

BALLANTYNE STRONG, INC.
Form 10-Q
November 15, 2010
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

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: 1-13906

BALLANTYNE STRONG, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

47-0587703
(IRS Employer
Identification Number)

4350 McKinley Street, Omaha, Nebraska
(Address of Principal Executive Offices)

68112
(Zip Code)

(402) 453-4444

(Registrant's telephone number, including area code:)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15 (d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 or a smaller reporting company. See definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act (check one):

Large accelerated filer

Accelerated filer

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

Smaller reporting company

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

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

Class
Common Stock, \$.01, par value

Outstanding as of November 2, 2010
14,300,799 shares

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Table of Contents**PART I. Financial Information****Item 1. Condensed Consolidated Financial Statements****Ballantyne Strong, Inc. and Subsidiaries****Condensed Consolidated Balance Sheets****September 30, 2010 and December 31, 2009****(Unaudited)**

	September 30, 2010	December 31, 2009
Assets		
Current assets:		
Cash and cash equivalents	\$ 19,167,244	\$ 23,589,025
Restricted cash	486,403	442,766
Accounts receivable (less allowance for doubtful accounts of \$242,339 and \$205,314, respectively)	17,738,205	8,877,980
Unbilled revenue	3,958,765	1,894,075
Inventories, net	26,581,450	12,987,048
Recoverable income taxes	1,602,505	1,850,699
Deferred income taxes	2,193,606	1,943,679
Consignment inventory	450,382	486,527
Other current assets	2,730,323	667,592
Total current assets	74,908,883	52,739,391
Investment in joint venture	2,306,931	2,216,638
Property, plant and equipment, net	7,373,726	3,612,935
Intangible assets, net	797,426	1,103,128
Other assets	20,000	17,257
Deferred income taxes	47,330	520,951
Total assets	\$ 85,454,296	\$ 60,210,300
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	\$ 26,518,101	\$ 9,768,896
Other accrued expenses	4,203,344	3,623,143
Customer deposits	3,652,809	2,295,946
Income tax payable	804,875	1,246,247
Total current liabilities	35,179,129	16,934,232
Deferred income taxes	245,871	274,977
Other accrued expenses, net of current portion	491,494	483,425
Total liabilities	35,916,494	17,692,634
Commitments and contingencies		
Stockholders equity:		
Preferred stock, par value \$.01 per share; Authorized 1,000,000 shares, none outstanding		
Common stock, par value \$.01 per share; Authorized 25,000,000 shares; issued 16,440,781 shares in 2010 and 16,283,676 shares in 2009	164,407	162,836

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Additional paid-in capital	36,094,616	35,332,787
Accumulated other comprehensive income (loss):		
Foreign currency translation	(126,821)	(286,086)
Minimum pension liability	110,665	110,665
Retained earnings	28,677,615	22,580,144
	64,920,482	57,900,346
Less 2,139,982 of common shares in treasury, at cost	(15,382,680)	(15,382,680)
Total stockholders' equity	49,537,802	42,517,666
Total liabilities and stockholders' equity	\$ 85,454,296	\$ 60,210,300

See accompanying notes to consolidated financial statements.

Table of Contents**Ballantyne Strong, Inc. and Subsidiaries****Condensed Consolidated Statements of Operations****Three and Nine Months Ended September 30, 2010 and 2009****(Unaudited)**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net revenues	\$ 32,929,645	\$ 16,552,036	\$ 91,015,727	\$ 53,298,196
Cost of revenues	26,461,344	12,996,753	74,280,945	42,111,250
Gross profit	6,468,301	3,555,283	16,734,782	11,186,946
Selling and administrative expenses:				
Selling	726,260	518,790	2,280,258	1,954,980
Administrative	2,214,355	1,921,228	6,352,801	5,873,540
Total selling and administrative expenses	2,940,615	2,440,018	8,633,059	7,828,520
Gain (loss) on disposal or transfer of assets	7,691	229	178,192	(1,714)
Income from operations	3,535,377	1,115,494	8,279,915	3,356,712
Interest income	4,197	10,369	17,587	80,903
Interest expense	(11,727)	(8,116)	(27,120)	(25,557)
Equity in income (loss) of joint venture	(23,373)	(219,420)	802,393	(637,557)
Other expense, net	(81,055)	(142,734)	(107,279)	(29,830)
Income before income taxes	3,423,419	755,593	8,965,496	2,744,671
Income tax expense	(1,102,698)	(212,497)	(2,867,816)	(725,935)
Net earnings	\$ 2,320,721	\$ 543,096	\$ 6,097,680	\$ 2,018,736
Basic earnings per share	\$ 0.16	\$ 0.04	\$ 0.43	\$ 0.14
Diluted earnings per share	\$ 0.16	\$ 0.04	\$ 0.42	\$ 0.14
Weighted average shares outstanding:				
Basic	14,199,858	14,005,912	14,139,682	13,996,533
Diluted	14,417,754	14,163,609	14,363,234	14,138,813

See accompanying notes to consolidated financial statements.

