

DUCOMMUN INC /DE/
Form 10-Q
August 06, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended June 30, 2018

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.) |
|---|---|

| | |
|---|--------------------------|
| 200 Sandpointe Avenue, Suite 700, Santa Ana, California (Address of principal executive offices) | 92707-5759 (Zip code) |
|---|--------------------------|

Registrant's telephone number, including area code: (657) 335-3665

N/A

(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 No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of July 26, 2018, the registrant had 11,401,525 shares of common stock outstanding.

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DUCOMMUN INCORPORATED AND SUBSIDIARIES

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Ducommun Incorporated and Subsidiaries

Condensed Consolidated Balance Sheets

(Unaudited)

(In thousands, except share and per share data)

| | June 30, 2018 | December 31, 2017 |
|---|------------------|----------------------|
| Assets | | |
| Current Assets | | |
| Cash and cash equivalents | \$3,532 | \$ 2,150 |
| Accounts receivable, net of allowance for doubtful accounts of \$838 and \$868 at June 30, 2018 and December 31, 2017, respectively | 64,439 | 74,064 |
| Contract assets | 81,663 | — |
| Inventories | 95,244 | 122,161 |
| Production cost of contracts | 10,719 | 11,204 |
| Other current assets | 12,638 | 11,435 |
| Total Current Assets | 268,235 | 221,014 |
| Property and equipment, net of accumulated depreciation of \$155,069 and \$143,216 at June 30, 2018 and December 31, 2017, respectively | 106,636 | 110,252 |
| Goodwill | 136,051 | 117,435 |
| Intangibles, net | 117,485 | 114,693 |
| Non-current deferred income taxes | 130 | 261 |
| Other assets | 3,356 | 3,098 |
| Total Assets | \$631,893 | \$ 566,753 |
| Liabilities and Shareholders' Equity | | |
| Current Liabilities | | |
| Accounts payable | \$71,660 | \$ 51,907 |
| Contract liabilities | 15,164 | — |
| Accrued liabilities | 25,813 | 28,329 |
| Total Current Liabilities | 112,637 | 80,236 |
| Long-term debt | 231,159 | 216,055 |
| Non-current deferred income taxes | 19,947 | 15,981 |
| Other long-term liabilities | 18,149 | 18,898 |
| Total Liabilities | 381,892 | 331,170 |
| Commitments and contingencies (Notes 11, 13) | | |
| Shareholders' Equity | | |
| Common stock - \$0.01 par value; 35,000,000 shares authorized; 11,401,525 and 11,332,841 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively | 114 | 113 |
| Additional paid-in capital | 81,331 | 80,223 |
| Retained earnings | 175,243 | 161,364 |
| Accumulated other comprehensive loss | (6,687) | (6,117) |
| Total Shareholders' Equity | 250,001 | 235,583 |
| Total Liabilities and Shareholders' Equity | \$631,893 | \$ 566,753 |

See accompanying notes to Condensed Consolidated Financial Statements.

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Ducommun Incorporated and Subsidiaries
Condensed Consolidated Statements of Income
(Unaudited)
(In thousands, except per share amounts)

| | Three Months Ended | | Six Months Ended | |
|--|--------------------|-----------------|------------------|-----------------|
| | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Net Revenues | \$ 154,827 | \$ 140,938 | \$ 305,282 | \$ 277,235 |
| Cost of Sales | 122,799 | 114,669 | 246,499 | 225,961 |
| Gross Profit | 32,028 | 26,269 | 58,783 | 51,274 |
| Selling, General and Administrative Expenses | 21,194 | 19,646 | 40,521 | 40,399 |
| Restructuring Charges | 5,238 | — | 7,411 | — |
| Operating Income | 5,596 | 6,623 | 10,851 | 10,875 |
| Interest Expense | (3,763) | (2,059) | (6,661) | (3,804) |
| Income Before Taxes | 1,833 | 4,564 | 4,190 | 7,071 |
| Income Tax Expense (Benefit) | 242 | 741 | (1) | 1,133 |
| Net Income | \$ 1,591 | \$ 3,823 | \$ 4,191 | \$ 5,938 |
| Earnings Per Share | | | | |
| Basic earnings per share | \$0.14 | \$0.34 | \$0.37 | \$0.53 |
| Diluted earnings per share | \$0.14 | \$0.33 | \$0.36 | \$0.51 |
| Weighted-Average Number of Common Shares Outstanding | | | | |
| Basic | 11,394 | 11,237 | 11,370 | 11,253 |
| Diluted | 11,624 | 11,491 | 11,609 | 11,556 |

See accompanying notes to Condensed Consolidated Financial Statements.

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Ducommun Incorporated and Subsidiaries
 Condensed Consolidated Statements of Comprehensive Income
 (Unaudited)
 (In thousands)

| | Three Months Ended June 30, July 1, 2018 2017 | | Six Months Ended June 30, July 1, 2018 2017 | |
|---|--|---------|--|---------|
| Net Income | \$1,591 | \$3,823 | \$4,191 | \$5,938 |
| Other Comprehensive Income (Loss), Net of Tax: | | | | |
| Amortization of actuarial losses and prior service costs, net of tax benefit of \$44 and \$88 for the three months ended June 30, 2018 and July 1, 2017, respectively, and \$89 and \$151 for the six months ended June 30, 2018 and July 1, 2017, respectively | 142 | 114 | 283 | 254 |
| Change in unrealized gains and losses on cash flow hedges, net of tax of \$28 and \$72 for the three months ended June 30, 2018 and July 1, 2017, respectively, and \$89 and \$144 for the six months ended June 30, 2018 and July 1, 2017, respectively | 87 | (122) | 281 | (243) |
| Other Comprehensive Income (Loss), Net of Tax | 229 | (8) | 564 | 11 |
| Comprehensive Income | \$1,820 | \$3,815 | \$4,755 | \$5,949 |
| See accompanying notes to Condensed Consolidated Financial Statements. | | | | |

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Ducommun Incorporated and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(In thousands)

| | Six Months Ended June 30, July 1, 2018 2017 | |
|--|---|-----------|
| Cash Flows from Operating Activities | | |
| Net Income | \$4,191 | \$ 5,938 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | |
| Depreciation and amortization | 12,315 | 11,530 |
| Property and equipment impairment due to restructuring | 4,375 | — |
| Stock-based compensation expense | 2,115 | 3,164 |
| Deferred income taxes | 3,966 | 478 |
| (Recovery of) provision for doubtful accounts | (30) | 41 |
| Other | 9,050 | (2,286) |
| Changes in Assets and Liabilities: | | |
| Accounts receivable | 11,172 | (5,767) |
| Contract assets | (81,663) | — |
| Inventories | 29,417 | (9,502) |
| Production cost of contracts | 160 | (1,777) |
| Other assets | 1,475 | 938 |
| Accounts payable | 20,117 | 14,998 |
| Contract liabilities | 15,164 | — |
| Accrued and other liabilities | (5,597) | (1,508) |
| Net Cash Provided by Operating Activities | 26,227 | 16,247 |
| Cash Flows from Investing Activities | | |
| Purchases of property and equipment | (7,513) | (16,242) |
| Proceeds from sale of assets | 67 | 3 |
| Payments for acquisition of Certified Thermoplastics Co., LLC, net of cash acquired | (30,993) | — |
| Net Cash Used in Investing Activities | (38,439) | (16,239) |
| Cash Flows from Financing Activities | | |
| Borrowings from senior secured revolving credit facility | 189,600 | 123,000 |
| Repayments of senior secured revolving credit facility | (175,000) | (110,800) |
| Repayments of term loan | — | (10,000) |
| Repayments of other debt | — | (3) |
| Net cash paid upon issuance of common stock under stock plans | (1,006) | (2,265) |
| Net Cash Provided by (Used in) Financing Activities | 13,594 | (68) |
| Net Increase (Decrease) in Cash and Cash Equivalents | 1,382 | (60) |
| Cash and Cash Equivalents at Beginning of Period | 2,150 | 7,432 |
| Cash and Cash Equivalents at End of Period | \$3,532 | \$ 7,372 |
| See accompanying notes to Condensed Consolidated Financial Statements. | | |

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Ducommun Incorporated and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1. Summary of Significant Accounting Policies

Description of Business

We are a leading global provider of engineering and manufacturing services for high-performance products and high-cost-of failure applications used primarily in the aerospace and defense (“A&D”), industrial, medical and other industries (collectively, “Industrial”). Our operations are organized into two primary businesses: Electronic Systems segment and Structural Systems segment, each of which is a reportable operating segment. Electronic Systems designs, engineers and manufactures high-reliability electronic and electromechanical products used in worldwide technology-driven markets including A&D and Industrial end-use markets. Electronic Systems’ product offerings primarily range from prototype development to complex assemblies. Structural Systems designs, engineers and manufactures large, complex contoured aerostructure components and assemblies and supplies composite and metal bonded structures and assemblies. Structural Systems’ products are primarily used on commercial aircraft, military fixed-wing aircraft, and military and commercial rotary-wing aircraft. All reportable operating segments follow the same accounting principles.

Basis of Presentation

The unaudited condensed consolidated financial statements include the accounts of Ducommun Incorporated and its subsidiaries (“Ducommun,” the “Company,” “we,” “us” or “our”), after eliminating intercompany balances and transactions. The December 31, 2017 condensed consolidated balance sheet data was derived from audited financial statements, but does not contain all disclosures required by accounting principles generally accepted in the United States of America (“GAAP”).

Our significant accounting policies were described in Part IV, Item 15(a)(1), “Note 1. Summary of Significant Accounting Policies” in our Annual Report on Form 10-K for the year ended December 31, 2017. We followed the same accounting policies for interim reporting. The financial information included in this Quarterly Report on Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2017. In the opinion of management, all adjustments, consisting of recurring accruals, have been made that are necessary to fairly state our condensed consolidated financial position, statements of income, comprehensive income and cash flows in accordance with GAAP for the periods covered by this Quarterly Report on Form 10-Q. The results of operations for the three and six months ended June 30, 2018 are not necessarily indicative of the results to be expected for the full year ending December 31, 2018.

Our fiscal quarters typically end on the Saturday closest to the end of March, June and September for the first three fiscal quarters of each year, and ends on December 31 for our fourth fiscal quarter. As a result of using fiscal quarters for the first three quarters combined with leap years, our first and fourth fiscal quarters can range between 12 1/2 weeks to 13 1/2 weeks while the second and third fiscal quarters remain at a constant 13 weeks per fiscal quarter. Certain reclassifications have been made to prior period amounts to conform to the current year’s presentation.

Changes in Accounting Policies

We adopted ASC 606, “Revenue from Contracts with Customers” (“ASC 606”), on January 1, 2018. As a result, we changed our accounting policy for revenue recognition as detailed below and in Note 2, as well as other accounting policies as noted below.

We applied ASC 606 using the modified retrospective method (also known as the cumulative effect method) and therefore, recognized the cumulative effect of initially applying ASC 606 as an adjustment to the opening condensed consolidated balance sheet at January 1, 2018. Therefore, the comparative information has not been adjusted and continues to be reported under the previous revenue recognition accounting standard, ASC 605, “Revenue Recognition” (“ASC 605”). The details of the significant changes and quantitative impact of the changes are described below and Note 2.

Use of Estimates

Certain amounts and disclosures included in the unaudited condensed consolidated financial statements require management to make estimates and judgments that affect the amounts of assets, liabilities (including forward loss

reserves), 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.

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Supplemental Cash Flow Information

| | (In thousands) | |
|--|----------------|---------|
| | Six Months | |
| | Ended | |
| | June 30, | July 1, |
| | 2018 | 2017 |
| Interest paid | \$5,202 | \$3,102 |
| Taxes paid | \$91 | \$685 |
| Non-cash activities: | | |
| Purchases of property and equipment not paid | \$1,589 | \$2,878 |

Earnings Per Share

Basic earnings per share are 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 by the weighted-average number of common shares outstanding, plus any potentially dilutive shares that could be issued if exercised or converted into common stock in each period.

The net income and weighted-average common shares outstanding used to compute earnings per share were as follows:

| | (In thousands, except per share data) | | (In thousands, except per share data) | |
|--|---------------------------------------|---------|---------------------------------------|---------|
| | Three Months | | Six Months | |
| | Ended | | Ended | |
| | June 30, | July 1, | June 30, | July 1, |
| | 2018 | 2017 | 2018 | 2017 |
| Net income | \$1,591 | \$3,823 | \$4,191 | \$5,938 |
| Weighted-average number of common shares outstanding | | | | |
| Basic weighted-average common shares outstanding | 11,394 | 11,237 | 11,370 | 11,253 |
| Dilutive potential common shares | 230 | 254 | 239 | 303 |
| Diluted weighted-average common shares outstanding | 11,624 | 11,491 | 11,609 | 11,556 |
| Earnings per share | | | | |
| Basic | \$0.14 | \$0.34 | \$0.37 | \$0.53 |
| Diluted | \$0.14 | \$0.33 | \$0.36 | \$0.51 |

Potentially dilutive stock options and stock units to purchase common stock, as shown below, were excluded from the computation of diluted earnings per share because their inclusion would have been anti-dilutive. However, these shares may be potentially dilutive common shares in the future.

| | (In thousands) | | (In thousands) | |
|-------------------------------|----------------|---------|----------------|---------|
| | Three | | Six | |
| | Months Ended | | Months Ended | |
| | June 30, | July 1, | June 30, | July 1, |
| | 2018 | 2017 | 2018 | 2017 |
| Stock options and stock units | 224 | 154 | 186 | 156 |

Fair Value

Assets and liabilities that are measured, recorded or disclosed at fair value on a recurring basis are categorized using the fair value hierarchy. The fair value hierarchy has three levels based on the reliability of the inputs used to determine fair value. Level 1, the highest level, refers to the values determined based on quoted prices in active markets for identical assets. Level 2 refers to fair values estimated using significant observable inputs. Level 3, the lowest level, includes fair values estimated using significant unobservable inputs.

