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FAIRCHILD CORP

Form 10-Q

May 10, 2002

28

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 March 31, 2002 Commission File Number 1-6560

THE FAIRCHILD CORPORATION
(Exact name of Registrant as specified in its charter)

Delaware 34-0728587
(State or other jurisdiction of (I.R.S. Employer Identification No.)
Incorporation or organization)

45025 Aviation Drive, Suite 400, Dulles, VA 20166
(Address of principal executive offices)

(703) 478-5800
(Registrant's telephone number, including area code)

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

YES X NO

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

| Title of Class | Outstanding at March 31, 2002 |
|--|----------------------------------|
| Class A Common Stock, \$0.10 Par Value | 22,540,021 |
| Class B Common Stock, \$0.10 Par Value | 2,621,502 |

THE FAIRCHILD CORPORATION INDEX TO QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED MARCH 31, 2002

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| | Page |
|---|------|
| PART I. FINANCIAL INFORMATION | |
| Item 1. Condensed Consolidated Balance Sheets as of March 31, 2002 (Unaudited) and June 30, 2001..... | 3 |
| Condensed Consolidated Statements of Earnings (Unaudited) for the Three And Nine Months ended March 31, 2002 and April 1, 2001..... | 5 |
| Condensed Consolidated Statements of Cash Flows (Unaudited) for the Nine Months ended March 31, 2002 and April 1, 2001 | 6 |
| Notes to Condensed Consolidated Financial Statements (Unaudited) | 7 |
| Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition..... | 19 |
| Item 3. Quantitative and Qualitative Disclosure About Market Risk | 25 |
| PART II. OTHER INFORMATION | |
| Item 1. Legal Proceedings..... | 27 |
| Item 2. Changes in Securities and Use of Proceeds..... | 27 |
| Item 5. Other Information..... | 27 |
| Item 6. Exhibits and Reports on Form 8-K..... | 27 |

All references in this Quarterly Report on Form 10-Q to the terms "we," "our," "us," the "Company" and "Fairchild" refer to The Fairchild Corporation and its subsidiaries. All references to "fiscal" in connection with a year shall mean the 12 months ended June 30.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
March 31, 2002 (Unaudited) and June 30, 2001
(In thousands)

ASSETS

Marc

CURRENT ASSETS:

Cash and cash equivalents, \$572 and \$1,184 restricted
 Short-term investments
 Accounts receivable-trade, less allowances of \$5,895 and \$6,951
 Inventories:
 Finished goods
 Work-in-process
 Raw materials

Prepaid expenses and other current assets

Total Current Assets

Property, plant and equipment, net of accumulated
 depreciation of \$175,927 and \$156,914
 Net assets held for sale
 Goodwill
 Investments and advances, affiliated companies
 Prepaid pension assets
 Deferred loan costs
 Real estate investment
 Long-term investments
 Other assets

TOTAL ASSETS

\$

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES
 CONDENSED CONSOLIDATED BALANCE SHEETS
 March 31, 2002 (Unaudited) and June 30, 2001
 (In thousands)

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:

Bank notes payable and current maturities of long-term debt
 Accounts payable
 Accrued liabilities:
 Salaries, wages and commissions
 Employee benefit plan costs
 Insurance
 Interest

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| | |
|--|----------------------|
| Other accrued liabilities | ----- |
| Total Current Liabilities | |
| LONG-TERM LIABILITIES: | |
| Long-term debt, less current maturities | |
| Fair value of interest rate contract | |
| Other long-term liabilities | |
| Retiree health care liabilities | |
| Noncurrent income taxes | ----- |
| TOTAL LIABILITIES | |
| STOCKHOLDERS' EQUITY: | |
| Class A common stock, \$0.10 par value; 40,000 shares authorized, 30,347 (30,335 in June) shares issued and 22,540 (22,528 in June) shares outstanding | |
| Class B common stock, \$0.10 par value; 20,000 shares authorized, 2,622 shares issued and outstanding | |
| Paid-in capital | |
| Treasury stock, at cost, 7,807 shares of Class A common stock | |
| Retained earnings | |
| Notes due from stockholders | |
| Cumulative other comprehensive income | ----- |
| TOTAL STOCKHOLDERS' EQUITY | ----- |
| TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY | ----- \$ ----- |

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF EARNINGS (Unaudited)
For The Three (3) and Nine (9) Months Ended March 31, 2002 and
April 1, 2001 (In thousands, except per share data)

| | Three Months Ended | |
|-----------------------------------|--------------------|--------|
| | 03/31/02 | 04/01 |
| REVENUE: | ----- | ----- |
| Net sales | \$153,231 | \$162, |
| Rental revenue | 1,625 | 1, |
| Other income (expense), net | 1,357 | (1,1 |
| | ----- | ----- |
| | 156,213 | 162, |
| COSTS AND EXPENSES: | | |
| Cost of goods sold | 115,595 | 119, |
| Cost of rental revenue | 1,173 | |
| Selling, general & administrative | 32,106 | 32, |
| Amortization of intangibles | - | 3, |
| | ----- | ----- |

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| | | |
|---|------------|----------|
| | 148,874 | 156, |
| OPERATING INCOME | 7,339 | 6, |
| Interest expense | 12,788 | 13, |
| Interest income | (1,052) | (7) |
| Net interest expense | 11,736 | 12, |
| Investment income (loss) | 30 | 4, |
| Change in fair market value of interest rate contract | 1,924 | (3,3 |
| Loss from continuing operations before taxes | (2,443) | (5,2 |
| Income tax benefit | 3,081 | 1, |
| Equity in earnings (loss) of affiliates, net | (132) | |
| NET EARNINGS (LOSS) | \$ 506 | \$ (3,4 |
| Other comprehensive income (loss), net of tax: | | |
| Foreign currency translation adjustments | (5,341) | (6,0 |
| Unrealized holding changes on derivatives | 14 | |
| Unrealized periodic holding changes on securities | (408) | (2,9 |
| Other comprehensive loss | (5,735) | (8,9 |
| COMPREHENSIVE INCOME (LOSS) | \$ (5,229) | \$ (12,4 |
| BASIC AND DILUTED EARNINGS (LOSS) PER SHARE: | | |
| NET EARNINGS (LOSS) | \$ 0.02 | (0. |
| Other comprehensive income (loss), net of tax: | | |
| Foreign currency translation adjustments | \$ (0.21) | \$ (0. |
| Unrealized holding changes on derivatives | - | |
| Unrealized periodic holding changes on securities | (0.02) | (0. |
| Other comprehensive loss | (0.23) | (0. |
| COMPREHENSIVE INCOME (LOSS) | \$ (0.21) | \$ (0. |
| Weighted average shares outstanding: | | |
| Basic | 25,158 | 25, |
| Diluted | 25,164 | 25, |

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
 For The Nine (9) Months Ended March 31, 2002 and April 1, 2001
 (In thousands)

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Cash flows from operating activities:

Net loss
Depreciation and amortization
Amortization of deferred loan fees
Unrealized holding loss on derivatives
Paid-in kind interest income
Loss (gain) on sale of investments
Undistributed (earnings) loss of affiliates, net
Change in assets and liabilities

Net cash provided by (used for) operating activities

Cash flows from investing activities:

Purchase of property, plant and equipment
Net proceeds received from the sale of property, plant, and equipment
Net proceeds received from investment securities
Real estate investment
Equity investment in affiliates
Proceeds received from net assets held for sale
Change in notes receivable

Net cash provided by investing activities

Cash flows from financing activities:

Proceeds from issuance of debt
Debt repayments
Issuance of Class A common stock
Net loans to stockholders'

Net cash provided by (used for) financing activities

Effect of exchange rate changes on cash

Net change in cash and cash equivalents

Cash and cash equivalents, beginning of the year

Cash and cash equivalents, end of the period

The accompanying Notes to Consolidated Financial Statements are an integral part of these statements.