Table of Contents**Ballantyne Strong, Inc. and Subsidiaries****Condensed Consolidated Statements of Cash Flows****Nine Months Ended September 30, 2010 and 2009****(Unaudited)**

	2010	2009
Cash flows from operating activities:		
Net earnings	\$ 6,097,680	\$ 2,018,736
Adjustments to reconcile net earnings to net cash used in operating activities:		
Provision for doubtful accounts	61,664	30,518
Provision for obsolete inventory	168,941	284,224
Provision for warranty reserve	405,819	252,265
Depreciation of consignment inventory	318,082	397,636
Depreciation of property, plant and equipment	661,743	638,062
Amortization of intangibles	320,786	293,313
Equity in (gain) loss of joint venture	(802,393)	637,557
Loss on forward contracts	104,131	2,589
Loss (gain) on disposal or transfer of assets	(178,192)	1,714
Deferred income taxes	190,972	(839,515)
Share-based compensation expense	226,424	161,728
Excess tax benefits from share-based arrangements	(156,919)	
Changes in assets and liabilities:		
Accounts receivable	(8,609,788)	(1,943,149)
Unbilled revenue	(2,064,690)	(335,369)
Inventories	(13,748,459)	(3,114,564)
Consignment inventory	(281,937)	(340,559)
Other current assets and liabilities	(2,061,755)	(226,121)
Accounts payable	16,499,595	2,311,154
Customer deposits	1,355,647	1,764,435
Accrued expenses	26,864	297
Current income taxes	(51,052)	276,660
Other assets	(2,743)	
Net cash provided by (used in) operating activities	(1,519,580)	2,271,611
Cash flows from investing activities:		
Investment in joint venture/return on investment	888,000	20,568
Increase in restricted investments	(466)	24,106
Capital expenditures	(4,397,526)	(807,715)
Proceeds from sales of assets	27,576	
Proceeds from sales of investments in securities		10,025,000
Net cash provided by (used in) investing activities	(3,482,416)	9,261,959
Cash flows from financing activities:		
Proceeds from exercise of stock options	359,117	
Excess tax benefits from share-based arrangements	156,919	
Net cash provided by financing activities	516,036	
Effect of exchange rate changes on cash and cash equivalents	64,179	304,344
Net (decrease) increase in cash and cash equivalents	(4,421,781)	11,837,914
Cash and cash equivalents at beginning of year	23,589,025	11,424,984

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Cash and cash equivalents at end of year	\$	19,167,244	\$	23,262,898
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See accompanying notes to consolidated financial statements.

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Ballantyne Strong, Inc. and Subsidiaries

Notes to the Condensed Consolidated Financial Statements

Nine Months Ended September 30, 2010 and 2009

1. Nature of Operations

Ballantyne Strong, Inc. (Ballantyne or the Company), a Delaware corporation, and its wholly owned subsidiaries Strong Westrex, Inc., Strong Technical Services, Inc., Strong / MDI Screen Systems, Inc., and the American West Beijing Trading Company, Ltd., design, develop, manufacture, service and distribute theatre and lighting systems. The Company s products are distributed to movie exhibition companies, sports arenas, auditoriums, amusement parks and special venues.

2. Summary of Significant Accounting Policies

Basis of Presentation and Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and all majority owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

The condensed consolidated financial statements included in this report are presented in accordance with the requirements of Form 10-Q and consequently do not include all of the disclosures normally required by accounting principles generally accepted in the United States of America for annual reporting purposes or those made in the Company s annual Form 10-K, as amended. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto included in the Company s Form 10-K, as amended, for the fiscal year-ended December 31, 2009.

In the opinion of management, the unaudited condensed consolidated financial statements of the Company reflect all adjustments of a normal recurring nature necessary to present a fair statement of the financial position and the results of operations and cash flows for the respective interim periods. The results for interim periods are not necessarily indicative of trends or results expected for a full year.

Use of Management Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and

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liabilities at the date of the condensed consolidated financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results and changes in facts and circumstances may alter such estimates and affect results of operations and financial position in future periods. Certain 2009 amounts in the accompanying condensed consolidated financial statements and notes thereto have been reclassified to conform to the 2010 presentation.