Cash and Cash Equivalents

Cash equivalents consist of highly liquid instruments purchased with original maturities of three months or less. These assets are valued at cost, which approximates fair value, which we classify as Level 1. See Fair Value above.

Derivative Instruments

We recognize derivative instruments on our condensed consolidated balance sheets at their fair value. On the date that we enter into a derivative contract, we designate the derivative instrument as a fair value hedge, a cash flow hedge, a hedge of a net

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investment in a foreign operation, or a derivative instrument that will not be accounted for using hedge accounting methods. As of June 30, 2018, all of our derivative instruments were designated as cash flow hedges.

We record changes in the fair value of a derivative instrument that is highly effective and that is designated and qualifies as a cash flow hedge in other comprehensive income (loss), net of tax until our earnings are affected by the variability of cash flows of the underlying hedge. We record any hedge ineffectiveness and amounts excluded from effectiveness testing in current period earnings within interest expense. We report changes in the fair values of derivative instruments that are not designated or do not qualify for hedge accounting in current period earnings. We classify cash flows from derivative instruments in the condensed consolidated statements of cash flows in the same category as the item being hedged or on a basis consistent with the nature of the instrument.

When we determine that a derivative instrument is not highly effective as a hedge, we discontinue hedge accounting prospectively. In all situations in which we discontinue hedge accounting and the derivative instrument remains outstanding, we will carry the derivative instrument at its fair value on our condensed consolidated balance sheets and recognize subsequent changes in its fair value in our current period earnings.

Inventories

Inventories are stated at the lower of cost or net realizable value with cost being determined using a moving average cost basis for raw materials and actual cost for work-in-process and finished goods. The majority of our inventory is charged to cost of sales as raw materials are placed into production and the related revenue is recognized. Inventoried costs include raw materials, outside processing, direct labor and allocated overhead, adjusted for any abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) incurred. We assess the inventory carrying value and reduce it, if necessary, to its net realizable value based on customer orders on hand, and internal demand forecasts using management's best estimates given information currently available. As a result of adopting ASC 606 on January 1, 2018, where we utilized the modified retrospective method of adoption and we changed our revenue recognition for the majority of our revenue from point in time to over time, our inventory balance decreased significantly. For revenue contracts where revenue is recognized using the point in time method, inventory is not reduced until it is shipped or transfer of control to the customer has occurred. Our ending inventory consists of raw materials, work-in-process, and finished goods. See Note 2.

Production Cost of Contracts

Production cost of contracts includes non-recurring production costs, such as design and engineering costs, and tooling and other special-purpose machinery necessary to build parts as specified in a contract. Production costs of contracts are recorded to cost of sales using the over time revenue recognition model. We review the value of the production cost of contracts on a quarterly basis to ensure when added to the estimated cost to complete, the value is not greater than the estimated realizable value of the related contracts.

Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss, as reflected on the condensed consolidated balance sheets under the equity section, was comprised of cumulative pension and retirement liability adjustments, net of tax, and change in net unrealized gains and losses on cash flow hedges, net of tax.

Provision for Estimated Losses on Contracts

We record provisions for the total anticipated losses on contracts, considering total estimated costs to complete the contract compared to total anticipated revenues, in the period in which such losses are identified. The provisions for estimated losses on contracts require us to make certain estimates and assumptions, including those with respect to the future revenue under a contract and the future cost to complete the contract. Our estimate of the future cost to complete a contract may include assumptions as to changes in manufacturing efficiency, operating and material costs, and our ability to resolve claims and assertions with our customers. If any of these or other assumptions and estimates do not materialize in the future, we may be required to adjust the provisions for estimated losses on contracts. As a result of the adoption of ASC 606 on January 1, 2018, the definition of a revenue contract with a customer for us now has changed and is typically defined as a customer purchase order, in certain scenarios, we may be required to recognize anticipated losses on contracts that would not have occurred under ASC 605. In addition, provision for estimated losses on contracts are now included as part of contract liabilities on the condensed consolidated balance sheets.

Revenue Recognition

Our customers typically engage us to manufacture products based on designs and specifications provided by the end-use customer. This will require the building of tooling and manufacturing first article inspection products (prototypes) before

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volume manufacturing. Contracts with our customers generally include a termination for convenience clause. We have a significant number of contracts that are derived from long-term contracts and programs that can span several years, as well as contracts that are started and completed within the same year. We recognize revenue under ASC 606, which utilizes a five-step model. Further, we utilized the modified retrospective method (also known as the cumulative effect method) of adoption of ASC 606. See Note 2.

The definition of a contract under ASC 606 for us is typically defined as a customer purchase order as this is when we achieve enforceable right to payment. The majority of our contracts are firm fixed-price contracts. The deliverables within a customer purchase order are analyzed to determine the number of performance obligations. In addition, at times, in order to achieve economies of scale and based on our customer's forecasted demand, we may build in advance of receiving a purchase order from our customers.

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer, and is the unit of account under ASC 606. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied. The majority of our contracts have a single performance obligation as the promise to transfer the individual goods or services is not separately identifiable from the other promises in the contracts and therefore, not distinct. For contracts with multiple performance obligations, we allocate the contract transaction price to each performance obligation using our best estimate of the standalone selling price of each distinct good or service in the contract. The primary method used to estimate the standalone selling price is the expected cost plus a margin approach, under which we forecast our expected costs of satisfying a performance obligation and then add an appropriate margin for that distinct good or service.

The majority of our performance obligations are satisfied over time as work progresses. Typically, revenue is recognized over time using an input measure (i.e., costs incurred to date relative to total estimated costs at completion, also known as cost-to-cost plus reasonable profit) to measure progress. The majority of our revenues are recognized over time. Contract costs typically include labor, materials, and overhead.

Contract estimates are based on various assumptions to project the outcome of future events that can span multiple months or years. These assumptions include labor productivity and availability; the complexity of the work to be performed; the cost and availability of materials; and the performance of subcontractors.

As a significant change in one or more of these estimates could affect the profitability of our contracts, we review and update our contract-related estimates on a regular basis. We recognize adjustments in estimated profit on contracts under the cumulative catch-up method. Under this method, the impact of the adjustment on profit recorded to date is recognized in the period the adjustment is identified. Revenue and profit in future periods of contract performance is recognized using the adjusted estimate. If at any time the estimate of contract profitability indicates an anticipated loss on the contract, we recognize the total loss in the quarter it is identified.

The impact of adjustments in contract estimates on our operating earnings can be reflected in either operating costs and expenses or revenue. See Note 2 for the net impact of these adjustments to our unaudited condensed consolidated financial statements for the three-and six months ended June 30, 2018.

Contract Assets and Contract Liabilities

Contract assets consist of our right to payment for work performed but not yet billed. Contract assets are transferred to accounts receivable when we ship the products to our customers and meet the shipping terms within the revenue contract. Contract liabilities consist of advance or progress payments received from our customers prior to the time transfer of control occurs plus the estimated losses on contracts.

Contract assets and contract liabilities from revenue contracts with customers are as follows:

(In thousands)

| | June 30, 2018 | December 31, 2017 |
|----------------------|------------------|-------------------------|
| Contract assets | \$81,663 | \$ — |
| Contract liabilities | \$15,164 | \$ — |

Remaining performance obligations is defined as customer placed purchase orders ("POs") with firm fixed price and firm delivery dates. Our remaining performance obligations as of June 30, 2018 totaled \$524.3 million. We anticipate

recognizing an estimated 40% of our remaining performance obligations as revenue during the remainder of 2018 with the remaining performance obligations being recognized in 2019 and beyond.

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Revenue by Category

In addition to the revenue categories disclosed above, the following table reflects our revenue disaggregated by major end-use market:

| | (In thousands) | | (In thousands) | |
|-----------------------|--------------------|-----------------|------------------|-----------------|
| | Three Months Ended | | Six Months Ended | |
| | June 30 2018 | July 1, 2017 | June 30 2018 | July 1, 2017 |
| Consolidated Ducommun | | | | |
| Military and space | \$70,326 | \$70,174 | \$136,681 | \$134,115 |
| Commercial aerospace | 71,844 | 55,730 | 142,676 | 113,091 |
| Industrial | 12,657 | 15,034 | 25,925 | 30,029 |
| Total | \$154,827 | \$140,938 | \$305,282 | \$277,235 |

Structural Systems

| | | | | |
|----------------------|----------|----------|-----------|-----------|
| Military and space | \$15,958 | \$15,476 | \$29,780 | \$29,780 |
| Commercial aerospace | 54,367 | 43,636 | 108,592 | 86,907 |
| Total | \$70,325 | \$59,112 | \$138,372 | \$116,687 |

Electronic Systems

| | | | | |
|----------------------|----------|----------|-----------|-----------|
| Military and space | \$54,368 | \$54,698 | \$106,901 | \$104,335 |
| Commercial aerospace | 17,477 | 12,094 | 34,084 | 26,184 |
| Industrial | 12,657 | 15,034 | 25,925 | 30,029 |
| Total | \$84,502 | \$81,826 | \$166,910 | \$160,548 |

Recent Accounting Pronouncements

New Accounting Guidance Adopted in 2018

In February 2018, the FASB issued ASU 2018-02, "Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income ("AOCI")" ("ASU 2018-02"), which provides financial statement preparers with an option to reclassify stranded income tax effects within AOCI to retained earnings in each period in which the effect of the change in U.S. federal corporate income tax rate in the Tax Cuts and Jobs Act (or portion thereof) is recorded. The new guidance was effective for fiscal years beginning after December 15, 2018, and interim periods within those fiscal years. Early adoption is permitted and we have chosen to early adopt ASU 2018-02 beginning January 1, 2018. Further, in March 2018, the FASB issued ASU 2018-05, "Income Taxes (Topic 740): Amendments to SEC Paragraphs Pursuant to Staff Accounting Bulletin No. 118" ("ASU 2018-05"), which amends certain SEC material in Topic 740 for the income tax accounting implications of the recently issued Tax Cuts and Jobs Act ("Tax Cuts and Jobs Act"). The new guidance was effective upon inclusion in the FASB Codification. The adoption of these standards resulted in reclassifying \$1.3 million of income tax effects from AOCI to retained earnings during the six months ended June 30, 2018 on our condensed consolidated balance sheets. The income tax effects remaining in AOCI will be released into earnings as the related pre-tax AOCI amounts are reclassified to earnings.

In May 2017, the FASB issued ASU 2017-09, "Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting" ("ASU 2017-09"), which provides clarity on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. The new guidance was effective for us beginning January 1, 2018. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

In March 2017, the FASB issued ASU 2017-07, "Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Costs" ("ASU 2017-07"), which requires an employer to report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost

are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be appropriately described. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. The amendments also allow only the service cost component to be eligible for capitalization when applicable. The new guidance was effective for us beginning January 1, 2018. The adoption of this standard did not have a material impact on our condensed consolidated financial statements. See Note 10.

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In January 2017, the FASB issued ASU 2017-01, “Business Combinations (Topic 805): Clarifying the Definition of a Business” (“ASU 2017-01”), which clarifies the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of businesses. The new guidance was effective for us beginning January 1, 2018. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments” (“ASU 2016-15”), which addresses the following eight specific cash flow issues: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (“COLIs”) (including bank-owned life insurance policies [“BOLIs”]); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The new guidance was effective for us beginning January 1, 2018. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, “Revenue from Contracts with Customers (Topic 606)” (“ASU 2014-09”), which outlines a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. This new revenue recognition model provides a five-step analysis in determining when and how revenue is recognized. It depicts the transfer of promised goods or services to customers in an amount that reflects the consideration an entity expects to receive in exchange for those goods or services. Companies have the option of applying the provisions of ASU 2014-09 either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying this guidance recognized at the date of initial application. Additional guidance was issued subsequently as follows:

- December 2016, the FASB issued ASU 2016-20, “Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers” (“ASU 2016-20”);

- May 2016, the FASB issued ASU 2016-12, “Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients” (“ASU 2016-12”);

- May 2016, the FASB issued ASU 2016-11, “Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-06 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting” (“ASU 2016-11”);

- April 2016, the FASB issued ASU 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing” (“ASU 2016-10”); and

- August 2015, the FASB issued ASU 2015-14, “Revenue From Contracts With Customers (Topic 606)” (“ASU 2015-14”).

All of this new guidance was effective for us beginning January 1, 2018. The cumulative impact to our retained earnings at January 1, 2018 was a net increase of \$8.7 million. See Note 2.

Recently Issued Accounting Standards

In July 2018, the FASB issued ASU 2018-11, “Leases (Topic 842): Targeted Improvements” (“ASU 2018-11”), which provides entities an additional (and optional) transition method to adopt the new leases standard. Under this new transition method, an entity initially applies the new leases standard at adoption date and recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption. Consequently, an entity's reporting for the comparative periods presented in the financial statements in which the entity adopts the new lease requirements would continue to be in accordance with current GAAP (Topic 840). An entity electing this additional (and optional) transition method must provide the required Topic 840 disclosures for all periods that continue to be in accordance with Topic 840. The amendments do not change the existing disclosure requirements in Topic 840. The new guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, which will be our interim period beginning January 1, 2019. We are evaluating the impact of this standard.

In July 2018, the FASB issued ASU 2018-10, “Codification Improvements to Topic 842, Leases” (“ASU 2018-10”), which provides clarification and guidance on multiple issues, some of which include how an entity should perform the lease classification reassessment, clarifying the periods covered by a lessor-only option to terminate the lease is included in the lease term, seller-lessee in a failed sale-and leaseback transaction should adjust the interest rate on its financial liability as necessary to ensure that the interest on the financial liability does not exceed the total payments (rather than the principal payments) on the financial liability. The new guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, which will be our interim period beginning January 1, 2019. We are evaluating the impact of this standard.