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands, except share data)

1. FINANCIAL STATEMENTS

The consolidated balance sheet as of March 31, 2002, and the consolidated statements of earnings and cash flows for the nine months ended March 31, 2002 and April 1, 2001 have been prepared by us, without audit. In the opinion of management, all adjustments (consisting of normal recurring adjustments)

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necessary to present fairly the financial position, results of operations and cash flows at March 31, 2002, and for all periods presented, have been made. The balance sheet at June 30, 2001 was condensed from the audited financial statements as of that date.

Certain information and footnote disclosures normally included in financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in our 2001 Annual Report on Form 10-K. The results of operations for the period ended March 31, 2002 are not necessarily indicative of the operating results for the full year. Certain amounts in the prior year's quarterly financial statements have been reclassified to conform to the current presentation.

2. EQUITY SECURITIES

We had 22,540,021 shares of Class A common stock and 2,621,502 shares of Class B common stock outstanding at March 31, 2002. Class A common stock is traded on both the New York and Pacific Stock Exchanges. There is no public market for the Class B common stock. The shares of Class A common stock are entitled to one vote per share and cannot be exchanged for shares of Class B common stock. The shares of Class B common stock are entitled to ten votes per share and can be exchanged, at any time, for shares of Class A common stock on a share-for-share basis.

During the nine months ended March 31, 2002, we issued 12,220 shares of Class A common stock as a result of the pay out of 12,220 deferred compensation units pursuant to our stock option deferral plan. During the nine months ended March 31, 2002, stock warrants entitled to purchase 400,000 shares of our common stock expired.

3. RESTRICTED CASH

On March 31, 2002 and June 30, 2001, we had restricted cash of \$572 and \$1,184, respectively, all of which is maintained as collateral for certain debt facilities and escrow arrangements.

4. EARNINGS PER SHARE

The following table illustrates the computation of basic and diluted earnings per share:

| | Three Months Ended | |
|--|--------------------|---------|
| | 3/31/02 | 4/1/01 |
| Basic earnings per share: | | |
| Earnings (loss) from continuing operations | \$ 506 | \$ (3,4 |
| Weighted average common shares outstanding | 25,158 | 25, |
| Basic earnings (loss) from continuing operations per share | \$ 0.02 | \$ (0. |

Diluted earnings per share:

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| | | |
|--|--------------|------------|
| Earnings (loss) from continuing operations | \$ 506 | \$ (3,4 |
| Weighted average common shares outstanding | 25,158 | 25, |
| Options | 6 | antidiluti |
| Warrants | antidilutive | antidiluti |
| Total shares outstanding | 25,164 | 25, |
| Diluted earnings (loss) from continuing operations per share | \$ 0.02 | \$ (0. |

Stock options entitled to purchase 2,131,102 and 2,126,154 shares of Class A common stock were antidilutive and not included in the earnings per share calculation for the three months and nine months ended March 31, 2002, respectively. Stock options entitled to purchase 2,118,835 and 2,213,936 shares of Class A common stock were antidilutive and not included in the earnings per share calculation for the three months and nine months ended April 1, 2001, respectively. Stock warrants entitled to purchase 273,000 and 340,293 shares of Class A common stock were antidilutive and not included in the earnings per share calculation for the three months and nine ended March 31, 2002, respectively. Stock warrants entitled to purchase 400,000 and 519,091 shares of Class A common stock were antidilutive and not included in the earnings per share calculation for the three and nine months ended April 1, 2001, respectively. These shares could be dilutive in future periods.

5. CONTINGENCIES

Environmental Matters

Our operations are subject to stringent government imposed environmental laws and regulations concerning, among other things, the discharge of materials into the environment and the generation, handling, storage, transportation and disposal of waste and hazardous materials. To date, such laws and regulations have not had a material effect on our financial condition, results of operations, or net cash flows, although we have expended, and can be expected to expend in the future, significant amounts for the investigation of environmental conditions and installation of environmental control facilities, remediation of environmental conditions and other similar matters, particularly in our aerospace fasteners segment.

In connection with our plans to dispose of certain real estate, we must investigate environmental conditions and we may be required to take certain corrective action prior or pursuant to any such disposition. In addition, we have identified several areas of potential contamination related to other facilities owned, or previously owned, by us, that may require us either to take corrective action or to contribute to a clean-up. We are also a defendant in certain lawsuits and proceedings seeking to require us to pay for investigation or remediation of environmental matters and we have been alleged to be a potentially responsible party at various "superfund" sites. We believe that we have recorded adequate reserves in our financial statements to complete such investigation and take any necessary corrective actions or make any necessary contributions. No amounts have been recorded as due from third parties, including insurers, or set off against, any environmental liability, unless such parties are contractually obligated to contribute and are not disputing such liability.

As of March 31, 2002, the consolidated total of our recorded liabilities for environmental matters was approximately \$12.4 million, which represented the estimated probable exposure for these matters. It is reasonably possible that our total exposure for these matters could be approximately \$16.6 million.

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Other Matters

We are involved in various other claims and lawsuits incidental to our business. We, either on our own or through our insurance carriers, are contesting these matters. In the opinion of management, the ultimate resolution of the legal proceedings, including those mentioned above, will not have a material adverse effect on our financial condition, future results of operations or net cash flows.

6. BUSINESS SEGMENT INFORMATION

We currently report in three principal business segments: aerospace fasteners, aerospace distribution and real estate operations. The following table provides the historical results of our operations for the three and nine months ended March 31, 2002 and April 1, 2001, respectively.

| | Three Months Ended | |
|---|---------------------|------------------|
| | 3/31/02 | 4/1/01 |
| SALES BY SEGMENT: | | |
| Aerospace Fasteners Segment | \$ 136,960 | \$ 140, |
| Aerospace Distribution Segment | 16,271 | 21, |
| TOTAL SALES | \$ 153,231 | \$ 162, |
| OPERATING RESULTS BY SEGMENT: | | |
| Aerospace Fasteners Segment | \$ 10,155 | \$ 9, |
| Aerospace Distribution Segment | 1,202 | 1, |
| Real Estate Segment (a) | 226 | (7 |
| Corporate and Other Segment | (4,244) | (4,7 |
| TOTAL OPERATING INCOME (b) | \$ 7,339 | \$ 6, |
| EARNINGS (LOSS) FROM CONTINUING OPERATIONS BEFORE TAXES: | | |
| Aerospace Fasteners Segment | \$ 9,611 | \$ 9, |
| Aerospace Distribution Segment | 1,188 | 1, |
| Real Estate Segment | (270) | (1,6 |
| Corporate and Other Segment | (12,972) | (14,5 |
| Total loss from continuing operations before taxes | \$ (2,443) | \$ (5,2 |
| ASSETS BY SEGMENT: | | |
| Aerospace Fasteners Segment | \$ 752,524 | \$ 579, |
| Aerospace Distribution Segment | 40,153 | 46, |
| Real Estate Segment | 115,551 | 116, |
| Corporate and Other Segment | 271,901 | 466, |
| TOTAL ASSETS | \$ 1,180,129 | \$ 1,209, |

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7. RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, "Accounting for Business Combinations." This statement requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001, and establishes specific criteria for the recognition of intangible assets separately from goodwill. We will follow the requirements of this statement for business acquisitions made after June 30, 2001. There were no acquisitions during the nine months ended March 31, 2002.