No changes were made to the Company's significant accounting policies disclosed in Note 2 of the Notes to the Consolidated Financial Statements in the Company's Annual Report on Form 10-K, as amended, for the fiscal year ending December 31, 2009.

Recently Issued Accounting Pronouncements

In June 2009, the FASB issued SFAS No. 167, Amendments to FASB Interpretation No. 46(R) (to be included in ASC Topic 810). This statement requires reporting entities to evaluate former Qualifying Special Purpose Entities (QSPE) for consolidation, changes to approach to determining a Variable Interest Entities (VIE) primary beneficiary from a quantitative assessment to a qualitative assessment designed to identify a controlling financial interest. This statement was effective as of the beginning of a Company's first fiscal year that begins after November 15, 2009. The adoption did not impact the consolidated financial statements.

In January 2010, the FASB issued ASU 2010-06, Fair Value Measurements and Disclosures (Topic 820): Improving Disclosures about Fair Value Measurements, which amends Subtopic 829-10. ASU 2010-06 enhances disclosure requirements related to fair value measurements. Certain provisions of ASU 2010-06 are effective for annual and interim periods beginning after December 15, 2009 and others for fiscal years beginning after December 15, 2010. Beginning with the quarter ended March 31, 2010, the Company provided new disclosures, as applicable, to its fair value instruments. The disclosures required for fiscal periods beginning after December 15, 2010 are currently not applicable to the Company.

Table of Contents**Ballantyne Strong, Inc. and Subsidiaries****Notes to the Condensed Consolidated Financial Statements****Nine Months Ended September 30, 2010 and 2009****3. Earnings Per Common Share**

Basic earnings per share have been computed on the basis of the weighted average number of shares of common stock outstanding. Diluted earnings per share has been computed on the basis of the weighted average number of shares of common stock outstanding after giving effect to potential common shares from dilutive stock options and restricted stock awards. The following table provides reconciliation between basic and diluted earnings per share:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Basic earnings per share:				
Earnings applicable to common stock	\$ 2,320,721	\$ 543,096	\$ 6,097,680	\$ 2,018,736
Basic weighted average common shares outstanding	14,199,858	14,005,912	14,139,682	13,996,533
Basic earnings per share	\$ 0.16	\$ 0.04	\$ 0.43	\$ 0.14
Diluted earnings per share:				
Earnings applicable to common stock	\$ 2,320,721	\$ 543,096	\$ 6,097,680	\$ 2,018,736
Basic weighted average common shares outstanding	14,199,858	14,005,912	14,139,682	13,996,533
Dilutive effect of stock options and restricted stock awards	217,896	157,697	223,552	142,280
Dilutive weighted average common shares outstanding	14,417,754	14,163,609	14,363,234	14,138,813
Diluted earnings per share	\$ 0.16	\$ 0.04	\$ 0.42	\$ 0.14

For the three months ended September 30, 2010 the Company had no anti-dilutive shares outstanding. For the nine months ended September 30, 2010, the Company had 10,200 shares of restricted stock at a weighted average price of \$8.02 per share that were outstanding but were not included in the computation of diluted earnings per share as the fair value price on the date of grant was greater than the average market price of the common shares. These restricted stock shares vest in May 2011.

For the three and nine months ended September 30, 2009, options to purchase 118,125 shares of common stock at a weighted average price of \$4.55 per share were outstanding, but were not included in the computation of diluted earnings per share as the options exercise price was greater than the average market price of the common shares.

4. Comprehensive Income

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The accumulated other comprehensive income, net, shown in the Company's condensed consolidated balance sheets includes the unrealized income on investments in securities and the accumulated foreign currency translation adjustment. The following table shows the difference between the Company's reported net earnings and its comprehensive income:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Comprehensive income:				
Net earnings	\$ 2,320,721	\$ 543,096	\$ 6,097,680	\$ 2,018,736
Other comprehensive income:				
Unrealized gain on investment in securities				742,027
Foreign currency translation adjustment	305,824	354,253	159,265	525,523
Total comprehensive income	\$ 2,626,545	\$ 897,349	\$ 6,256,945	\$ 3,286,286

5. Warranty Reserves

The Company generally grants a warranty to its customers for a one-year period following the sale of all manufactured equipment, and on selected repaired equipment for a one-year period following the repair. The warranty period is extended under certain circumstances and for certain products. Warranty costs are generally passed through to the manufacturer for items distributed by the Company. The Company accrues for warranty costs at the time of sale or repair, and when events dictate that additional accruals are necessary.