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In January 2018, the FASB issued ASU 2018-01, “Leases (Topic 842): Land Easement Practical Expedient for Transition to Topic 842” (“ASU 2018-01”), which clarifies the application of the new leases guidance to land easements and eases adoption efforts for some land easements. The new guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, which will be our interim period beginning January 1, 2019. We are evaluating the impact of this standard.

In August 2017, the FASB issued ASU 2017-12, “Derivatives and Hedging (Topic 815): Targeted Improvements to Accounting for Hedging” (“ASU 2017-12”), which intends to improve and simplify accounting rules around hedge accounting. ASU 2017-12 refines and expands hedge accounting for both financial (i.e., interest rate) and commodity risks. In addition, it creates more transparency around how economic results are presented, both on the face of the financial statements and in the footnotes. The new guidance is effective for annual periods beginning after December 15, 2018, including interim periods within those annual periods, which will be our interim period beginning January 1, 2019. Early adoption is permitted, including adoption in any interim period after the issuance of ASU 2017-12. We are evaluating the impact of this standard.

In January 2017, the FASB issued ASU 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment” (“ASU 2017-04”), which simplifies the subsequent measurement of goodwill, the amendments eliminate Step Two from the goodwill impairment test. The annual, or interim, goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. In addition, income tax effects from any tax deductible goodwill on the carrying amount of the reporting unit should be considered when measuring the goodwill impairment loss, if applicable. The amendments also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step Two of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The new guidance is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We are evaluating the impact of this standard.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)” (“ASU 2016-02”), which requires lessees to present right-of-use assets and lease liabilities on the balance sheet. Lessees are required to apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The new guidance is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, which will be our interim period beginning January 1, 2019. We are currently completing the assessment and gap identification phases of the implementation project. This includes gathering our leases, identifying differences that would result from applying the requirements under ASU 2016-02, and the selection of a new lease accounting software package. We anticipate the majority of our leases will be recorded onto our condensed consolidated balance sheets. As such, various line items on our condensed consolidated balance sheets, income statements, and cash flows will be impacted.

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Note 2. Adoption of Accounting Standards Codification 606

We adopted ASC 606 with an initial application as of January 1, 2018. We utilized the modified retrospective method, under which the cumulative effect of initially applying the new guidance is recognized as an adjustment to certain captions on the condensed consolidated balance sheet, including the opening balance of retained earnings in the six months ended June 30, 2018.

The net impact to the various captions on our January 1, 2018 opening unaudited condensed consolidated balance sheets was as follows:

| Unaudited Condensed Consolidated Balance Sheets | (In thousands) | | |
|---|--|-----------------------|---|
| | December 31, 2017 Balances Without Adoption of ASC 606 | Effect of Adoption | January 1, 2018 Balances With Adoption of ASC 606 |
| Assets | | | |
| Contract assets | \$— | \$68,739 | \$68,739 |
| Inventories | \$122,161 | \$(39,002) | \$83,159 |
| Non-current deferred income taxes | \$261 | \$(95) | \$166 |
| Liabilities | | | |
| Contract liabilities | \$— | \$24,460 | \$24,460 |
| Accrued liabilities | \$28,329 | \$(6,091) | \$22,238 |
| Non-current deferred income taxes | \$15,981 | \$2,608 | \$18,589 |
| Shareholders' Equity | | | |
| Retained earnings | \$161,364 | \$8,665 | \$170,029 |

Under ASC 606, we no longer net progress payments from customers related to inventory purchases against inventories but instead, they are included in contract liabilities on the condensed consolidated balance sheets. See Note 6.

The net impact to retained earnings as a result of adopting ASC 606 on the January 1, 2018 opening balance sheet was shown as a change in "other" on the condensed consolidated statements of cash flows.

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The following tables summarize the impact of adopting ASC 606 on our unaudited condensed consolidated financial statements for the three and six months ended June 30, 2018 (in thousands, except per share data):

| | June 30, 2018 | | |
|---|------------------|--------------------|--------------------------------------|
| Unaudited Condensed Consolidated Balance Sheets | As Reported | Effect of Adoption | Balances Without Adoption of ASC 606 |
| Assets | | | |
| Current Assets | | | |
| Cash and cash equivalents | \$3,532 | \$— | \$3,532 |
| Accounts receivable, net of allowance for doubtful accounts of \$838 and \$868 at March 31, 2018 and December 31, 2017, respectively | 64,439 | — | 64,439 |
| Contract assets | 81,663 | (81,663) | — |
| Inventories | 95,244 | 53,730 | 148,974 |
| Production cost of contracts | 10,719 | — | 10,719 |
| Other current assets | 12,638 | (1,109) | 11,529 |
| Total Current Assets | 268,235 | (29,042) | 239,193 |
| Property and equipment, net of accumulated depreciation of \$155,069 and \$143,216 at June 30, 2018 and December 31, 2017, respectively | 106,636 | — | 106,636 |
| Goodwill | 136,051 | — | 136,051 |
| Intangibles, net | 117,485 | — | 117,485 |
| Non-current deferred income taxes | 130 | 131 | 261 |
| Other assets | 3,356 | — | 3,356 |
| Total Assets | \$631,893 | \$(28,911) | \$602,982 |
| Liabilities and Shareholders' Equity | | | |
| Current Liabilities | | | |
| Accounts payable | \$71,660 | \$— | \$71,660 |
| Contract liabilities | 15,164 | (15,164) | — |
| Accrued liabilities | 25,813 | 2,673 | 28,486 |
| Total Current Liabilities | 112,637 | (12,491) | 100,146 |
| Long-term debt | 231,159 | — | 231,159 |
| Non-current deferred income taxes | 19,947 | (3,606) | 16,341 |
| Other long-term liabilities | 18,149 | — | 18,149 |
| Total Liabilities | 381,892 | (16,097) | 365,795 |
| Commitments and contingencies (Notes 11, 13) | | | |
| Shareholders' Equity | | | |
| Common stock - \$0.01 par value; 35,000,000 shares authorized; 11,401,525 and 11,332,841 shares issued and outstanding at June 30, 2018 and December 31, 2017, respectively | 114 | — | 114 |
| Additional paid-in capital | 81,331 | — | 81,331 |
| Retained earnings | 175,243 | (12,814) | 162,429 |
| Accumulated other comprehensive loss | (6,687) | — | (6,687) |
| Total Shareholders' Equity | 250,001 | (12,814) | 237,187 |
| Total Liabilities and Shareholders' Equity | \$631,893 | \$(28,911) | \$602,982 |

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| Unaudited Condensed Consolidated Statements of Operations | Three Months Ended June 30, 2018 | | | Six Months Ended June 30, 2018 | | |
|---|----------------------------------|--------------------|--------------------------------------|--------------------------------|--------------------|--------------------------------------|
| | As Reported | Effect of Adoption | Balances Without Adoption of ASC 606 | As Reported | Effect of Adoption | Balances Without Adoption of ASC 606 |
| Net Revenues | \$154,827 | \$45 | \$154,872 | \$305,282 | \$(11,952) | \$293,330 |
| Cost of Sales | 122,799 | 2,597 | 125,396 | 246,499 | (7,606) | 238,893 |
| Gross Profit | 32,028 | (2,552) | 29,476 | 58,783 | (4,346) | 54,437 |
| Selling, General and Administrative Expenses | 21,194 | — | 21,194 | 40,521 | — | 40,521 |
| Restructuring Charges | 5,238 | — | 5,238 | 7,411 | — | 7,411 |
| Operating Income | 5,596 | (2,552) | 3,044 | 10,851 | (4,346) | 6,505 |
| Interest Expense | (3,763) | — | (3,763) | (6,661) | — | (6,661) |
| Income (Loss) Before Taxes | 1,833 | (2,552) | (719) | 4,190 | (4,346) | (156) |
| Income Tax Expense (Benefit) | 242 | (11) | 231 | (1) | (87) | (88) |
| Net Income (Loss) | \$1,591 | \$(2,541) | \$(950) | \$4,191 | \$(4,259) | \$(68) |
| Earnings (Loss) Per Share | | | | | | |
| Basic earnings (loss) per share | \$0.14 | | \$(0.08) | \$0.37 | | \$(0.01) |
| Diluted earnings (loss) per share | \$0.14 | | \$(0.08) | \$0.36 | | \$(0.01) |
| Weighted-Average Number of Common Shares Outstanding | | | | | | |
| Basic | 11,394 | | 11,394 | 11,370 | | 11,370 |
| Diluted | 11,624 | | 11,394 | 11,609 | | 11,370 |

| Unaudited Condensed Consolidated Statements of Comprehensive Income (Loss) | Three Months Ended June 30, 2018 | | | Six Months Ended June 30, 2018 | | |
|--|----------------------------------|--------------------|--------------------------------------|--------------------------------|--------------------|--------------------------------------|
| | As Reported | Effect of Adoption | Balances Without Adoption of ASC 606 | As Reported | Effect of Adoption | Balances Without Adoption of ASC 606 |
| Net Income (Loss) | \$1,591 | \$(2,541) | \$(950) | \$4,191 | \$(4,259) | \$(68) |
| Other Comprehensive Income (Loss), Net of Tax: | | | | | | |
| Amortization of actuarial losses and prior service costs, net of tax benefit of \$44 and \$89 for the three and six months ended June 30, 2018, respectively | 142 | — | 142 | 283 | — | 283 |
| Change in unrealized gains and losses on cash flow hedges, net of tax of \$28 and \$89 for the three and six months ended June 30, 2018, respectively | 87 | — | 87 | 281 | — | 281 |
| Other Comprehensive Income (Loss), Net of Tax | 229 | — | 229 | 564 | — | 564 |
| Comprehensive Income (Loss) | \$1,820 | \$(2,541) | \$(721) | \$4,755 | \$(4,259) | \$496 |

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| | Six Months Ended June 30, 2018 | | |
|---|-----------------------------------|-----------------------|--|
| | As Reported | Effect of Adoption | Balances Without Adoption of ASC 606 |
| Unaudited Condensed Consolidated Statements of Cash Flows | | | |
| Cash Flows from Operating Activities | | | |
| Net Income (Loss) | \$4,191 | \$ (4,259) | \$ (68) |
| Adjustments to Reconcile Net Income (Loss) to Net Cash Provided by Operating Activities: | | | |
| Depreciation and amortization | 12,315 | — | 12,315 |
| Property and equipment impairment due to restructuring | 4,375 | — | 4,375 |
| Stock-based compensation expense | 2,115 | — | 2,115 |
| Deferred income taxes | 3,966 | (3,606) | 360 |
| Recovery of doubtful accounts | (30) | — | (30) |
| Other | 9,050 | (7,661) | 1,389 |
| Changes in Assets and Liabilities: | | | |
| Accounts receivable | 11,172 | — | 11,172 |
| Contract assets | (81,663) | 81,663 | — |
| Inventories | 29,417 | (53,730) | (24,313) |
| Production cost of contracts | 160 | — | 160 |
| Other assets | 1,475 | (1,494) | (19) |
| Accounts payable | 20,117 | — | 20,117 |
| Contract liabilities | 15,164 | (15,164) | — |
| Accrued and other liabilities | (5,597) | 4,251 | (1,346) |
| Net Cash Provided by Operating Activities | 26,227 | — | 26,227 |
| Cash Flows from Investing Activities | | | |
| Purchases of property and equipment | (7,513) | — | (7,513) |
| Proceeds from sale of assets | 67 | — | 67 |
| Payments for purchase of Certified Thermoplastics Co., LLC, net of cash acquired | (30,993) | — | (30,993) |
| Net Cash Used in Investing Activities | (38,439) | — | (38,439) |
| Cash Flows from Financing Activities | | | |
| Borrowings from senior secured revolving credit facility | 189,600 | — | 189,600 |
| Repayments of senior secured revolving credit facility | (175,000) | — | (175,000) |
| Net cash paid upon issuance of common stock under stock plans | (1,006) | — | (1,006) |
| Net Cash Provided by Financing Activities | 13,594 | — | 13,594 |
| Net Increase in Cash and Cash Equivalents | 1,382 | — | 1,382 |
| Cash and Cash Equivalents at Beginning of Period | 2,150 | — | 2,150 |
| Cash and Cash Equivalents at End of Period | \$3,532 | \$— | \$ 3,532 |

Note 3. Business Combination

On April 23, 2018, we acquired 100.0% of the outstanding equity interests of Certified Thermoplastics Co., LLC (“CTP”), a privately-held leader in precision profile extrusions and extruded assemblies of engineered thermoplastic resins, compounds, and alloys for a wide range of commercial aerospace, defense, medical, and industrial applications. CTP is located in Santa Clarita, California. The acquisition of CTP was part of our strategy to diversify towards more customized, higher value, engineered products with greater aftermarket potential.

The purchase price for CTP was \$30.5 million, net of cash acquired, all payable in cash. We paid \$31.1 million upon the closing of the transaction. We preliminarily allocated the gross purchase price of \$31.1 million to the assets

acquired and liabilities assumed at estimated fair values. The excess of the purchase price over the aggregate fair values of the net assets is recorded as goodwill. The allocation is subject to revision as the estimates of fair value of current assets, non-current assets, identifiable intangible assets, and current liabilities are based on preliminary information and are subject to refinement. We are in the process of reviewing third party valuations of certain assets.