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142, "Accounting for Goodwill and Other Intangible Assets." This statement requires that goodwill and intangible assets deemed to have an indefinite life not be amortized. Instead of amortizing goodwill and intangible assets deemed to have an indefinite life, the statement requires a test for impairment to be performed annually, or immediately if conditions indicate that such an impairment could exist. The amortization period of intangible assets with finite lives will no longer be limited to forty years. This statement is effective for fiscal years beginning after December 15, 2001, and permits early adoption for fiscal years beginning after March 15, 2001. We have adopted SFAS No. 142 on July 1, 2001. As a result of adopting SFAS No. 142, we will no longer amortize goodwill of approximately \$12.5 million per year. Using the fair value measurement requirement, rather than the undiscounted cash flows approach, we expect to record an impairment from the implementation of SFAS No. 142. The initial evaluation of reporting units on a fair value basis, as required from the implementation of SFAS No. 142, indicates that impairments exist at the reporting units within our aerospace fasteners segment. Based upon the initial evaluation, the estimated range of impairment is between \$60 million to \$65 million. However, once impairment is determined at a reporting unit, SFAS No. 142 requires that the amount of goodwill impairment be determined based on what the balance of goodwill would have been if purchase accounting were applied at the date of impairment. We have not completed that analysis, but we expect to complete this analysis prior to June 30, 2002. If the carrying amount of goodwill exceeds its fair value, an impairment loss must be recognized in an amount equal to that excess. Once an impairment loss is recognized, the adjusted carrying amount of goodwill will become the new accounting basis of goodwill. The actual amount of impairment could be significantly different than the range provided above. We are currently measuring the amount of impairment of goodwill to be recorded from adopting this standard.

The following table provides the comparable effects of adoption of SFAS No. 142 for the three and nine months ended March 31, 2002 and April 1, 2001, respectively:

| | Three Months Ended | |
|---------------------------------|--------------------|---------|
| | 3/31/02 | 4/1/01 |
| Reported net income (loss) | \$ 506 | \$ (3,4 |
| Add back: Goodwill amortization | - | 3, |
| Adjusted net income (loss) | \$ 506 | \$ (3 |

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| | | |
|-----------------------------------|---------|--------|
| Basic and Diluted loss per share: | | |
| Reported net income (loss) | \$ 0.02 | \$ (0. |
| Add back: Goodwill amortization | - | 0 |
| | \$ 0.02 | \$ (0. |

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations". This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and associated asset retirement costs. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development, and normal operation of a long-lived asset, except for certain lease obligations. This statement is effective for fiscal years beginning after June 15, 2002. We are currently evaluating the impact of adopting this standard.

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets," which supersedes SFAS No. 121. Though it retains the basic requirements of SFAS 121 regarding when and how to measure an impairment loss, SFAS 144 provides additional implementation guidance. SFAS 144 applies to long-lived assets to be held and used or to be disposed of, including assets under capital leases of lessees; assets subject to operating leases of lessors; and prepaid assets. SFAS 144 also expands the scope of a discontinued operation to include a component of an entity, and eliminates the current exemption to consolidation when control over a subsidiary is likely to be temporary. This statement is effective for fiscal years beginning after December 15, 2001. We are currently evaluating the impact of adopting this standard.

8. NOTES RECEIVABLE

At March 31, 2002, \$5.3 million of promissory notes were due to us from an unaffiliated third party and are recorded in other assets. The promissory notes earn \$1.4 million of annual cash interest and are being accreted to a face value of \$12.8 million through interest income. The promissory notes are secured by \$12.8 million face value of our outstanding 10.75% senior subordinated debentures due 2009 acquired by the third party. The third party may sell these debentures for cash provided that it satisfies its obligation under its promissory notes.

9. CONSOLIDATING FINANCIAL STATEMENTS

The following unaudited consolidating financial statements show separately The Fairchild Corporation and the subsidiaries of The Fairchild Corporation. These financial statements are provided to fulfill public reporting requirements, and present separately the guarantors of the 10 3/4% senior subordinated notes, due 2009, issued by The Fairchild Corporation. The "parent company" provides the results of The Fairchild Corporation on an unconsolidated basis. The guarantors are composed primarily of our domestic subsidiaries, excluding our shopping center in Farmingdale New York, and certain other subsidiaries.

CONSOLIDATING BALANCE SHEET
MARCH 31, 2002

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| | Parent Company | Guarantors | Non Guarantors |
|---|-------------------|-------------|-------------------|
| | ----- | ----- | ----- |
| Cash and cash equivalents | \$ 11 | \$ 5,433 | \$ 7,8 |
| Marketable securities | 72 | 1,227 | |
| Accounts Receivable (including intercompany), less allowances | 2,447 | 671,920 | 93,5 |
| Inventory, net | - | 137,798 | 50,2 |
| Prepaid expenses and other current assets | 1,080 | 21,316 | 6,1 |
| | ----- | ----- | ----- |
| Total current assets | 3,610 | 837,694 | 157,9 |
| Investment in Subsidiaries | 894,775 | - | |
| Net fixed assets | 485 | 104,512 | 33,3 |
| Net assets held for sale | - | 13,907 | |
| Investments in affiliates | 93 | 3,278 | |
| Goodwill | - | 386,160 | 32,9 |
| Deferred loan costs | 10,834 | 18 | 5 |
| Prepaid pension assets | - | 64,849 | |
| Real estate investment | - | - | 108,3 |
| Long-term investments | 60 | 3,723 | 3,4 |
| Other assets | 17,546 | 6,446 | 9 |
| | ----- | ----- | ----- |
| Total assets | \$ 927,403 | \$1,420,587 | \$ 337,6 |
| | ----- | ----- | ----- |
| Bank notes payable & current maturities of debt | \$ 2,266 | \$ 2,000 | \$ 22,0 |
| Accounts payable (including intercompany) | - | 880,274 | 202,5 |
| Other accrued expenses | (27,184) | 54,957 | 25,9 |
| | ----- | ----- | ----- |
| Total current liabilities | (24,918) | 937,231 | 250,4 |
| Long-term debt, less current maturities | 429,625 | 3,216 | 33,3 |
| Fair market value of interest rate contract | 7,402 | - | |
| Other long-term liabilities | 407 | 19,258 | 4,9 |
| Noncurrent income taxes | 111,122 | (733) | 1 |
| Retiree health care liabilities | - | 37,331 | 2,7 |
| | ----- | ----- | ----- |
| Total liabilities | 523,638 | 996,303 | 291,5 |
| Class A common stock | 3,035 | - | |
| Class B common stock | 262 | - | |
| Notes due from stockholders | (429) | (1,338) | |
| Paid-in-capital | 232,788 | 478,501 | 108,1 |
| Retained earnings | 244,600 | (28,332) | (47,69 |
| Cumulative other comprehensive income | (447) | (24,547) | (14,48 |
| Treasury stock, at cost | (76,044) | - | |
| | ----- | ----- | ----- |
| Total stockholders' equity | 403,765 | 424,284 | 46,0 |
| | ----- | ----- | ----- |
| Total liabilities & stockholders' equity | \$ 927,403 | \$1,420,587 | \$ 337,6 |
| | ----- | ----- | ----- |

