and indemnities under which it may be required to make payments to a guaranteed or indemnified party, in relation to certain transactions, including revenue transactions in the ordinary course of business. In connection with certain facility leases, the Company has indemnified its lessors for certain claims arising from the facility or the lease. The Company indemnifies its directors and officers to the maximum extent permitted under the laws of the State of Delaware. However, the Company has a directors and officers insurance policy that may reduce its exposure in certain circumstances and may enable it to recover a portion of future amounts that may be payable, if any. The duration of the guarantees and indemnities varies and, in many cases is indefinite but subject to statute of limitations. The majority of guarantees and indemnities do not provide any limitations of the maximum potential future payments the Company could be obligated to make. Historically, payments related to these guarantees and indemnities have been immaterial. The Company estimates the fair value of its indemnification obligations as insignificant based on this history and insurance coverage and has, therefore, not recorded any liability for these guarantees and indemnities in the accompanying consolidated balance sheets. However, there can be no assurances that the Company will not have any future financial exposure under these indemnification obligations.

Warranty Liability

The Company quantifies and records an estimate for warranty related costs for certain customer returns related to quality. These costs are based on current estimated repair costs.

The warranty liability at September 30, 2006 and December 31, 2005 was $98,000 and $122,000, respectively.

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Information regarding the changes in the Company s aggregate warranty liability is as follows for the nine months ended September 30, 2006 and the year ended December 31, 2005:

	(In thousands)	
	September 30, 2006	December 31, 2005
Warranty liability at beginning of period	$ 122	$ 1,728
Accruals for warranties during the period	26	150
Adjustments relating to pre-existing warranties	(50)	(1,756)
Warranty liability at end of period	$ 98	$ 122

Note 12. Leases

The Company leases certain facilities and equipment for periods ranging from 1 to 8 years. The leases generally are renewable and provide for the payment of property taxes, insurance and other costs relative to the property. Rental expense for the nine months ended September 30, 2006 and October 1, 2005, was $3,355,000 and $2,115,000, respectively. Future minimum rental payments under operating leases having initial or remaining noncancelable terms in excess of one year at September 30, 2006, are as follows:

	(In thousands) Lease Commitments
2006	$ 943,000
2007	3,175,000
2008	1,740,000
2009	758,000
2010	&nbs