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The following table summarizes the estimated fair value of the assets acquired and liabilities assumed at the date of acquisition (in thousands):

| | | |
|---|-------------|------------|
| | | Estimated |
| | | Fair |
| | | Value |
| Cash | | \$98 |
| Accounts receivable | | 1,517 |
| Inventories | | 2,500 |
| Other current assets | | 27 |
| Property and equipment | | 603 |
| Intangible assets | | 8,000 |
| Goodwill | | 18,616 |
| Total assets acquired | | 31,361 |
| Current liabilities | | (270) |
| Total liabilities assumed | | (270) |
| Total preliminary purchase price allocation | | \$31,091 |
| | | Estimated |
| | Useful Life | Fair Value |
| | (In years) | (In |
| | | thousands) |
| Intangible assets: | | |
| Customer relationships | 10 | \$ 6,600 |
| Trade names and trademarks | 15 | 1,400 |
| | | \$ 8,000 |

The intangible assets acquired of \$8.0 million were preliminarily determined based on the estimated fair values using valuation techniques consistent with the income approach to measure fair value. The useful lives were estimated based on the underlying agreements or the future economic benefit expected to be received from the assets. The fair values of the identifiable intangible assets were estimated using several valuation methodologies, which represented Level 3 fair value measurements. The value for customer relationships was estimated based on a multi-period excess earnings approach, while the value for trade names and trademarks was assessed using the relief from royalty methodology. The goodwill of \$18.6 million arising from the acquisition is preliminarily attributable to the benefits we expect to derive from expected synergies from the transaction, including complementary products that will enhance our overall product portfolio, opportunities within new markets, and an acquired assembled workforce. All the goodwill was assigned to the Structural Systems segment. Since the CTP acquisition, for tax purposes, was deemed an asset acquisition, the goodwill recognized is deductible for income tax purposes.

Acquisition related transaction costs are not included as components of consideration transferred but have been expensed as incurred. Total acquisition-related transaction costs incurred by us were \$0.3 million and \$0.6 million in the three months and six months ended June 30, 2018, respectively, and charged to selling, general and administrative expenses.

CTP's results of operations have been included in our condensed consolidated statements of income since the date of acquisition as part of the Structural Systems segment. Pro forma results of operations of the CTP acquisition during the three and six months ended June 30, 2018 have not been presented as the effect of the CTP acquisition was not material to our financial results.

In September 2017, we acquired 100.0% of the outstanding equity interests of Lightning Diversion Systems, LLC ("LDS"), a privately-held worldwide leader in lightning protection systems serving the aerospace and defense industries, located in Huntington Beach, California. The acquisition of LDS was part of our strategy to enhance revenue growth by focusing on advanced proprietary technology on various aerospace and defense platforms.

The purchase price for LDS was \$60.0 million, net of cash acquired, all payable in cash. We allocated the gross purchase price of \$62.0 million to the assets acquired and liabilities assumed at estimated fair values. The excess of

the purchase over the aggregate fair values was recorded as goodwill. All the goodwill was assigned to the Electronic Systems segment. Since the LDS acquisition, for tax purposes, was deemed an asset acquisition, the goodwill recognized is deductible for income tax purposes.

LDS' results of operations have been included in our condensed consolidated statements of income since the date of acquisition as part of the Electronic Systems segment.

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Note 4. Restructuring Activities

Summary of 2017 Restructuring Plan

In November 2017, management approved and commenced a restructuring plan that was intended to increase operating efficiencies. We currently estimate this initiative will result in \$20.0 million to \$22.0 million in total pre-tax restructuring charges through 2018, with \$8.8 million recorded during 2017. We continue to evaluate a number of possible scenarios to execute the second phase of the restructuring plan, which will result in additional restructuring charges during 2018. In June 2018, we finalized one of the scenarios which will result in the closure of our Phoenix operation, part of our Electronic Systems segment, by December 31, 2018. As a result, we recorded \$5.4 million of restructuring charges during the three months ended June 30, 2018. We anticipate the additional charges for the other possible scenarios will include cash payments for employee separation and non-cash charges for asset impairments. In the Electronic Systems segment, we recorded \$0.6 million during the three months ended June, 30, 2018 and cumulative expenses of \$2.2 million for severance and benefits which was classified as restructuring charges. We also recorded non-cash expenses of \$0.2 million during the three months ended June, 30, 2018 for inventory write off which was classified as cost of sales.

In the Structural Systems segment, we recorded \$0.5 million during the three months ended June 30, 2018 and cumulative expenses of \$2.5 million, for severance and benefits which were classified as restructuring charges. We also recorded non-cash expenses of \$3.3 million during the three months ended June 30, 2018 and cumulative expenses of \$7.9 million for property and equipment impairment which were classified as restructuring charges. Further, we recorded cumulative non-cash expenses of \$0.5 million for inventory write down which was classified as cost of sales.

In Corporate, we recorded \$0.7 million during the three months ended June 30, 2018 and cumulative expenses of \$1.1 million for severance and benefits and non-cash expenses of \$1.5 million for stock-based compensation awards which were modified, all of which were classified as restructuring charges. We also recorded \$0.4 million during the three months ended June 30, 2018 and cumulative expenses of \$0.4 million for professional service fees which were classified as restructuring charges.

As of June 30, 2018, we have accrued \$1.0 million, \$0.6 million, and \$0.3 million for severance and benefits and loss on early exit from lease in the Electronic Systems segment, Structural Systems segment, and Corporate, respectively. Our restructuring activities in the six months ended June 30, 2018 were as follows (in thousands):

| | December 31, 2017 | Six Months Ended June 30, 2018 | | | June 30, 2018 | |
|--|----------------------|--------------------------------|------------------|----------------------|------------------------|----------|
| | Balance | Charges | Cash Payments | Non-Cash Payments | Change in Estimates | Balance |
| Severance and benefits | \$ 2,659 | \$2,554 | \$(3,631) | \$— | \$ | —\$1,582 |
| Modification of stock-based compensation awards | — | 105 | — | (105) |) — | — |
| Lease termination | 66 | 21 | (6) |) — | — | 81 |
| Property and equipment impairment due to restructuring | — | 4,375 | — | (4,375) |) — | — |
| Professional service fees | — | 356 | (265) |) — | — | 91 |
| Total charged to restructuring charges | 2,725 | 7,411 | (3,902) | (4,480) |) — | 1,754 |
| Inventory reserve | — | 168 | — | — | — | 168 |
| Total charged to cost of sales | — | 168 | — | — | — | 168 |
| Ending balance | \$ 2,725 | \$7,579 | \$(3,902) | \$(4,480) |) \$ | —\$1,922 |

Note 5. Fair Value Measurements

Fair value is defined as the price that would be received for an asset or the price that would be paid to transfer a liability (an exit price) in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. The accounting standard provides a framework for measuring fair value using a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. This hierarchy requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring

fair value. Three levels of inputs that may be used to measure fair value are as follows:
Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities;

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Level 2 - Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Our financial instruments consists primarily of cash and cash equivalents and interest rate cap derivatives designated as cash flow hedging instruments. The fair value of the interest rate cap hedge agreements was determined using pricing models that use observable market inputs as of the balance sheet date, a Level 2 measurement.

There were no transfers between Level 1, Level 2, or Level 3 financial instruments in the three months ended June 30, 2018.

Note 6. Inventories

Inventories consisted of the following:

| | (In thousands) | |
|----------------------------|----------------|-------------------|
| | June 30, 2018 | December 31, 2017 |
| Raw materials and supplies | \$80,985 | \$ 65,221 |
| Work in process | 11,815 | 62,584 |
| Finished goods | 2,444 | 10,665 |
| | 95,244 | 138,470 |
| Less progress payments | — | 16,309 |
| Total | \$95,244 | \$ 122,161 |

The December 31, 2017 balances were prior to the adoption of ASC 606 and as such, we netted progress payments from customers related to inventory purchases against inventories on the condensed consolidated balance sheets. See Note 2.

Note 7. Goodwill

We perform our annual goodwill impairment test during the fourth quarter. If certain factors occur, including significant under performance of our business relative to expected operating results, significant adverse economic and industry trends, significant decline in our market capitalization for an extended period of time relative to net book value, a decision to divest individual businesses within a reporting unit, or a decision to group individual businesses differently, we may perform an impairment test prior to the fourth quarter.

The increase in goodwill in Structural Systems was due to the acquisition of CTP on April 23, 2018. See Note 3.

The carrying amounts of our goodwill, all in our Electronic Systems segment, were as follows:

| | (In thousands) | | |
|---|--------------------|--------------------|-----------------------|
| | Structural Systems | Electronic Systems | Consolidated Ducommun |
| Gross goodwill | \$— | \$ 199,157 | \$ 199,157 |
| Accumulated goodwill impairment | — | (81,722) | (81,722) |
| Balance at December 31, 2017 | — | 117,435 | 117,435 |
| Goodwill from acquisition during the period | 18,616 | — | 18,616 |
| Balance at June 30, 2018 | \$18,616 | \$117,435 | \$ 136,051 |

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Note 8. Accrued Liabilities

The components of accrued liabilities were as follows:

| | (In thousands) | |
|-------------------------------------|----------------|--------------|
| | June 30, | December 31, |
| | 2018 | 2017 |
| Accrued compensation | \$19,750 | \$ 18,925 |
| Accrued income tax and sales tax | 23 | 71 |
| Customer deposits | — | 3,970 |
| Provision for forward loss reserves | — | 1,226 |
| Other | 6,040 | 4,137 |
| Total | \$25,813 | \$ 28,329 |

The December 31, 2017 balances of customer deposits and provision for forward losses were prior to the adoption of ASC 606 and as such, classified as accrued liabilities rather than contract liabilities on the condensed consolidated balance sheets. See Note 2.

Note 9. Long-Term Debt

Long-term debt and the current period interest rates were as follows:

| | (In thousands) | |
|--|----------------|--------------|
| | June 30, | December 31, |
| | 2018 | 2017 |
| Term loan | \$160,000 | \$ 160,000 |
| Revolving credit facility | 72,700 | 58,100 |
| Total debt | 232,700 | 218,100 |
| Less current portion | — | — |
| Total long-term debt | 232,700 | 218,100 |
| Less debt issuance costs | 1,541 | 2,045 |
| Total long-term debt, net of debt issuance costs | \$231,159 | \$ 216,055 |
| Weighted-average interest rate | 4.31 | % 3.73 |

Our credit facility consists of a \$275.0 million senior secured term loan, which matures on June 26, 2020 (“Term Loan”), and a \$200.0 million senior secured revolving credit facility (“Revolving Credit Facility”), which matures on June 26, 2020 (collectively, the “Credit Facilities”). The Credit Facilities bear interest, at our option, at a rate equal to either (i) the Eurodollar Rate (defined as LIBOR) plus an applicable margin ranging from 1.50% to 2.75% per year or (ii) the Base Rate (defined as the highest of [a] Federal Funds Rate plus 0.50%, [b] Bank of America’s prime rate, and [c] the Eurodollar Rate plus 1.00%) plus an applicable margin ranging from 0.50% to 1.75% per year, in each case based upon the consolidated total net adjusted leverage ratio. The undrawn portions of the commitments of the Credit Facilities are subject to a commitment fee ranging from 0.175% to 0.300%, based upon the consolidated total net adjusted leverage ratio.

Further, we are required to make mandatory prepayments of amounts outstanding under the Term Loan. The mandatory prepayments will be made quarterly, equal to 5.0% per year of the original aggregate principal amount during the first two years and increase to 7.5% per year during the third year, and increase to 10.0% per year during the fourth year and fifth years, with the remaining balance payable on June 26, 2020. The loans under the Revolving Credit Facility are due on June 26, 2020. As of June 30, 2018, we were in compliance with all covenants required under the Credit Facilities.

In addition, we incurred \$4.8 million of debt issuance costs related to the Credit Facilities and those costs were capitalized and are being amortized over the five year life of the Credit Facilities.

In July 2017, we entered into a technical amendment to the Credit Facilities (“First Amendment”) which provides more flexibility to close certain qualified acquisitions permitted under the Credit Facilities.

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We have made all mandatory prepayments under the Term Loan and thus, no mandatory payments are due until the Term Loan matures in June 2020. We did not make any voluntary principal prepayments under the Term Loan during the three and six months ended June 30, 2018.

On April 23, 2018, we acquired CTP for a purchase price of \$30.5 million, net of cash acquired, all payable in cash. Upon the closing of the transaction, we paid \$31.1 million in cash by drawing down on the Revolving Credit Facility. See Note 3.

In September 2017, we acquired LDS for a purchase price of \$60.0 million, net of cash acquired, all payable in cash. Upon the closing of the transaction, we paid \$61.4 million in cash by drawing down on the Revolving Credit Facility. The remaining \$0.6 million was paid in October 2017 in cash, also by drawing down on the Revolving Credit Facility. See Note 3.

As of June 30, 2018, we had \$127.0 million of unused borrowing capacity under the Revolving Credit Facility, after deducting \$72.7 million for draw down on the Revolving Credit Facility and \$0.3 million for standby letters of credit. The Credit Facilities were entered into by us (“Parent Company”) and guaranteed by all of our subsidiaries, other than one subsidiary (“Subsidiary Guarantors”) that was considered minor. The Parent Company has no independent assets or operations and the Subsidiary Guarantors jointly and severally guarantee, on a senior unsecured basis, the Credit Facilities. Therefore, no condensed consolidating financial information for the Parent Company and its subsidiaries are presented.

In October 2015, we entered into interest rate cap hedges designated as cash flow hedges with maturity dates of June 2020, and in aggregate, totaling \$135.0 million of our debt. We paid a total of \$1.0 million in connection with entering into the interest rate cap hedges. See Note 5 for further discussion.