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CONSOLIDATING STATEMENTS OF EARNINGS
FOR THE NINE MONTHS ENDED MARCH 31, 2002

| | Parent Company | Guarantors | Non Guarant |
|--|-------------------|-------------|----------------|
| | ----- | ----- | ----- |
| Revenue: | | | |
| Net Sales | \$ - | \$ 367,381 | \$ 123,0 |
| Rental Revenue | - | - | 5,0 |
| Other Income, net | (5) | 4,151 | 2,3 |
| | ----- | ----- | ----- |
| | (5) | 371,532 | 130,4 |
| Costs and expenses: | | | |
| Cost of sales | - | 284,524 | 89,0 |
| Cost of rental revenue | - | - | 3,7 |
| Selling, general & administrative | 6,867 | 71,921 | 19,3 |
| | ----- | ----- | ----- |
| | 6,867 | 356,445 | 112,0 |
| Operating income (loss) | (6,872) | 15,087 | 18,3 |
| Net interest expense (including intercompany) | (14,112) | 44,859 | 3,9 |
| Investment income (loss), net | 10 | (261) | |
| Intercompany dividends | - | 1,577 | |
| Decrease in market value of interest rate contract | 980 | - | |
| | ----- | ----- | ----- |
| Earnings (loss) before taxes | 6,270 | (31,610) | 14,3 |
| Income tax (provision) benefit | (4,177) | 21,058 | (9,56) |
| Equity in earnings of affiliates and subsidiaries | (4,279) | (152) | |
| | ----- | ----- | ----- |
| Net earnings (loss) | \$ (2,186) | \$ (10,704) | \$ 4,7 |
| | ----- | ----- | ----- |

CONSOLIDATING CASH FLOWS
FOR THE NINE MONTHS ENDED MARCH 31, 2002

| | Parent Company | Guarantors | Non Guarant |
|---------------------------------------|-------------------|-------------|----------------|
| | ----- | ----- | ----- |
| Cash Flows from Operating Activities: | | | |
| Net earnings (loss) | \$ (2,186) | \$ (10,704) | \$ 4,7 |
| Depreciation & amortization | 30 | 14,943 | 7,6 |
| Amortization of deferred loan fees | 1,156 | 2 | 3 |

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| | | | |
|--|----------|----------|--------|
| Unrealized holding (gain) loss on derivatives | 980 | - | |
| Undistributed (distributed) earnings of affiliates | (53) | 152 | |
| Change in assets and liabilities | 1,403 | (813) | (8,34) |
| | ----- | ----- | ----- |
| Net cash (used for) provided by operating activities | 1,330 | 3,580 | 4,5 |
| Cash Flows from Investing Activities: | | | |
| Proceeds received from (used for): | | | |
| Capital Expenditures | (14) | (6,627) | (2,51) |
| Investment securities, net | - | 895 | |
| Sale of fixed assets | - | 3,593 | 3 |
| Equity investment in affiliates | (414) | | |
| Real estate investment | - | - | (32) |
| Proceeds received from net assets held for sale | - | 4,023 | |
| Change in notes receivable | (53) | (4,928) | |
| | ----- | ----- | ----- |
| Net cash (used for) provided by investing activities | (481) | (3,044) | (2,40) |
| Cash Flows from Financing Activities: | | | |
| Proceeds from issuance of debt | | | |
| Debt repayments, net | 78,895 | 14,913 | 4 |
| | (80,295) | (16,562) | (2,81) |
| | ----- | ----- | ----- |
| Net cash (used for) provided by financing activities | (1,400) | (1,649) | (2,33) |
| Effect of exchange rate changes on cash | - | - | 1 |
| | ----- | ----- | ----- |
| Net change in cash | (551) | (1,113) | (3) |
| Cash, beginning of the year | 562 | 6,546 | 7,8 |
| | ----- | ----- | ----- |
| Cash, end of the period | \$ 11 | \$ 5,433 | \$ 7,8 |
| | ----- | ----- | ----- |

CONSOLIDATING BALANCE SHEET
JUNE 30, 2001

| | Parent Company | Guarantors | Non Guarantor |
|---|-------------------|------------|------------------|
| | ----- | ----- | ----- |
| Cash | \$ 562 | \$ 6,546 | \$ 7, |
| Marketable securities | 71 | 3,034 | |
| Accounts receivable (including intercompany), net | 2,336 | 628,104 | 84, |
| Inventory, net | - | 144,157 | 44, |
| Prepaid and other current assets | 287 | 22,134 | 7, |
| | ----- | ----- | ----- |
| Total current assets | 3,256 | 803,975 | 144, |
| Investment in subsidiaries | 880,945 | - | |
| Net fixed assets | 501 | 112,969 | 35, |
| Net assets held for sale | - | 17,999 | |
| Investments in affiliates | 93 | 2,720 | |
| Goodwill | 15,720 | 370,440 | 32, |

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| | | | |
|---|------------|--------------|---------|
| Deferred loan costs | 11,944 | 20 | |
| Prepaid pension assets | - | 65,249 | |
| Real estate investment | - | - | 110, |
| Long-term investments | 1,205 | 3,626 | 3, |
| Other assets | 2,607 | 1,335 | |
| | ----- | ----- | ----- |
| Total assets | \$ 916,271 | \$ 1,378,333 | \$ 328, |
| | ----- | ----- | ----- |
| Bank notes payable & current maturities of debt | \$ 2,250 | \$ 1,632 | \$ 22, |
| Accounts payable (including intercompany) | 20 | 778,541 | 230, |
| Other accrued liabilities | (54,398) | 57,839 | 30, |
| | ----- | ----- | ----- |
| Total current liabilities | (52,128) | 838,012 | 284, |
| | ----- | ----- | ----- |
| Long-term debt, less current maturities | 431,041 | 5,918 | 33, |
| Fair market value of interest rate contract | 6,422 | - | |
| Other long-term liabilities | 405 | 21,672 | 3, |
| Noncurrent income taxes | 124,466 | (587) | |
| Retiree health care liabilities | - | 37,335 | 4, |
| | ----- | ----- | ----- |
| Total liabilities | 510,206 | 902,350 | 326, |
| | ----- | ----- | ----- |
| Class A common stock | 3,034 | - | |
| Class B common stock | 262 | - | |
| Notes due from stockholders | (430) | (1,338) | |
| Paid-in-capital | 232,820 | 478,207 | 83, |
| Retained earnings | 246,788 | 25,623 | (64,9 |
| Cumulative other comprehensive income | (334) | (26,509) | (15,8 |
| Treasury stock, at cost | (76,075) | - | |
| | ----- | ----- | ----- |
| Total stockholders' equity | 406,065 | 475,983 | 2, |
| | ----- | ----- | ----- |
| Total liabilities & stockholders' equity | \$ 916,271 | \$ 1,378,333 | \$ 328, |
| | ----- | ----- | ----- |

CONSOLIDATING STATEMENTS OF EARNINGS
FOR THE NINE MONTHS ENDED APRIL 1, 2001

| | Parent Company | Guarantors | Non Guarantors |
|-----------------------------------|-------------------|------------|-------------------|
| | ----- | ----- | ----- |
| Net Sales | \$ - | \$349,521 | \$ 115, |
| Cost of sales | - | 267,441 | 80, |
| Selling, general & administrative | 5,191 | 70,020 | 16, |
| Amortization of goodwill | 606 | 8,034 | |
| | ----- | ----- | ----- |
| | 5,797 | 345,495 | 97, |
| | ----- | ----- | ----- |
| Operating income (loss) | (5,797) | 4,026 | 17, |

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| | | | |
|---|-------------|-------------|-------|
| Net interest expense (including intercompany) | (6,791) | 37,548 | 8, |
| Investment (income) loss, net | - | (181) | (5,3 |
| FMV Adj of Interest Rate Contract | 6,915 | - | |
| Earnings (loss) before taxes | (5,921) | (33,341) | 14, |
| Income tax (provision) benefit | 3,155 | 15,019 | (8,8 |
| Equity in earnings of affiliates and subsidiaries | (12,810) | 181 | |
| Net earnings (loss) | \$ (15,576) | \$ (18,141) | \$ 5, |

CONSOLIDATING STATEMENTS OF CASH FLOWS
FOR THE NINE MONTHS ENDED APRIL 1, 2001

| | Parent Company | Guarantors | Non Guarantors |
|--|-------------------|-------------|-------------------|
| Cash Flows from Operating Activities: | | | |
| Net earnings (loss) | \$ (15,576) | \$ (18,141) | \$ 5, |
| Depreciation & amortization | 670 | 24,426 | 7, |
| Accretion of discount on long-term liabilities | - | 1,148 | |
| Amortization of deferred loan fees | 1,054 | 2 | |
| Unrealized holding (gain) loss on derivatives | 7,726 | - | |
| Change in assets and liabilities | (10,651) | (30,296) | (11,1 |
| Net cash (used for) provided by operating activities | (16,777) | (22,861) | 2, |
| Cash Flows from Investing Activities: | | | |
| Proceeds received from (used for): | | | |
| Purchase of PP&E | - | (4,780) | (3,0 |
| Investment securities, net | - | 10,510 | |
| Equity investment in affiliates | (443) | - | |
| Change in real estate investment | - | - | (1,9 |
| Change in net assets held for sale | - | 1,936 | |
| Other changes | - | (96) | |
| Net cash (used for) provided by investing activities | (443) | 7,570 | (5,0 |
| Cash Flows from Financing Activities: | | | |
| Proceeds from issuance of debt | 114,174 | 130 | 9, |
| Debt repayments, net | (95,174) | (1,792) | (10,0 |
| Issuance of Class A common stock | 714 | - | |
| Loans to stockholders | 69 | 6 | |
| Net cash (used for) provided by financing activities | 19,783 | (1,656) | (5 |
| Effect of exchange rate changes on cash | - | - | (5 |
| Net change in cash | 2,563 | (16,947) | (3,6 |
| Cash, beginning of the year | 35 | 23,064 | 12, |
| Cash, end of the year | \$ 2,598 | \$ 6,117 | \$ 9, |

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

The Fairchild Corporation was incorporated in October 1969, under the laws of the State of Delaware, under the name of Banner Industries, Inc. On November 15, 1990, we changed our name from Banner Industries, Inc. to The Fairchild Corporation. We own 100% of RHI Holdings, Inc. and Banner Aerospace, Inc. RHI is the owner of 100% of Fairchild Holding Corp. Our principal operations are conducted through Fairchild Holding Corp. and Banner Aerospace.

The following discussion and analysis provide information which management believes is relevant to the assessment and understanding of our consolidated results of operations and financial condition. The discussion should be read in conjunction with the consolidated financial statements and notes thereto.

GENERAL

We are a leading worldwide aerospace and industrial fastener manufacturer and supply chain services provider and, through Banner Aerospace, an international supplier to airlines and general aviation businesses, distributing a wide range of aircraft parts and related support services. Through internal growth and strategic acquisitions, we have become one of the leading suppliers of fasteners to aircraft OEMs, such as Boeing, European Aeronautic Defense and Space Company, General Electric, Lockheed Martin, and Northrop Grumman.

Our business consists of three segments: aerospace fasteners, aerospace distribution and real estate operations. The aerospace fasteners segment manufactures and markets high performance fastening systems used in the manufacture and maintenance of commercial and military aircraft. Our aerospace distribution segment stocks and distributes a wide variety of aircraft parts to commercial airlines and air cargo carriers, fixed-base operators, corporate aircraft operators and other aerospace companies. Our real estate operations segment owns and operates a shopping center located in Farmingdale, New York.

CAUTIONARY STATEMENT

Certain statements in this financial discussion and analysis by management contain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to our financial condition, results of operation and business. These statements relate to analyses and other information, which are based on forecasts of future results and estimates of amounts not yet determinable. These statements also relate to our future prospects, developments and business strategies. These forward-looking statements are identified by their use of terms and phrases such as "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "plan," "predict," "project," "will" and similar terms and phrases, including references to assumptions. These forward-looking statements involve risks and uncertainties, including current trend information, projections for deliveries, backlog and other trend estimates, that may cause our actual future activities and results of operations to be materially different from those suggested or described in this financial discussion and analysis by management. These risks

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include: product demand; our dependence on the aerospace industry; reliance on Boeing and European Aeronautic Defense and Space Company; customer satisfaction and quality issues; labor disputes; competition; our ability to achieve and execute internal business plans; worldwide political instability and economic growth; reduced airline revenues as a result of the September 11, 2001 terrorist attacks on the United States, and their aftermath; the cost and availability of electric power to operate our plants; and the impact of any economic downturns and inflation.

If one or more of these risks or uncertainties materializes, or if underlying assumptions prove incorrect, our actual results may vary materially from those expected, estimated or projected. Given these uncertainties, users of the information included in this financial discussion and analysis by management, including investors and prospective investors are cautioned not to place undue reliance on such forward-looking statements. We do not intend to update the forward-looking statements included in this Quarterly Report, even if new information, future events or other circumstances have made them incorrect or misleading.

RESULTS OF OPERATIONS

Consolidated Results

We currently report in three principal business segments: aerospace fasteners, aerospace distribution and real estate operations. The following table provides the historical sales and operating income of our segments for the three and nine months ended March 31, 2002 and April 1, 2001, respectively.

| | Three Months Ended | |
|--|--------------------|-------------------|
| | 3/31/02 | 4/1/01 |
| SALES BY SEGMENT: | | |
| Aerospace Fasteners Segment | \$ 136,960 | \$ 140,806 |
| Aerospace Distribution Segment | 16,271 | 21,552 |
| TOTAL SALES | \$ 153,231 | \$ 162,358 |
| OPERATING RESULTS BY SEGMENT: | | |
| Aerospace Fasteners Segment | \$ 10,155 | \$ 9,788 |
| Aerospace Distribution Segment | 1,202 | 1,725 |
| Real Estate Segment (a) | 226 | (764) |
| Corporate and Other Segment | (4,244) | (4,713) |
| TOTAL OPERATING INCOME (b) | \$ 7,339 | \$ 6,036 |

Net sales of \$153.2 million in the third quarter of fiscal 2002 decreased by \$9.1 million, or 5.6%, compared to sales of \$162.4 million in the third quarter of fiscal 2001. Net sales of \$476.1 million in the first nine months of fiscal 2002 increased by \$17.3 million, or 3.8%, compared to sales of \$458.8 million in the first nine months of fiscal 2001. Results for the three and nine months ended April 1, 2001, included revenue of \$0.6 million and \$6.0 million, respectively, from an operation in our aerospace distribution segment which was shut down in June 2001. Excluding the results of the shut down operation, net sales would have decreased \$8.5 million, or 5.2%, for the three months ended

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March 31, 2002 and increased by \$31.9 million, or 5.1%, for the nine months ended March 31, 2002, as compared to the same periods of the prior year. Sales in the first nine months of fiscal 2002 reflected growth at our aerospace fasteners segment due to strong order activity prior to September 11, 2001. Sales in the third quarter of fiscal 2002 were adversely affected by the overall conditions in the aerospace industry, resulting primarily from the events of September 11, 2001. Sales in the third quarter and first nine months of fiscal 2002 were unfavorably affected by approximately \$2.7 million and \$2.5 million, respectively, from the foreign currency impact on our European operations due to the U.S. Dollar strengthening against the Euro on a period-to-period basis.