In December 2017 and 2016, we entered into agreements to purchase \$14.2 million and \$9.9 million of industrial revenue bonds (“IRBs”) issued by the city of Parsons, Kansas (“Parsons”) and concurrently, sold \$14.2 million and \$9.9 million of property and equipment (“Property”) to Parsons as well as entered into lease agreements to lease the Property from Parsons (“Leases”) with lease payments totaling \$14.2 million and \$9.9 million over the lease terms, respectively. The sale of the Property and concurrent lease back of the Property in December 2017 and 2016 did not meet the sale-leaseback accounting requirements as a result of our continuous involvement with the Property and thus, the \$14.2 million and \$9.9 million in cash received from Parsons was not recorded as a sale but as a financing obligation. Further, the Leases included a right of offset so long as we continue to own the IRBs and thus, the financing obligation of \$14.2 million and \$9.9 million was offset against the \$14.2 million and \$9.9 million, respectively, of IRBs assets and are presented net on the condensed consolidated balance sheets with no impact to the condensed consolidated income statements or condensed consolidated cash flow statements.

Note 10. Employee Benefit Plans

The components of net periodic pension expense were as follows:

| | (In thousands) | | (In thousands) | |
|----------------------------------|--------------------|--------------|------------------|--------------|
| | Three Months Ended | | Six Months Ended | |
| | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Service cost | \$150 | \$132 | \$300 | \$265 |
| Interest cost | 317 | 333 | 634 | 665 |
| Expected return on plan assets | (446) | (382) | (892) | (765) |
| Amortization of actuarial losses | 186 | 202 | 372 | 405 |
| Net periodic pension cost | \$207 | \$285 | \$414 | \$570 |

The components of the reclassifications of net actuarial losses from accumulated other comprehensive loss to net income for the three and six months ended June 30, 2018 were as follows:

(In thousands)

| | Three Months Ended June 30, 2018 | Six Months Ended June 30, 2018 |
|--|--|--|
| Amortization of actuarial losses - total before tax ⁽¹⁾ | \$ 186 | \$ 372 |
| Tax benefit | (44) | (89) |
| Net of tax | \$ 142 | \$ 283 |

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- (1) The amortization expense is included in the computation of periodic pension cost and is a decrease to net income upon reclassification from accumulated other comprehensive loss.

Note 11. Indemnifications

We have made guarantees and indemnities under which we 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, we have indemnified our lessors for certain claims arising from our use of the facility under our lease. We indemnify our directors and officers to the maximum extent permitted under the laws of the State of Delaware.

However, we have a directors and officers insurance policy that may reduce our exposure in certain circumstances and may enable us to recover a portion of future amounts that may be payable, if any. The duration of the guarantees and indemnities vary and, in many cases, are subject to statutes of limitations. The majority of guarantees and indemnities do not provide any limitations of the maximum potential future payments we could be obligated to make. Historically, payments related to these guarantees and indemnities have been immaterial. We estimate the amount of our indemnification obligations as insignificant based on this history and insurance coverage and therefore, have not recorded any liability for these guarantees and indemnities on the accompanying condensed consolidated balance sheets. Further, when considered with our insurance coverage, although recorded through different captions on our condensed consolidated balance sheets, the potential impact is further mitigated.

Note 12. Income Taxes

The provision for income taxes is determined using an estimated annual effective tax rate, which is generally less than the U.S. federal statutory rate, primarily due to research and development (“R&D”) tax credits. Our effective tax rate may be subject to fluctuations during the year as new information is obtained, which may affect the assumptions used to estimate the annual effective tax rate, including factors such as expected utilization of R&D tax credits, valuation allowances against deferred tax assets, the recognition or derecognition of tax benefits related to uncertain tax positions, and changes in or the interpretation of tax laws in jurisdictions where we conduct business. Also, excess tax benefits and tax deficiencies related to our equity compensation recognized in the income statement could result in fluctuations in our effective tax rate period-over-period depending on the volatility of our stock price and how many awards vest in the period. We recognize deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities along with net operating loss and tax credit carryovers.

We record a valuation allowance against our deferred tax assets to reduce the net carrying value to an amount that we believe is more likely than not to be realized. When we establish or reduce our valuation allowances against our deferred tax assets, the provision for income taxes will increase or decrease, respectively, in the period when that determination is made.

On December 22, 2017, the President of the United States signed into law the Tax Cuts and Jobs Act (“2017 Tax Act”) which, among a broad range of tax reform measures, reduced the U.S. corporate tax rate from 35.0% to 21.0% effective January 1, 2018. The reduction in the U.S. corporate tax rate required the federal portion of our deferred tax assets and liabilities at December 31, 2017 to be re-measured at the enacted tax rate expected to apply when the temporary differences are to be realized or settled using 21.0%.

SEC Staff Accounting Bulletin No. 118, “Income Tax Accounting Implications of the Tax Cuts and Jobs Act” (“SAB 118”), allows us to record provisional amounts for the tax effects of the 2017 Tax Act when we do not have necessary information available, prepared, or analyzed in reasonable detail to finalize its accounting for the changes in the tax law during a measurement period not to extend beyond one year of the enactment date. During the six months ended June 30, 2018, we did not recognize any changes to the provisional amounts recorded in our 2017 Annual Report on Form 10-K in connection with the 2017 Tax Act. We expect to finalize our analysis within the measurement period in accordance with SAB 118 after completing our reviews of additional guidance issued by the Internal Revenue Service (“IRS”) and available tax methods and elections related to 2017 tax return positions.

We recorded an income tax expense of \$0.2 million for the three months ended June 30, 2018 compared to \$0.7 million for the three months ended July 1, 2017. The decrease in income tax expense for the second quarter of 2018 compared to the second quarter of 2017 was primarily due to the reduction in the U.S. corporate tax rate from 35.0% to 21.0% and tax incentives such as the research and development tax credits having a greater impact on the annual effective tax rate as a result of lower pre-tax income in the second quarter of 2018 compared to the second quarter of 2017. The decrease was partially offset by the repeal of the U.S. Domestic Production Activities Deduction in 2018. We recorded an income tax benefit of less than \$0.1 million for the six months ended June 30, 2018 compared to income tax expense of \$1.1 million for the six months ended July 1, 2017. The decrease in income tax expense for the first six months of

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2018 compared to the first six months of 2017 was primarily due to the reduction in the U.S. corporate tax rate from 35.0% to 21.0% and tax incentives such as the research and development tax credits having a greater impact on the annual effective tax rate as a result of lower pre-tax income in the first six months of 2018 compared to the first six months of 2017. The decrease was partially offset by the repeal of the U.S. Domestic Production Activities Deduction in 2018.

Our total amount of unrecognized tax benefits was \$5.4 million and \$5.3 million as of June 30, 2018 and December 31, 2017, respectively. If recognized, \$3.6 million would affect the effective tax rate. The decrease in unrecognized tax benefits as of June 30, 2018 compared to March 31, 2018 is related to a change in our accounting treatment of advanced payments for tax purposes. We filed an Application for Change in Accounting Method ("Form 3115") with the IRS to provide for different treatment of advanced payments for tax purposes compared to book purposes in the second quarter of 2018. Upon filing the automatic method change, audit protection was provided for tax years subject to examination and we reclassified the unrecognized tax benefits to deferred tax liabilities. We do not reasonably expect significant increases or decreases to our unrecognized tax benefits in the next twelve months.

Note 13. Contingencies

Structural Systems has been directed by California environmental agencies to investigate and take corrective action for groundwater contamination at its facilities located in El Mirage and Monrovia, California. Based on currently available information, Ducommun has established an accrual for its estimated liability for such investigation and corrective action of \$1.5 million at both June 30, 2018 and December 31, 2017, which is reflected in other long-term liabilities on its condensed consolidated balance sheets.

Structural Systems also faces liability as a potentially responsible party for hazardous waste disposed at landfills located in Casmalia and West Covina, California. Structural Systems and other companies and government entities have entered into consent decrees with respect to these landfills with the United States Environmental Protection Agency and/or California environmental agencies under which certain investigation, remediation and maintenance activities are being performed. Based on currently available information, Ducommun preliminarily estimates that the range of its future liabilities in connection with the landfill located in West Covina, California is between \$0.4 million and \$3.1 million. Ducommun has established an accrual for its estimated liability, in connection with the West Covina landfill of \$0.4 million at June 30, 2018, which is reflected in other long-term liabilities on its condensed consolidated balance sheet. Ducommun's ultimate liability in connection with these matters will depend upon a number of factors, including changes in existing laws and regulations, the design and cost of construction, operation and maintenance activities, and the allocation of liability among potentially responsible parties.

In the normal course of business, Ducommun and its subsidiaries are defendants in certain other litigation, claims and inquiries, including matters relating to environmental laws. In addition, Ducommun makes various commitments and incurs contingent liabilities. While it is not feasible to predict the outcome of these matters, Ducommun does not presently expect that any sum it may be required to pay in connection with these matters would have a material adverse effect on its condensed consolidated financial position, results of operations or cash flows.

Note 14. Business Segment Information

We supply products and services primarily to the aerospace and defense industries. Our subsidiaries are organized into two strategic businesses, Structural Systems and Electronic Systems, each of which is a reportable operating segment.

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Financial information by reportable operating segment was as follows:

| | (In thousands) | | (In thousands) | |
|--|--------------------|-----------------|------------------|-----------------|
| | Three Months Ended | | Six Months Ended | |
| | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Net Revenues | | | | |
| Structural Systems | \$70,325 | \$59,112 | \$138,372 | \$116,687 |
| Electronic Systems | 84,502 | 81,826 | 166,910 | 160,548 |
| Total Net Revenues | \$154,827 | \$140,938 | \$305,282 | \$277,235 |
| Segment Operating Income | | | | |
| Structural Systems | \$5,026 | \$2,127 | \$9,417 | \$4,837 |
| Electronic Systems | 8,668 | 8,894 | 14,412 | 16,072 |
| | 13,694 | 11,021 | 23,829 | 20,909 |
| Corporate General and Administrative Expenses ⁽¹⁾ | (8,098) | (4,398) | (12,978) | (10,034) |
| Operating Income | \$5,596 | \$6,623 | \$10,851 | \$10,875 |
| Depreciation and Amortization Expenses | | | | |
| Structural Systems | \$2,618 | \$2,307 | \$4,934 | \$4,659 |
| Electronic Systems | 3,683 | 3,439 | 7,315 | 6,862 |
| Corporate Administration | 33 | 2 | 66 | 9 |
| Total Depreciation and Amortization Expenses | \$6,334 | \$5,748 | \$12,315 | \$11,530 |
| Capital Expenditures | | | | |
| Structural Systems | \$1,101 | \$7,580 | \$2,630 | \$12,768 |
| Electronic Systems | 1,478 | 1,030 | 4,212 | 2,463 |
| Corporate Administration | 190 | 648 | 190 | 648 |
| Total Capital Expenditures | \$2,769 | \$9,258 | \$7,032 | \$15,879 |

(1) Includes costs not allocated to either the Structural Systems or Electronic Systems operating segments.

Segment assets include assets directly identifiable to or allocated to each segment. Our segment assets are as follows:

| | (In thousands) | |
|---|------------------|----------------------|
| | June 30, 2018 | December 31, 2017 |
| Total Assets | | |
| Structural Systems | \$216,104 | \$193,600 |
| Electronic Systems | 402,206 | 362,831 |
| Corporate Administration ⁽¹⁾ | 13,583 | 10,322 |
| Total Assets | \$631,893 | \$566,753 |
| Goodwill and Intangibles | | |
| Structural Systems | \$28,954 | \$2,836 |
| Electronic Systems | 224,582 | 229,292 |
| Total Goodwill and Intangibles | \$253,536 | \$232,128 |

(1) Includes assets not specifically identified to or allocated to either the Structural Systems or Electronic Systems operating segments, including cash and cash equivalents.

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Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Overview

Ducommun Incorporated (“Ducommun,” “the Company,” “we,” “us” or “our”) is a leading global provider of engineering and manufacturing services for high-performance products and high-cost-of failure applications used primarily in the aerospace and defense (“A&D”), industrial, medical and other industries (collectively, “Industrial”). We differentiate ourselves as a full-service solution-based provider, offering a wide range of value-added products and services in our primary businesses of electronics, structures and integrated solutions. We operate through two primary business segments: Electronic Systems and Structural Systems, each of which is a reportable segment.

We adopted ASC 606, “Revenue from Contracts with Customers” (“ASC 606”), as of January 1, 2018, using the modified retrospective method of adoption. As such, our results for the three and six months ended June 30, 2018 are reported under ASC 606 while our results for the three and six months ended July 1, 2017 are reported under the prior revenue recognition accounting standard, ASC 605, “Revenue Recognition” (“ASC 605”). However, our discussions are primarily based on a comparison of our results in the three and six months ended June 30, 2018 under ASC 605 compared to the three and six months ended July 1, 2017 also under ASC 605. See Note 1 and Note 2 to condensed consolidated financial statements included in Part I, Item I of this Form 10-Q.

Second quarter 2018 highlights:

• Revenues of \$154.8 million

• Net income of \$1.6 million, or \$0.14 per diluted share

• Adjusted EBITDA of \$18.7 million

• Backlog of \$823.0 million

• Completed the acquisition of Certified Thermoplastics Co., LLC

Non-GAAP Financial Measures

Adjusted earnings before interest, taxes, depreciation, amortization, stock-based compensation expense, and restructuring charges (“Adjusted EBITDA”) was \$18.7 million and \$13.7 million for the three months ended June 30, 2018 and July 1, 2017, respectively.

When viewed with our financial results prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and accompanying reconciliations, we believe Adjusted EBITDA provides additional useful information to clarify and enhance the understanding of the factors and trends affecting our past performance and future prospects. We define these measures, explain how they are calculated and provide reconciliations of these measures to the most comparable GAAP measure in the table below. Adjusted EBITDA and the related financial ratios, as presented in this Quarterly Report on Form 10-Q (“Form 10-Q”), are supplemental measures of our performance that are not required by, or presented in accordance with, GAAP. They are not a measurement of our financial performance under GAAP and should not be considered as alternatives to net income or any other performance measures derived in accordance with GAAP, or as an alternative to net cash provided by operating activities as measures of our liquidity. The presentation of these measures should not be interpreted to mean that our future results will be unaffected by unusual or nonrecurring items.