Gross margin as a percentage of sales was 24.6% and 26.2% in the third quarter of fiscal 2002 and fiscal 2001, respectively, and 24.5% and 25.4% in the first nine months of fiscal 2002 and fiscal 2001, respectively. The reduced margins in the fiscal 2002 periods are attributable primarily to a higher volume of sales of lower margin products.

Selling, general & administrative expense as a percentage of sales was 21.0% and 20.2% in the third quarter of fiscal 2002 and 2001, respectively, and 20.6% and 20.7% in the first nine months of fiscal 2002, respectively. The change in the fiscal 2002 periods was attributable primarily to the volume of sales and the related economies of scale.

Rental revenue remained stable in the first nine months of fiscal 2002, compared to the first nine months of fiscal 2001.

Other income increased \$4.9 million in the first nine months of fiscal 2002, compared to the first nine months of fiscal 2001. The increase was due primarily to income recognized from the disposition of future royalty revenues to an unaffiliated third party in exchange for \$4.9 million of promissory notes secured by \$12.8 million face value of our outstanding 10.75% senior subordinated debentures due 2009 acquired by the third party.

Operating income for the three and nine months ended March 31, 2002, increased by \$1.3 million and \$10.9 million, respectively, as compared to the same periods of the prior year. The results for the three and nine months ended April 1, 2001, included goodwill amortization of \$3.1 million and \$9.4 million, respectively, prior to the implementation of a new accounting pronouncement that eliminates goodwill amortization in the current periods. Changes in foreign currency resulted in approximately a \$0.3 million unfavorable effect on operating income at our European operations in the third quarter of fiscal 2002, as compared to the third quarter of fiscal 2001.

Net interest expense decreased by \$4.6 million, or 11.7%, and cash interest expense decreased by \$4.1 million in the first nine months of fiscal 2002, as compared to the first nine months of fiscal 2001, due primarily to lower interest rates.

We recognized \$0.3 million of investment loss in the first nine months of fiscal 2002. Investment activity included \$0.8 million of realized losses from investments we liquidated and a recognized investment impairment of \$0.4 million, offset partially by a \$0.6 million increase in the fair market value of trading securities and \$0.4 million of dividend income. We recognized investment income of \$5.5 million in the first nine months of fiscal 2001, due primarily to recognition of gains on investments liquidated.

We recognized income of \$1.9 million in the third quarter of fiscal 2002 and expense of \$3.4 million in the third quarter of 2001 from the fair market value adjustment of a ten-year \$100 million interest rate contract. The fair market value adjustment of the ten-year \$100 million interest rate contract resulted in an expense of \$1.0 million in the first nine months of fiscal 2002 and \$6.9 million in the first nine months of 2001.

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An income tax benefit of \$7.3 million in the first nine months of fiscal 2002 was higher than the statutory rate, due primarily to lower tax rates on \$14.3 million of earnings generated by our foreign operations, which utilize net operating loss carry forwards. An income tax benefit of \$9.3 million in the first nine months of fiscal 2001 represented a 37.1% effective tax rate on pre-tax losses from continuing operations.

Comprehensive income includes foreign currency translation adjustments and unrealized holding changes in the fair market value of available-for-sale investment securities. For the nine months ended March 31, 2002, the foreign currency translation adjustment resulted in a \$4.0 million increase, and was offset partially by a \$0.8 million decrease in the fair market value of unrealized holding gains on investment securities. For the nine months ended April 1, 2001, foreign currency translation adjustments decreased by \$12.1 million, the fair market value of unrealized holding gains on investment securities decreased by \$0.9 million, and we recorded a \$0.5 million decrease in the fair market value of our \$100 million interest rate swap agreement due to the cumulative effect of the adoption of SFAS 133 "Accounting for Derivative Instruments and Hedging Activities".

Segment Results

Aerospace Fasteners Segment

Sales in our Aerospace Fasteners segment decreased by \$3.8 million, or 2.7%, in the third quarter and increased by \$33.6 million, or 8.5% in the first nine months of fiscal 2002, respectively, as compared to the same periods of fiscal 2001. The improvement in the nine months reflected internal growth, which was partially offset by a reduction in deliveries in the third quarter due to sluggish conditions in the aerospace industry resulting from the September 11, 2001 terrorist attacks. Sales by our European locations were affected unfavorably by approximately \$2.7 million in the third quarter and \$2.5 million in the first nine months of fiscal 2002, as compared to the same periods of the prior year, due to the strengthening of the U.S. Dollar against the Euro. Our backlog decreased by \$10.3 million in the third quarter of fiscal 2002, to \$187.4 million at March 31, 2002. Our book-to-bill ratio was 92.0% for the first nine months of fiscal 2002, reflecting the stronger level of shipments and a softening of new orders following the September 11, 2001 terrorist attacks.

Operating income increased by \$0.4 million, or 3.7%, in the third quarter, and \$10.2 million, or 38.4%, in the first nine months of fiscal 2002, as compared to the same periods of fiscal 2001. The improvement in the first nine months of fiscal 2002 was due primarily to the increase in sales and related economies of scale and the adoption, on July 1, 2001, of a new accounting pronouncement that does not require us to amortize goodwill. Goodwill amortization of \$2.8 million and \$8.5 million was recorded in the third quarter and first nine months of fiscal 2001. During the three months ended March 31, 2001, we reduced our work force by approximately 8.0% and paid \$0.5 million in severance. Operating expenses continue to be monitored as management attempts to efficiently reduce operating costs.

Announcements by our major customers have reinforced our view that projected aircraft build rates will be adversely affected by decreased worldwide demand for travel following September 11, 2001. Accordingly, we believe overall demand for aerospace fasteners will decrease during the remainder of calendar 2002, and our business will be affected by this decreased demand. Nevertheless,

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we also believe the impact on our business will be partially offset by the supply chain service programs we entered into during the past several years and by the decrease in fastener inventory available to original equipment manufacturers and distributors. In addition, we maintain ongoing efforts to achieve additional savings through cost reductions and further plant rationalization.

Aerospace Distribution Segment

Sales in our aerospace distribution segment decreased by \$5.3 million in the third quarter and \$16.2 million in the first nine months of fiscal 2002, compared to the same periods in fiscal 2001. Results from the prior three months and nine months ended April 1, 2001, included revenue of \$0.6 million and \$6.0 million from an operation which was shut down in June 2001. Sales in the three and nine months ended March 31, 2002 were also adversely affected due to the terrorist attacks on September 11, 2001 and have been sluggish since then.