We use Adjusted EBITDA non-GAAP operating performance measures internally as complementary financial measures to evaluate the performance and trends of our businesses. We present Adjusted EBITDA and the related financial ratios, as applicable, because we believe that measures such as these provide useful information with respect to our ability to meet our operating commitments.

Adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation or as substitutes for analysis of our results as reported under GAAP. Some of these limitations include:

- They do not reflect our cash expenditures, future requirements for capital expenditures or contractual commitments;
- They do not reflect changes in, or cash requirements for, our working capital needs;
- They do not reflect the significant interest expense or the cash requirements necessary to service interest or principal payments on our debt;

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Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;

• They are not adjusted for all non-cash income or expense items that are reflected in our statements of cash flows;

• They do not reflect the impact on earnings of charges resulting from matters unrelated to our ongoing operations; and

• Other companies in our industry may calculate Adjusted EBITDA differently from us, limiting their usefulness as comparative measures.

Because of these limitations, Adjusted EBITDA and the related financial ratios should not be considered as measures of discretionary cash available to us to invest in the growth of our business or as a measure of cash that will be available to us to meet our obligations. You should compensate for these limitations by relying primarily on our GAAP results and using Adjusted EBITDA only as supplemental information. See our Condensed Consolidated Financial Statements contained in this Form 10-Q.

However, in spite of the above limitations, we believe that Adjusted EBITDA is useful to an investor in evaluating our results of operations because these measures:

• Are widely used by investors to measure a company's operating performance without regard to items excluded from the calculation of such terms, which can vary substantially from company to company depending upon accounting methods and book value of assets, capital structure and the method by which assets were acquired, among other factors;

• Help investors to evaluate and compare the results of our operations from period to period by removing the effect of our capital structure from our operating performance; and

• Are used by our management team for various other purposes in presentations to our Board of Directors as a basis for strategic planning and forecasting.

The following financial items have been added back to or subtracted from our net income when calculating Adjusted EBITDA:

• Interest expense may be useful to investors for determining current cash flow;

• Income tax expense may be useful to investors because it represents the taxes which may be payable for the period and the change in deferred taxes during the period, and may reduce cash flow available for use in our business;

• Depreciation may be useful to investors because it generally represents the wear and tear on our property and equipment used in our operations;

• Amortization expense may be useful to investors because it represents the estimated attrition of our acquired customer base and the diminishing value of product rights;

• Stock-based compensation may be useful to our investors for determining current cash flow;

• Restructuring charges may be useful to our investors in evaluating our core operating performance.

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Reconciliations of net income to Adjusted EBITDA and the presentation of Adjusted EBITDA as a percentage of net revenues were as follows:

| | (In thousands) | | (In thousands) | | |
|---|--------------------|----------|------------------|----------|---|
| | Three Months Ended | | Six Months Ended | | |
| | June 30, | July 1, | June 30, | July 1, | |
| | 2018 | 2017 | 2018 | 2017 | |
| Net income | \$1,591 | \$3,823 | \$4,191 | \$5,938 | |
| Interest expense | 3,763 | 2,059 | 6,661 | 3,804 | |
| Income tax expense (benefit) | 242 | 741 | (1) | 1,133 | |
| Depreciation | 3,418 | 3,338 | 6,782 | 6,668 | |
| Amortization | 2,916 | 2,410 | 5,533 | 4,862 | |
| Stock-based compensation expense | 1,025 | 1,342 | 2,115 | 3,164 | |
| Restructuring charges | 5,406 | — | 7,579 | — | |
| Inventory purchase accounting adjustments | 329 | — | 329 | — | |
| Adjusted EBITDA | \$18,690 | \$13,713 | \$33,189 | \$25,569 | |
| % of net revenues | 12.1 | % 9.7 | % 10.9 | % 9.2 | % |

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Results of Operations

Second Quarter of 2018 Compared to Second Quarter of 2017

The following table sets forth net revenues, selected financial data, the effective tax rate and diluted (loss) earnings per share:

| | (in thousands, except per share data) | | | | (in thousands, except per share data) | | | |
|--|---------------------------------------|-------------------------|------------------|-------------------------|---------------------------------------|-------------------------|------------------|-------------------------|
| | Three Months Ended | | Six Months Ended | | Three Months Ended | | Six Months Ended | |
| | June 30, 2018 | % of Net Revenues | July 1, 2017 | % of Net Revenues | June 30, 2018 | % of Net Revenues | July 1, 2017 | % of Net Revenues |
| Net Revenues | \$154,827 | 100.0 % | \$140,938 | 100.0 % | \$305,282 | 100.0 % | \$277,235 | 100.0 % |
| Cost of Sales | 122,799 | 79.3 % | 114,669 | 81.4 % | 246,499 | 80.7 % | 225,961 | 81.5 % |
| Gross Profit | 32,028 | 20.7 % | 26,269 | 18.6 % | 58,783 | 19.3 % | 51,274 | 18.5 % |
| Selling, General and Administrative Expenses | 21,194 | 13.7 % | 19,646 | 13.9 % | 40,521 | 13.3 % | 40,399 | 14.6 % |
| Restructuring Charges | 5,238 | 3.4 % | — | — % | 7,411 | 2.4 % | — | — % |
| Operating Income | 5,596 | 3.6 % | 6,623 | 4.7 % | 10,851 | 3.6 % | 10,875 | 3.9 % |
| Interest Expense | (3,763) | (2.3)% | (2,059) | (1.5)% | (6,661) | (2.2)% | (3,804) | (1.4)% |
| Income Before Taxes | 1,833 | 1.2 % | 4,564 | 3.2 % | 4,190 | 1.4 % | 7,071 | 2.5 % |
| Income Tax (Benefit) Expense | 242 | nm | 741 | nm | (1) | nm | 1,133 | nm |
| Net Income | \$1,591 | 1.0 % | \$3,823 | 2.7 % | \$4,191 | 1.4 % | \$5,938 | 2.1 % |
| Effective Tax (Benefit) Rate | 13.2 % | nm | 16.2 % | nm | — % | nm | 16.0 % | nm |
| Diluted Earnings Per Share | \$0.14 | nm | \$0.33 | nm | \$0.36 | nm | \$0.51 | nm |

nm = not meaningful

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Net Revenues by End-Use Market and Operating Segment

Net revenues by end-use market and operating segment during the first fiscal three and six months of 2018 and 2017, respectively, were as follows:

| | Three Months Ended | | | | | Six Months Ended | | | | | |
|--|--------------------|------------------|------------------|-------------------|---------------|------------------|------------------|------------------|-------------------|---------------|--|
| | Change | (In thousands) | | % of Net Revenues | | Change | (In thousands) | | % of Net Revenues | | |
| | | June 30 2018 | July 1, 2017 | June 30 2018 | July 1, 2017 | | June 30 2018 | July 1, 2017 | June 30 2018 | July 1, 2017 | |
| Consolidated Ducommun | | | | | | | | | | | |
| Military and space | \$152 | \$70,326 | \$70,174 | 45.4 % | 49.8 % | \$2,566 | \$136,681 | \$134,115 | 44.8% | 48.4% | |
| Commercial aerospace | 16,114 | 71,844 | 55,730 | 46.4 % | 39.5 % | 29,585 | 142,676 | 113,091 | 46.7% | 40.8% | |
| Industrial | (2,377) | 12,657 | 15,034 | 8.2 % | 10.7 % | (4,104) | 25,925 | 30,029 | 8.5% | 10.8% | |
| Total | \$13,889 | \$154,827 | \$140,938 | 100.0% | 100.0% | \$28,047 | \$305,282 | \$277,235 | 100.0% | 100.0% | |
| Structural Systems | | | | | | | | | | | |
| Military and space (defense structures) | \$482 | \$15,958 | \$15,476 | 22.7 % | 26.2 % | \$— | \$29,780 | \$29,780 | 21.5% | 25.5% | |
| Commercial aerospace | 10,731 | 54,367 | 43,636 | 77.3 % | 73.8 % | 21,685 | 108,592 | 86,907 | 78.5% | 74.5% | |
| Total | \$11,213 | \$70,325 | \$59,112 | 100.0% | 100.0% | \$21,685 | \$138,372 | \$116,687 | 100.0% | 100.0% | |
| Electronic Systems | | | | | | | | | | | |
| Military and space (defense electronics) | \$(330) | \$54,368 | \$54,698 | 64.3 % | 66.8 % | \$2,566 | \$106,901 | \$104,335 | 64.0% | 65.0% | |
| Commercial aerospace | 5,383 | 17,477 | 12,094 | 20.7 % | 14.8 % | 7,900 | 34,084 | 26,184 | 20.4% | 16.3% | |
| Industrial | (2,377) | 12,657 | 15,034 | 15.0 % | 18.4 % | (4,104) | 25,925 | 30,029 | 15.6% | 18.7% | |
| Total | \$2,676 | \$84,502 | \$81,826 | 100.0% | 100.0% | \$6,362 | \$166,910 | \$160,548 | 100.0% | 100.0% | |

Net revenues for the three months ended June 30, 2018 were \$154.8 million, compared to \$140.9 million for the three months ended July 1, 2017. The year-over-year increase was due to the following:

\$16.1 million higher revenues in our commercial aerospace end-use markets due to higher build rates which favorably impacted our large aircraft platforms; and

\$0.2 million higher revenues in our military and space end-use markets; partially offset by

\$2.4 million lower revenues in our industrial end-use markets.

Net revenues for the six months ended June 30, 2018 were \$305.3 million, compared to \$277.2 million for the six months ended July 1, 2017. The year-over-year increase was due to the following:

\$29.6 million higher revenues in our commercial aerospace end-use markets due to higher build rates which favorably impacted our large aircraft platforms; and

\$2.6 million higher revenues in our military and space end-use markets; partially offset by

\$4.1 million lower revenues in our industrial end-use markets.

Net Revenues by Major Customers

A significant portion of our net revenues are from our top ten customers as follows:

| | Three Months Ended | Six Months Ended |
|--|--------------------|------------------|
|--|--------------------|------------------|

| | June 30, | July 1, | June 30, | July 1, |
|--|----------|---------|----------|---------|
| | 2018 | 2017 | 2018 | 2017 |
| Boeing Company | 16.1% | 16.3% | 17.1% | 16.2% |
| Lockheed Martin Corporation | 4.6 % | 5.3 % | 4.7 % | 5.8 % |
| Raytheon Company | 13.2% | 14.8% | 12.0% | 14.0% |
| Spirit Aerosystems Holdings, Inc. | 8.8 % | 7.4 % | 8.9 % | 7.5 % |
| United Technologies Corporation | 6.2 % | 4.2 % | 5.3 % | 5.2 % |
| Total top ten customers ⁽¹⁾ | 65.4% | 61.9% | 63.5% | 61.9% |

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Includes the Boeing Company (“Boeing”), Lockheed Martin Corporation (“Lockheed Martin”), Raytheon Company (1)(“Raytheon”), Spirit Aerosystems Holdings, Inc. (“Spirit”), and United Technologies Corporation (“United Technologies”).

Boeing, Lockheed Martin, Raytheon, Spirit, and United Technologies represented the following percentages of total accounts receivable:

| | June 30, 2018 | | December 31, 2017 | |
|---------------------|---------------|---|-------------------|---|
| Boeing | 7.8 | % | 7.8 | % |
| Lockheed Martin | 3.6 | % | 5.9 | % |
| Raytheon | 4.5 | % | 1.4 | % |
| Spirit | 1.5 | % | 13.5 | % |
| United Technologies | 2.9 | % | 2.3 | % |

The net revenues and accounts receivable from Boeing, Lockheed Martin, Raytheon, Spirit, and United Technologies are diversified over a number of commercial, military and space programs and were generated by both operating segments.

Gross Profit

Gross profit consists of net revenues less cost of sales. Cost of sales includes the cost of production of finished products and other expenses related to inventory management, manufacturing quality, and order fulfillment. Gross profit margin as a percentage of net revenues increased year-over-year in the three months ended June 30, 2018 to 20.7%, compared to the three months ended July 1, 2017 of 18.6% due to higher manufacturing volume and favorable product mix, partially offset by higher compensation and benefit costs and higher other manufacturing costs.

Gross profit margin as a percentage of net revenues increased year-over-year in the six months ended June 30, 2018 to 19.3%, compared to the six months ended July 1, 2017 of 18.5% due to higher manufacturing volume and favorable product mix, partially offset by higher compensation and benefit costs and higher forward loss reserve.

Selling, General and Administrative (“SG&A”) Expenses

SG&A expenses increased \$1.5 million year-over-year in the three months ended June 30, 2018 compared to the three months ended July 1, 2017 due to higher professional services fees of \$1.5 million, which includes acquisition related costs of \$0.3 million.

SG&A expenses increased \$0.1 million year-over-year in the six months ended June 30, 2018 compared to the six months ended July 1, 2017 due to higher professional services fees of \$2.0 million, which includes acquisition related costs of \$0.6 million, and amortization of intangibles of \$0.8 million, partially offset by lower compensation and benefit costs of \$2.2 million.

Interest Expense

Interest expense increased year-over-year in the three months ended June 30, 2018 compared to the three months ended July 1, 2017 due to a higher outstanding balance on the Revolving Credit Facility, due to the acquisitions of Certified Thermoplastics Co., LLC (“CTP”) in April 2018 and Lightning Diversion Systems, LLC (“LDS”) during the third quarter of 2017, and higher interest rates.