Operating income decreased by \$0.5 million in the third quarter and \$1.4 million in the first nine months of fiscal 2002, as compared to the same periods in fiscal 2001. The results for the nine months ended March 31, 2002, were affected by the reduction in revenue. Results from the prior three months and nine months ended April 1, 2001, included an operating loss of \$0.3 million and \$0.7 million from an operation which was shut down in June 2001.

Real Estate Operations Segment

Our real estate operations segment owns and operates a shopping center located in Farmingdale, New York. Included in operating income was rental revenue of \$1.6 million for each of the three months ended March 31, 2002 and April 1, 2001, respectively, and \$5.0 million and \$5.1 million for the nine months ended March 31, 2002 and April 1, 2001, respectively. As of March 31, 2002, we have leased approximately 82% of the developed shopping center.

We reported operating income of \$0.2 million and \$0.7 million for the third quarter and first nine months of fiscal 2002, respectively, compared to an operating loss of \$0.8 million and \$0.7 million for the third quarter of fiscal 2001 and nine months ended April 1, 2001. In the three and nine months ended March 31, 2002, we recorded a charge of \$0.1 million and \$0.4 million, respectively, to write-off specialized tenant improvements associated with terminated tenancies. In the third quarter of fiscal 2001, we recorded a one-time charge of \$1.3 million for road improvements. Additionally, in the first nine months of fiscal 2001, we recorded a charge of \$1.0 million to write-off specialized tenant improvements associated with a terminated tenancy.

Corporate

The operating loss at corporate was reduced by \$0.7 million in the first nine months of fiscal 2002, compared to the first nine months of fiscal 2001. This improvement was due primarily to an increase of \$3.3 million in royalty income recognized in the first nine months of fiscal 2002.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Total capitalization as of March 31, 2002 and June 30, 2001 amounted to \$855.4 million and \$858.9 million, respectively. The nine-month change in capitalization included a \$4.6 million decrease in debt reflecting cash provided by our operations, and an increase in equity of \$1.1 million which was due primarily to a \$3.2 million favorable increase in other comprehensive income, partially offset by our reported net loss.

We maintain a portfolio of investments classified primarily as available-for-sale securities, which had a fair market value of \$8.1 million at

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March 31, 2002. The market value of these investments decreased by \$0.2 million in the nine months ended March 31, 2002. There is risk associated with market fluctuations inherent in stock investments, and because our portfolio is not diversified, changes in its value may occur.

Net cash provided by operating activities for the nine months ended March 31, 2002, was \$9.4 million. The working capital uses of cash in the first nine months of fiscal 2002 included a \$10.7 million decrease in accounts payable and other accrued liabilities and a \$6.5 million increase in other current assets, offset partially by a \$4.0 million decrease in accounts receivable and a \$0.9 million decrease in inventory. The working capital uses of cash were offset by \$16.3 million of earnings after deducting non-cash expenses of \$22.7 million for depreciation, \$1.5 million from the amortization of deferred loan fees, and \$1.0 million from the reduction in the fair market value of an interest rate contract. Net cash used for operating activities for the nine months ended April 1, 2001, was \$37.1 million. The working capital uses of cash in the first nine months of fiscal 2001 included a \$22.8 million decrease in accounts payable and other accrued liabilities, a \$14.4 million increase in inventories, and a \$14.4 million increase in other current assets, offset partially by a \$7.4 million decrease in accounts receivable.

Net cash used for investing activities was \$5.9 million for the nine months ended March 31, 2002. In the first nine months of fiscal 2002, the primary source of cash was \$8.0 million provided from the dispositions of non-core real estate and net assets held for sale, offset by \$9.2 million of capital expenditures and a \$5.0 increase in notes receivable. Net cash provided by investing activities was \$2.1 million for the nine months ended April 1, 2001. In the first nine months of fiscal 2001, the primary source of cash was \$12.4 million provided from the sale of investments and dispositions of non-core real estate, partially offset by \$11.3 million of capital expenditures and \$1.7 million for real estate development at our Farmingdale shopping center.

Net cash used by financing activities was \$5.4 million for the nine months ended March 31, 2002 and net cash provided by financing activities was \$17.6 million for the nine months ended April 1, 2001. Cash from operations was used to reduce debt in the nine months ended March 31, 2001. Cash provided by financing activities in the first nine months of fiscal 2001, included \$16.8 million of net proceeds from the issuance of additional debt.

At March 31, 2002, \$5.3 million of promissory notes were due to us from an unaffiliated third party and are recorded in other assets. The promissory notes earn \$1.4 million of annual cash interest and are being accreted to a face value of \$12.8 million through interest income. The promissory notes are secured by \$12.8 million face value of our outstanding 10.75% senior subordinated debentures due 2009 acquired by the third party. The third party may sell these debentures for cash provided that it satisfies its obligation under its promissory notes.

Our principal cash requirements include debt service, capital expenditures, and the payment of other liabilities including postretirement benefits, environmental investigation and remediation obligations, and litigation settlements and related costs. We expect that cash on hand, cash generated from operations, cash available from borrowings and additional financing, and proceeds received from dispositions of non-core assets will be adequate to satisfy our cash requirements during the next twelve months.

We are required under the credit agreement with our lending institutions, to comply with certain financial and non-financial loan covenants, including maintaining certain interest and fixed charge coverage ratios and maintaining certain indebtedness to EBITDA ratios at the end of each fiscal quarter. Our most restrictive covenant is the interest coverage ratio, which represents the ratio of EBITDA to interest expense, as defined in the credit agreement. At

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March 31, 2002, the interest coverage ratio was 2.32, which exceeded the minimum requirement of 2.0. Our interest rates vary based upon the consolidated indebtedness to EBITDA covenant, which represents the ratio of total debt to EBITDA, as defined in the credit agreement. At March 31, 2002, our indebtedness to EBITDA ratio increased to 5.42, and will result in a 1/4% increase in our interest rates under the credit agreement during the next quarter. Additionally, the credit agreement restricts annual capital expenditures to \$40 million during the life of the facility. For the nine months ended March 31, 2002, capital expenditures were \$9.2 million. Except for assets of our subsidiaries that are not guarantors of the credit agreement, substantially all of our assets are pledged as collateral under the credit agreement. The credit agreement restricts the payment of dividends to our shareholders to an aggregate of the lesser of \$0.01 per share or \$0.4 million over the life of the agreement. Noncompliance with any of the financial covenants without cure or waiver would constitute an event of default under the credit agreement. An event of default resulting from a breach of a financial covenant may result, at the option of lenders holding a majority of the loans, in an acceleration of the principal and interest outstanding, and a termination of the revolving credit line. At March 31, 2002, we were in compliance with the covenants under the credit agreement.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 141, "Accounting for Business Combinations." This statement requires that the purchase method of accounting be used for all business combinations initiated after June 30, 2001, and establishes specific criteria for the recognition of intangible assets separately from goodwill. We will follow the requirements of this statement for business acquisitions made after June 30, 2001. There were no acquisitions during the nine months ended March 31, 2002.