Interest expense increased year-over-year in the six months ended June 30, 2018 compared to the six months ended July 1, 2017 due to a higher outstanding balance on the Revolving Credit Facility, due to the acquisitions of CTP and LDS, and higher interest rates.

Income Tax Expense

We recorded an income tax expense of \$0.2 million for the three months ended June 30, 2018 compared to \$0.7 million for the three months ended July 1, 2017. The decrease in income tax expense for the second quarter of 2018 compared to the second quarter of 2017 was primarily due to the reduction in the U.S. corporate tax rate from 35.0% to 21.0% and tax incentives such as the research and development tax credits having a greater impact on the annual effective tax rate as a result of lower pre-tax income in the second quarter of 2018 compared to the second quarter of 2017. The decrease was partially offset by the repeal of the U.S. Domestic Production Activities Deduction in 2018. We recorded an income tax benefit of less than \$0.1 million for the six months ended June 30, 2018 compared to income tax expense of \$1.1 million for the six months ended July 1, 2017. The decrease in income tax expense for the

first six months of 2018 compared to the first six months of 2017 was primarily due to the reduction in the U.S. corporate tax rate from 35.0% to 21.0% and tax incentives such as the research and development tax credits having a greater impact on the annual effective tax rate as a result of lower pre-tax income in the second quarter of 2018 compared to the second quarter of 2017. The decrease was partially offset by the repeal of the U.S. Domestic Production Activities Deduction in 2018.

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Our total amount of unrecognized tax benefits was \$5.4 million and \$5.3 million as of June 30, 2018 and December 31, 2017, respectively. If recognized, \$3.6 million would affect the effective tax rate. The decrease in unrecognized tax benefits as of June 30, 2018 compared to March 31, 2018 is related to a change in our accounting treatment of advance payments for tax purposes. We filed an Application for Change in Accounting Method (“Form 3115”) with the IRS to provide for different treatment of advanced payments for tax purposes compared to book purposes in the second quarter of 2018. Upon filing the automatic method change, audit protection was provided for tax years subject to examination and we reclassified the unrecognized tax benefits to deferred tax liabilities. We do not reasonably expect significant increases or decreases to our unrecognized tax benefits in the next twelve months.

Net Income and Earnings per Share

Net income and earnings per share for the three months ended June 30, 2018 were \$1.6 million, or \$0.14 per diluted share, compared to \$3.8 million, or \$0.33 per diluted share, for the three months ended July 1, 2017. The decrease in net income for the three months ended June 30, 2018 compared to the three months ended July 1, 2017 was due to \$5.4 million of restructuring charges, \$0.2 million of which was included in cost of sales. The \$5.8 million increase in gross profit was due to higher revenues that was partially offset by \$1.7 million of higher interest expense and \$1.5 million of higher selling, general and administrative expenses.

Net income and earnings per share for the six months ended June 30, 2018 were \$4.2 million, or \$0.36 per diluted share, compared to \$5.9 million, or \$0.51 per diluted share, for the six months ended July 1, 2017. The decrease in net income for the six months ended June 30, 2018 compared to the six months ended July 1, 2017 was due to \$7.6 million of restructuring charges, \$0.2 million of which was included in cost of sales. The \$7.5 million increase in gross profit was due to higher revenues that was partially offset by \$2.9 million of higher interest expense.

Business Segment Performance

We report our financial performance based upon the two reportable operating segments: Structural Systems and Electronic Systems. The results of operations differ between our reportable operating segments due to differences in competitors, customers, extent of proprietary deliverables and performance. The following table summarizes our business segment performance for the three and six months ended June 30, 2018 and July 1, 2017:

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| | Three Months Ended | | | | | Six Months Ended | | | | |
|--|--------------------|------------------|-----------------|----------------------|-----------------|------------------|------------------|-----------------|----------------------|-----------------|
| | % Change | (In thousands) | | % of Net Revenues | | % Change | (In thousands) | | % of Net Revenues | |
| | | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 | | June 30, 2018 | July 1, 2017 | June 30, 2018 | July 1, 2017 |
| Net Revenues | | | | | | | | | | |
| Structural Systems | 19.0% | \$70,325 | \$59,112 | 45.4% | 41.9% | 18.6% | \$138,372 | \$116,687 | 45.3% | 42.1% |
| Electronic Systems | 3.3% | 84,502 | 81,826 | 54.6% | 58.1% | 4.0% | 166,910 | 160,548 | 54.7% | 57.9% |
| Total Net Revenues Segment | 9.9% | \$154,827 | \$140,938 | 100.0% | 100.0% | 10.1% | \$305,282 | \$277,235 | 100.0% | 100.0% |
| Operating Income | | | | | | | | | | |
| Structural Systems | | \$5,026 | \$2,127 | 7.1% | 3.6% | | \$9,417 | \$4,837 | 6.8% | 4.1% |
| Electronic Systems | | 8,668 | 8,894 | 10.3% | 10.9% | | 14,412 | 16,072 | 8.6% | 10.0% |
| Corporate General and Administrative Expenses ⁽¹⁾ | | 13,694 | 11,021 | | | | 23,829 | 20,909 | | |
| Total Operating Income | | (8,098) | (4,398) | (5.2)% | (3.1)% | | (12,978) | (10,034) | (4.3)% | (3.6)% |
| Adjusted EBITDA | | \$5,596 | \$6,623 | 3.6% | 4.7% | | \$10,851 | \$10,875 | 3.6% | 3.9% |
| Structural Systems Operating Income | | \$5,026 | \$2,127 | | | | \$9,417 | \$4,837 | | |
| Depreciation and Amortization | | 2,618 | 2,307 | | | | 4,934 | 4,659 | | |
| Restructuring Charges | | 3,610 | — | | | | 5,137 | — | | |
| Inventory Purchase Accounting Adjustments | | 329 | — | | | | 329 | — | | |
| Electronic Systems Operating Income | | 11,583 | 4,434 | 16.5% | 7.5% | | 19,817 | 9,496 | 14.3% | 8.1% |
| Depreciation and Amortization | | 8,668 | 8,894 | | | | 14,412 | 16,072 | | |
| | | 3,683 | 3,439 | | | | 7,315 | 6,862 | | |

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| | | | | | | | | | | |
|--|----------|----------|--------|--------|--|-----------|-----------|--------|--------|--|
| Restructuring Charges | 735 | — | | | | 1,255 | — | | | |
| | 13,086 | 12,333 | 15.5 % | 15.1 % | | 22,982 | 22,934 | 13.8 % | 14.3 % | |
| Corporate General and Administrative Expenses ⁽¹⁾ | | | | | | | | | | |
| Operating Loss | (8,098) | (4,398) | | | | (12,978) | (10,034) | | | |
| Depreciation and Amortization | 33 | 2 | | | | 66 | 9 | | | |
| Stock-Based Compensation Expense | 1,025 | 1,342 | | | | 2,115 | 3,164 | | | |
| Restructuring Charges | 1,061 | — | | | | 1,187 | — | | | |
| | (5,979) | (3,054) | | | | (9,610) | (6,861) | | | |
| Adjusted EBITDA | \$18,690 | \$13,713 | 12.1 % | 9.7 % | | \$33,189 | \$25,569 | 10.9 % | 9.2 % | |
| Capital Expenditures | | | | | | | | | | |
| Structural Systems | \$1,101 | \$7,580 | | | | \$2,630 | \$12,768 | | | |
| Electronic Systems | 1,478 | 1,030 | | | | 4,212 | 2,463 | | | |
| Corporate Administration | 190 | 648 | | | | 190 | 648 | | | |
| Total Capital Expenditures | \$2,769 | \$9,258 | | | | \$7,032 | \$15,879 | | | |

(1) Includes costs not allocated to either the Structural Systems or Electronic Systems operating segments.

Structural Systems

Structural Systems' net revenues in the three months ended June 30, 2018 compared to the three months ended July 1, 2017 increased \$11.2 million due to the following:

\$10.7 million higher revenues in our commercial aerospace end-use markets due to higher build rates which favorably impacted our large aircraft platforms; and

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\$0.5 million higher revenues in our military and space end-use markets.

Structural Systems' net revenues in the six months ended June 30, 2018 compared to the six months ended July 1, 2017 increased \$21.7 million due to \$21.7 million higher revenues in our commercial aerospace end-use markets due to higher build rates which favorably impacted our large aircraft platforms.

The Structural Systems segment operating income in the three and six months ended June 30, 2018 compared to the three and six months ended July 1, 2017 increased \$2.9 million and \$4.6 million, respectively due to favorable product mix, favorable manufacturing volume, partially offset by higher compensation and benefits costs and restructuring charges.

Electronic Systems

Electronic Systems' net revenues in the three months ended June 30, 2018 compared to the three months ended July 1, 2017 increased \$2.7 million due to the following:

- \$5.4 million higher revenues in our commercial aerospace end-use markets due to increased build rates which favorably impacted our large aircraft platforms; partially offset by
- \$2.4 million lower revenues in our industrial end-use markets and \$0.3 million lower revenues in our military and space end-use markets.

Electronic Systems' net revenues in the six months ended June 30, 2018 compared to the six months ended July 1, 2017 increased \$6.4 million due to the following:

- \$7.9 million higher revenues in our commercial aerospace end-use markets due to increased build rates which favorably impacted our large aircraft platforms; and
- \$2.6 million higher revenues in our military and space end-use markets; partially offset by
- \$4.1 million lower revenues in our industrial end-use markets.

Electronic Systems' segment operating income in the three and six months ended June 30, 2018 compared to the three and six months ended July 1, 2017 decreased \$0.2 million and \$1.7 million, respectively, due to restructuring charges, unfavorable product mix, and higher compensation and benefits costs, partially offset by favorable manufacturing volume.

Corporate General and Administrative ("CG&A") Expenses

CG&A expenses increased \$3.7 million in the three months ended June 30, 2018 compared to the three months ended July 1, 2017 due to higher compensation and benefit costs of \$1.4 million and higher professional services fees of \$1.2 million, which includes acquisition related costs of \$0.3 million.

CG&A expenses increased \$2.9 million in the six months ended June 30, 2018 compared to the six months ended July 1, 2017 due to higher professional services fees of \$1.7 million, which includes acquisition related costs of \$0.6 million, and higher compensation and benefit costs of \$1.0 million .

Backlog

We define backlog as potential revenue and is based on customer placed purchase orders ("POs") and long-term agreements ("LTAs") with firm fixed price and firm delivery dates of 24 months or less. The majority of the LTAs do not meet the definition of a contract under ASC 606 and thus, the backlog amount disclosed below is greater than the backlog amount disclosed in Note 1 to our condensed consolidated financial statements included in Part I, Item 1 of this Form 10-Q. Backlog is subject to delivery delays or program cancellations, which are beyond our control.

Backlog is affected by timing differences in the placement of customer orders and tends to be concentrated in several programs to a greater extent than our net revenues. Backlog in industrial markets tends to be of a shorter duration and is generally fulfilled within a three month period. As a result of these factors, trends in our overall level of backlog may not be indicative of trends in our future net revenues.

The increase in backlog was primarily in the commercial aerospace end-use markets and defense technologies end-use markets. \$558.0 million of total backlog is expected to be delivered over the next 12 months. The following table summarizes our backlog as of June 30, 2018 and December 31, 2017:

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| | (In thousands) | | |
|------------------------------|----------------|------------------|-------------------------|
| | Change | June 30, 2018 | December 31, 2017 |
| Consolidated Ducommun | | | |
| Military and space | \$45,805 | \$323,234 | \$277,429 |
| Commercial aerospace | 41,525 | 459,506 | 417,981 |
| Industrial | 9,149 | 40,217 | 31,068 |
| Total | \$96,479 | \$822,957 | \$726,478 |
| Structural Systems | | | |
| Military and space | \$27,406 | \$88,327 | \$60,921 |
| Commercial aerospace | 33,659 | 395,245 | 361,586 |
| Total | \$61,065 | \$483,572 | \$422,507 |
| Electronic Systems | | | |
| Military and space | \$18,399 | \$234,907 | \$216,508 |
| Commercial aerospace | 7,866 | 64,261 | 56,395 |
| Industrial | 9,149 | 40,217 | 31,068 |
| Total | \$35,414 | \$339,385 | \$303,971 |

Liquidity and Capital Resources

Available Liquidity

Total debt, the weighted-average interest rate, cash and cash equivalents and available credit facilities were as follows:

| | (In millions) | | | |
|---|------------------|-------------------------|---|--|
| | June 30, 2018 | December 31, 2017 | | |
| Total debt, including long-term portion | \$232.7 | \$218.1 | | |
| Weighted-average interest rate on debt | 4.31 | % 3.73 | % | |
| Term Loan interest rate | 4.55 | % 3.74 | % | |
| Cash and cash equivalents | \$3.5 | \$2.2 | | |
| Unused Revolving Credit Facility | \$127.0 | \$141.6 | | |

Our credit facility consists of a \$275.0 million senior secured term loan, which matures on June 26, 2020 (“Term Loan”), and a \$200.0 million senior secured revolving credit facility (“Revolving Credit Facility”), which matures on June 26, 2020 (collectively, the “Credit Facilities”). We are required to make mandatory prepayments of amounts outstanding under the Term Loan. As of June 30, 2018, we were in compliance with all covenants required under the Credit Facilities. See Note 9 to our condensed consolidated financial statements included in Part I, Item 1 of this Form 10-Q for further information. In July 2017, we entered into a technical amendment to the Credit Facilities (“First Amendment”) which provides more flexibility to close certain qualified acquisitions permitted under the Credit Facilities. We have made all mandatory prepayments under the Term Loan and thus, no mandatory payments are due until the Term Loan matures in June 2020.

In October 2015, we entered into interest rate cap hedges designated as cash flow hedges with maturity dates of June 2020, and in aggregate, totaling \$135.0 million of our debt. We paid a total of \$1.0 million in connection with entering into the interest rate cap hedges.

On April 23, 2018, we acquired Certified Thermoplastics Co., LLC (“CTP”) for a purchase price of \$30.5 million, net of cash acquired, all payable in cash. Upon the closing of the transaction, we paid \$31.1 million in cash by drawing down on the Revolving Credit Facility. See Note 3 to our condensed consolidated financial statements included in Part I, Item 1 of this Form 10-Q.

In September 2017, we acquired LDS for a purchase price of \$60.0 million, net of cash acquired, all payable in cash. Upon the closing of the transaction, we paid \$61.4 million in cash by drawing down on the Revolving Credit Facility.

The remaining \$0.6

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million was paid in October 2017 in cash, also by drawing down on the Revolving Credit Facility. See Note 3 to our condensed consolidated financial statements included in Part I, Item 1 of this Form 10-Q.

We expect to spend a total of \$15.0 million to \$17.0 million for capital expenditures in 2018 financed by cash generated from operations, principally to support new contract awards in Structural Systems and Electronic Systems. As part of our strategic plan to become a Tier 2 supplier and win new contract awards, additional up-front investment in tooling will be required for newer programs which have higher engineering content and higher levels of complexity in assemblies.

We believe the ongoing aerospace and defense subcontractor consolidation makes acquisitions an increasingly important component of our future growth. We will continue to make prudent acquisitions and capital expenditures for manufacturing equipment and facilities to support long-term contracts for commercial and military aircraft and defense programs.

We continue to depend on operating cash flow and the availability of our Credit Facilities to provide short-term liquidity. Cash generated from operations and bank borrowing capacity are expected to provide sufficient liquidity to meet our obligations during the next twelve months.

In November 2017, management approved and commenced a restructuring plan that was intended to increase operating efficiencies. We continue to evaluate a number of possible scenarios to execute the second phase of the restructuring plan, which will result in additional restructuring charges during 2018. On an annualized basis, beginning in 2019, we anticipate these restructuring actions will result in estimated total savings of \$14.0 million.

Cash Flow Summary

Net cash provided by operating activities for the six months ended June 30, 2018 increased to \$26.2 million, compared to \$16.2 million for the six months ended July 1, 2017. The higher net cash generated during the first six months of 2018 was due to lower accounts receivable, partially offset by higher inventories.

Net cash used in investing activities was \$38.4 million for the six months ended June 30, 2018 compared to \$16.2 million in the six months ended July 1, 2017. The higher net cash used in the first six months of 2018 compared to the prior year was due to the payments for the purchase of CTP, net of cash acquired of \$31.0 million, partially offset by lower purchases of property and equipment.

Net cash provided by financing activities for the six months ended June 30, 2018 of \$13.6 million was due to higher net borrowings on the Revolving Credit Facility.

Off-Balance Sheet Arrangements

Our off-balance sheet arrangements consist of operating leases and indemnities.

Critical Accounting Policies

The preparation of our condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States requires estimation and judgment that affect the reported amounts of net revenues, expenses, assets and liabilities. For a description of our critical accounting policies, please refer to “Critical Accounting Policies” in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our 2017 Annual Report on Form 10-K. As a result of adopting ASC 606 as of January 1, 2018, there have been material changes in our critical accounting policies during the six months ended June 30, 2018, and are described in Note 1 and Note 2 to our condensed consolidated financial statements included in Part I, Item I of this Form 10-Q.

Recent Accounting Pronouncements

See “Part I, Item 1. Ducommun Incorporated and Subsidiaries—Notes to Condensed Consolidated Financial Statements—Note 1. Summary of Significant Accounting Policies—Recent Accounting Pronouncements” for further information.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our main market risk exposure relates to changes in U.S. interest rates on our outstanding long-term debt. At June 30, 2018, we had total borrowings of \$232.7 million under our Credit Facilities which bear interest, at our option, at a rate

equal to either an alternate base rate or an adjusted LIBOR rate for a one-, two-, three-, or six-month interest period chosen by us, plus an applicable margin percentage. This LIBOR rate has a margin ranging from 1.50% to 2.75%. A hypothetical 10% increase or decrease in the interest rate would have an immaterial impact on our financial condition and results of operations.

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Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company's chief executive officer ("CEO") and chief financial officer ("CFO") have conducted an evaluation of the Company's disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(e)), that such disclosure controls were effective as of the end of the period covered by this report.

Changes in Internal Control over Financial Reporting

There were no changes in our internal controls over financial reporting during the three months ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See Note 13 to our condensed consolidated financial statements included in Part I, Item 1 of this Form 10-Q for a description of our legal proceedings.

Item 1A. Risk Factors

See Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2017 for a discussion of our risk factors. There have been no material changes in the six months ended June 30, 2018 to the risk factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 4. Mine Safety Disclosures

Not applicable.

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Item 6. Exhibits

- 2.1 Agreement and Plan of Merger, dated as of April 3, 2011, among Ducommun Incorporated, DLBMS, Inc. and LaBarge, Inc. Incorporated by reference to Exhibit 2.1 to Form 8-K filed on April 5, 2011.
- 2.2 Agreement and Plan of Merger, dated as of September 11, 2017, among Ducommun LaBarge Technologies, Inc., LS Holdings Company LLC, and DLS Company LLC. Incorporated by reference to Exhibit 2.1 to Form 8-K filed on September 11, 2017.
- 2.3 Stock Purchase Agreement dated January 22, 2016, by and among Ducommun Incorporated, Ducommun LaBarge Technologies, Inc., as Seller, LaBarge Electronics, Inc., and Intervala, LLC, as Buyer. Incorporated by reference to Exhibit 2.1 to Form 8-K dated January 25, 2016.
- 2.4 Stock Purchase Agreement dated February 24, 2016, by and between Ducommun LaBarge Technologies, Inc., as Seller, and General Atomics, as Buyer. Incorporated by reference to Exhibit 2.1 to Form 8-K dated February 24, 2016.
- 3.1 Restated Certificate of Incorporation filed with the Delaware Secretary of State on May 29, 1990. Incorporated by reference to Exhibit 3.1 to Form 10-K for the year ended December 31, 1990.
- 3.2 Certificate of Amendment of Certificate of Incorporation filed with the Delaware Secretary of State on May 27, 1998. Incorporated by reference to Exhibit 3.2 to Form 10-K for the year ended December 31, 1998.
- 3.3 Bylaws as amended and restated on March 19, 2013. Incorporated by reference to Exhibit 99.1 to Form 8-K dated March 22, 2013.
- 3.4 Amendment to Bylaws dated January 5, 2017. Incorporated by reference to Exhibit 99.2 to Form 8-K dated January 9, 2017.
- 3.5 Amendment to Bylaws dated February 21, 2018. Incorporated by reference to Exhibit 3.1 to Form 8-K dated February 26, 2018.
- 10.1 Credit Agreement, dated as of June 26, 2015, among Ducommun Incorporated, certain of its subsidiaries, Bank of America, N.A., as administrative agent, swingline lender and issuing bank, and other lenders party thereto. Incorporated by reference to Exhibit 10.1 to Form 8-K dated June 26, 2015.
- 10.2 First Amendment to Credit Agreement, dated as of July 14, 2017, among Ducommun Incorporated, certain of its subsidiaries, Bank of America, N.A., as administrative agent, swingline lender and issuing bank, and other lenders party thereto. Incorporated by reference to Exhibit 10.2 to Form 10-Q for the period ended July 1, 2017.
- *10.3 2007 Stock Incentive Plan. Incorporated by reference to Appendix B of Definitive Proxy Statement on Schedule 14a, filed on March 29, 2010.
- *10.4 2013 Stock Incentive Plan (Amended and Restated March 18, 2015). Incorporated by reference to Appendix B of Definitive Proxy Statement on Schedule 14a, filed on April 22, 2015.
- *10.5 2013 Stock Incentive Plan (Amended and Restated May 2, 2018). Incorporated by reference to Appendix A of Definitive Proxy Statement on Schedule 14a, filed on March 23, 2018.
- *10.6 2018 Employee Stock Purchase Plan. Incorporated by reference to Appendix B of Definitive Proxy Statement on Schedule 14a, filed on March 23, 2018.
- *10.7 Form of Stock Option Agreement for 2016 and earlier. Incorporated by reference to Exhibit 10.8 to Form 10-K for the year ended December 31, 2003.
- *10.8 Form of Stock Option Agreement for 2017. Incorporated by reference to Exhibit 10.5 to Form 10-K for the year ended December 31, 2016.
- *10.9 Form of Stock Option Agreement for 2018 and after. Incorporated by reference to Exhibit 4.7 to Form S-8, filed on May 10, 2018.
- *10.10 Form of Performance Stock Unit Agreement for 2014 and 2015. Incorporated by reference to Exhibit 10.19 to Form 10-Q dated April 28, 2014.
- *10.11 Form of Performance Stock Unit Agreement for 2016. Incorporated by reference to Exhibit 10.6 to Form 10-Q for the period ended April 2, 2016.
- *10.12 Form of Performance Stock Unit Agreement for 2017. Incorporated by reference to Exhibit 10.21 to Form 10-Q for the period ended April 1, 2017.
- *10.13 Form of Restricted Stock Unit Agreement for 2016 and earlier. Incorporated by reference to Exhibit 99.1 to Form 8-K dated May 8, 2007.

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*10.14 Form of Restricted Stock Unit Agreement for 2017 and after. Incorporated by reference to Exhibit 10.9 to Form 10-K for the year ended December 31, 2016.

*10.15 Form of Directors' Restricted Stock Unit Agreement. Incorporated by reference to Exhibit 99.1 to Form 8-K dated May 10, 2010.

*10.16 Performance Restricted Stock Unit Agreement dated January 23, 2017 between Ducommun Incorporated and Stephen G. Oswald. Incorporated by reference to Exhibit 10.11 to Form 10-K for the year ended December 31, 2016.

Form of Indemnity Agreement entered with all directors and officers of Ducommun. Incorporated by reference to Exhibit 10.8 to Form 10-K for the year ended December 31, 1990. All of the Indemnity Agreements are identical except for the name of the director or officer and the date of the Agreement:

| Director/Officer | Date of Agreement |
|------------------------|-------------------|
| Richard A. Baldrige | March 19, 2013 |
| Gregory S. Churchill | March 19, 2013 |
| Robert C. Ducommun | December 31, 1985 |
| Dean M. Flatt | November 5, 2009 |
| Douglas L. Groves | February 12, 2013 |
| Jay L. Haberland | February 2, 2009 |
| Stephen G. Oswald | January 23, 2017 |
| Robert D. Paulson | March 25, 2003 |
| Jerry L. Redondo | October 1, 2015 |
| Rosalie F. Rogers | July 24, 2008 |
| Christopher D. Wampler | January 1, 2016 |

*10.18 Ducommun Incorporated 2016 Bonus Plan. Incorporated by reference to Exhibit 99.3 to Form 8-K dated March 1, 2016.

*10.19 Ducommun Incorporated 2017 Bonus Plan. Incorporated by reference to Exhibit 99.1 to Form 8-K dated February 27, 2017.

*10.20 Directors' Deferred Compensation and Retirement Plan, as amended and restated February 2, 2010. Incorporated by reference to Exhibit 10.15 to Form 10-K for the year ended December 31, 2009.

*10.21 Key Executive Severance Agreement between Ducommun Incorporated and Stephen G. Oswald dated January 23, 2017. Incorporated by reference to Exhibit 99.1 to Form 8-K dated January 27, 2017.

*10.22 Form of Key Executive Severance Agreement between Ducommun Incorporated and each of the individuals listed below. Incorporated by reference to Exhibit 99.2 to Form 8-K dated January 27, 2017. All of the Key Executive Severance Agreements are identical except for the name of the person and the address for notice:

| Person | Date of Agreement |
|------------------------|-------------------|
| Douglas L. Groves | January 23, 2017 |
| Jerry L. Redondo | January 23, 2017 |
| Rosalie F. Rogers | January 23, 2017 |
| Christopher D. Wampler | January 23, 2017 |

*10.23 Employment Letter Agreement dated January 3, 2017 between Ducommun Incorporated and Stephen G. Oswald. Incorporated by reference to Exhibit 99.1 to Form 8-K dated January 9, 2017.

*10.24 Employment Letter Agreement dated December 19, 2016 between Ducommun Incorporated and Amy M. Paul. Incorporated by reference to Exhibit 10.19 to Form 10-K for the year ended December 31, 2016.

*10.25 Transition Services Letter Agreement dated January 10, 2017 between Ducommun Incorporated and James S. Heiser. Incorporated by reference to Exhibit 99.1 to Form 8-K dated January 16, 2017.

*10.26 Separation and Release Agreement dated May 16, 2018 between Ducommun Incorporated and Amy M. Paul. Incorporated by reference to Exhibit 10.1 to Form 8-K dated May 23, 2018.

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31.1 Certification of Principal Executive Officer.

31.2 Certification of Principal Financial Officer.

32 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema

101.CAL XBRL Taxonomy Extension Calculation Linkbase

101.DEF XBRL Taxonomy Extension Definition Linkbase

101.LAB XBRL Taxonomy Extension Label Linkbase

101.PRE XBRL Taxonomy Extension Presentation Linkbase

* Indicates an executive compensation plan or arrangement.

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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.

Date: August 6, 2018 By: /s/ Stephen G. Oswald
Stephen G. Oswald
Chairman, President and Chief Executive Officer
(Principal Executive Officer)

Date: August 6, 2018 By: /s/ Douglas L. Groves
Douglas L. Groves
Vice President, Chief Financial Officer and Treasurer
(Principal Financial Officer)

Date: August 6, 2018 By: /s/ Christopher D. Wampler
Christopher D. Wampler
Vice President, Controller and Chief Accounting Officer
(Principal Accounting Officer)