In June 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 142, "Accounting for Goodwill and Other Intangible Assets." This statement requires that goodwill and intangible assets deemed to have an indefinite life not be amortized. Instead of amortizing goodwill and intangible assets deemed to have an indefinite life, the statement requires a test for impairment to be performed annually, or immediately if conditions indicate that such an impairment could exist. The amortization period of intangible assets with finite lives will no longer be limited to forty years. This statement is effective for fiscal years beginning after December 15, 2001, and permits early adoption for fiscal years beginning after March 15, 2001. We have adopted SFAS No. 142 on July 1, 2001. As a result of adopting SFAS No. 142, we will no longer amortize goodwill of approximately \$12.5 million per year. Using the fair value measurement requirement, rather than the undiscounted cash flows approach, we expect to record an impairment from the implementation of SFAS No. 142. The initial evaluation of reporting units on a fair value basis, as required from the implementation of SFAS No. 142, indicates that impairments exist at the reporting units within our aerospace fasteners segment. Based upon the initial evaluation, the estimated range of impairment is between \$60 million to \$65 million. However, once impairment is determined at a reporting unit, SFAS No. 142 requires that the amount of goodwill impairment be determined based on what the balance of goodwill would have been if purchase accounting were applied at the date of impairment. We have not completed that analysis, but we expect to complete this analysis prior to June 30, 2002. If the carrying amount of goodwill exceeds its fair value, an impairment loss must be recognized in an amount equal to that excess. Once an impairment loss is recognized, the adjusted carrying amount of goodwill will become the new accounting basis of goodwill. The actual amount of impairment could be significantly different than the range provided above. We are currently measuring the amount of impairment of goodwill to be recorded from adopting this standard.

In June 2001, the Financial Accounting Standards Board issued Statement of

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Financial Accounting Standards No. 143, "Accounting for Asset Retirement Obligations". This statement addresses financial accounting and reporting for obligations associated with the retirement of tangible long-lived assets and associated asset retirement costs. It applies to legal obligations associated with the retirement of long-lived assets that result from the acquisition, construction, development, and normal operation of a long-lived asset, except for certain lease obligations. This statement is effective for fiscal years beginning after June 15, 2002. We are currently evaluating the impact of adopting this standard.

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets," which supersedes SFAS No. 121. Though it retains the basic requirements of SFAS 121 regarding when and how to measure an impairment loss, SFAS 144 provides additional implementation guidance. SFAS 144 applies to long-lived assets to be held and used or to be disposed of, including assets under capital leases of lessees; assets subject to operating leases of lessors; and prepaid assets. SFAS 144 also expands the scope of a discontinued operation to include a component of an entity, and eliminates the current exemption to consolidation when control over a subsidiary is likely to be temporary. This statement is effective for fiscal years beginning after December 15, 2001. We are currently evaluating the impact of adopting this standard.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

In fiscal 1998, we entered into a ten-year interest rate swap agreement to reduce our cash flow exposure to increases in interest rates on variable rate debt. The ten-year interest rate swap agreement provides us with interest rate protection on \$100 million of variable rate debt, with interest being calculated based on a fixed LIBOR rate of 6.24% to February 17, 2003. On February 17, 2003, the bank with which we entered into the interest rate swap agreement, will have a one-time option to elect to cancel the agreement or to do nothing and proceed with the transaction, using a fixed LIBOR rate of 6.715% for the period February 17, 2003 to February 19, 2008.

We did not elect to pursue hedge accounting for the interest rate swap agreement, which was executed to provide an economic hedge against cash flow variability on the floating rate note. When evaluating the impact of SFAS No. 133 on this hedge relationship, we assessed the key characteristics of the interest rate swap agreement and the note. Based on this assessment, we determined that the hedging relationship would not be highly effective. The ineffectiveness is caused by the existence of the embedded written call option in the interest rate swap agreement, and the absence of a mirror option in the hedged item. As such, pursuant to SFAS No. 133, we designated the interest rate swap agreement in the no hedging designation category. Accordingly, we have recognized a non-cash decrease in fair market value of interest rate derivatives, of \$1.0 million and \$6.9 million, in the nine months ended March 31, 2002 and April 1, 2001, respectively, as a result of the fair market value adjustment for our interest rate swap agreement.

The fair market value adjustment of these agreements will generally fluctuate based on the implied forward interest rate curve for 3-month LIBOR. If the implied forward interest rate curve decreases, the fair market value of the interest hedge contract will increase and we will record an additional charge. If the implied forward interest rate curve increases, the fair market value of the interest hedge contract will decrease, and we will record income.

In March 2000, the Company issued a floating rate note with a principal amount of \$30,750,000. Embedded within the promissory note agreement is an interest rate cap. The embedded interest rate cap limits the 1-month LIBOR interest rate that we must pay on the note to 8.125%. At execution of the

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promissory note, the strike rate of the embedded interest rate cap of 8.125% was above the 1-month LIBOR rate of 6.61%. Under SFAS 133, the embedded interest rate cap is considered to be clearly and closely related to the debt of the host contract and is not required to be separated and accounted for separately from the host contract. We are accounting for the hybrid contract, comprised of the variable rate note and the embedded interest rate cap, as a single debt instrument.

The table below provides information about our derivative financial instruments and other financial instruments that are sensitive to changes in interest rates, which include interest rate swaps. For interest rate swaps, the table presents notional amounts and weighted average interest rates by expected (contractual) maturity dates. Notional amounts are used to calculate the contractual payments to be exchanged under the contract. Weighted average variable rates are based on implied forward rates in the yield curve at the reporting date.

(In thousands)

Expected Fiscal Year Maturity Date

2003

| | | |
|-------------------------------------|--|--|
| Type of Interest Rate Contracts | | |
| Variable to Fixed | | |
| Fixed LIBOR rate | | |
| LIBOR cap rate | | |
| Average floor rate | | |
| Weighted average forward LIBOR rate | | |
| Fair Market Value at March 31, 2002 | | |

| | | |
|--|-------------------|------|
| | | |
| | Interest Rate Cap | Vari |
| | \$30,750 | |
| | N/A | |
| | 8.125% | |
| | N/A | |
| | 2.64% | |
| | \$23 | |

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information required to be disclosed under this Item is set forth in Footnote 5 (Contingencies) of the Consolidated Financial Statements (Unaudited) included in this Report.

Item 2. Changes in Securities and Use of Proceeds

At the Annual Meeting held on November 13, 2001, our Stockholders approved the issuance of 86,942 stock options (in the aggregate) to non-employee directors. On February 15, 2002 the shares to be issued pursuant to these stock options were registered with the Securities and Exchange Commission. A description of the stock options was included in our Proxy Statement for the November 13, 2001 Annual Meeting.

Item 5. Other Information

Articles have appeared in the French press reporting an inquiry by a French magistrate into allegedly improper business transactions involving Elf Aquitaine, a French petroleum company, its former chairman and various third parties, including Maurice Bidermann. In connection with this inquiry, the magistrate has made inquiry into allegedly improper transactions between Mr.

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Jeffrey Steiner and that petroleum company. In response to the magistrate's request, Mr. Steiner has submitted written statements concerning the transactions and appeared in person, in France, before the magistrate and others. The magistrate put Mr. Steiner under examination (mis en examen) with respect to this matter and imposed a surety (caution) of ten million French Francs which has been paid. The examining magistrate has notified Mr. Steiner that he intends to transmit the dossier to the Republic prosecutor (procureur de la Republique) for his consideration. However, to date, Mr. Steiner has not been charged.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

None

(b) Reports on Form 8-K:

There were no reports filed on Form 8-K during the quarter ended March 31, 2002 for which this report is filed.

SIGNATURES

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

For THE FAIRCHILD CORPORATION
(Registrant) and as its Chief
Financial Officer:

By: /s/ JOHN L. FLYNN
John L. Flynn
Senior Vice President and
Chief Financial Officer

Date: May 9, 2002