Table of Contents**Ballantyne Strong, Inc. and Subsidiaries****Notes to the Condensed Consolidated Financial Statements****Nine Months Ended September 30, 2010 and 2009**

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Warranty accrual at beginning of period	\$ 412,027	\$ 445,823	\$ 378,145	\$ 491,556
Charged to expense	177,192	60,132	405,819	252,265
Amounts written off, net of recoveries	(75,153)	(106,032)	(266,372)	(355,096)
Foreign currency adjustment	3,916	18,739	390	29,937
Warranty accrual at end of period	\$ 517,982	\$ 418,662	\$ 517,982	\$ 418,662

6. Digital Link II Joint Venture*Investment in Digital Link II*

On March 6, 2007, the Company entered into an agreement with RealD to form an operating entity Digital Link II, LLC (the LLC). Under the agreement, the LLC was formed with the Company and RealD as the only two members with membership interests of 44.4% and 55.6%, respectively. The LLC was formed for purposes of commercializing certain 3D technology and to fund the deployment of digital projector systems to exhibitors.

Summarized financial data for the LLC is as follows, in thousands:

	September 24, 2010	December 25, 2009
Balance Sheet		
Current assets	\$ 4,637	\$ 877
Property, plant and equipment, net	9,389	12,935
Current liabilities	3,454	3,047
Non-current liabilities	5,804	5,574
Equity	\$ 4,768	\$ 5,191

Statement of Operations	Three Months Ended September 24,		Nine Months Ended September 26,	
	2010	2009	2010	2009
Revenue	\$ 1	\$ 1	\$ 8,239	\$ 22
Cost of sales	(277)	(392)	(6,174)	(1,152)
Selling and administrative expenses	(60)	(68)	(207)	(184)
Operating income (loss)	(336)	(459)	1,858	(1,314)
Other expense	(86)	(53)	(283)	(194)

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Net income (loss)	\$	(422)	\$	(512)	\$	1,575	\$	(1,508)
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The Company accounts for its investment by the equity method. Under this method, the Company recorded its proportionate share of LLC net income or loss based on the LLC's unaudited financial statements as of September 24, 2010. The LLC uses four 13-week periods for a total of 52 weeks to align its fiscal year end with that of its majority interest holder, RealD. The Company's portion of income of the LLC was insignificant for the three months and \$0.8 million for the nine months ended September 30, 2010 as compared to the portion of loss of the LLC of approximately \$0.2 million and \$0.6 million for the three and nine months ended September 30, 2009, respectively.

The Company sold digital theatre projection equipment, in the normal course of business, to the LLC for approximately \$0.3 million and \$5.0 million for the three and nine months ended September 30, 2010 and approximately \$0.4 million and \$2.3 million for the three and nine months ended September 30, 2009, respectively. The LLC in turn provides and sells the digital projection equipment to third party customers under system use agreements or through sales agreements. Revenue recognized by Ballantyne was \$0.2 million and \$4.1 million in the three and nine month periods ended September 30, 2010, respectively, as compared to \$0.1 and \$1.1 million in the three and nine months ended September 30, 2009, respectively. Revenue recognized by the Company on the sale transaction to DL II is limited by its 44.4% ownership in the joint venture which will be recognized upon sale of the equipment to the third parties. The total receivable balance due from the LLC was \$0.3 million at September 30, 2010 and \$0.2 million at December 31, 2009.

Table of Contents**Ballantyne Strong, Inc. and Subsidiaries****Notes to the Condensed Consolidated Financial Statements****Nine Months Ended September 30, 2010 and 2009**

During the second quarter of 2010, the LLC made a significant sale of equipment to a third party customer that resulted in the LLC recording a gain on the sale of assets of approximately \$2.8 million.

During the third quarter of 2010 the Company received a \$0.9 million return of the investment in the LLC. The Company received no other distributions from the LLC.

Guarantees

The Company and RealD have provided guarantees to notes payable entered into by Digital Link II, LLC to finance digital projection equipment deployed in the normal course of business. The notes bear interest at rates ranging from 7.0% to 7.46%. The following table summarizes the Company's guarantees:

Guarantee Date	Interest Rate	Original Notes Payable Balance	Ballantyne Ownership	Original Guarantee	Remaining Guarantee as of September 30, 2010
July-08	7.00%	\$ 626,663	44.40%	\$ 278,238	\$ 83,321
November-08	7.20%	756,440	44.40%	335,860	44,718
November-08	7.00%	1,142,239	44.40%	507,154	162,841
January-09	7.20%	265,538	44.40%	117,899	25,848
April-09	7.20%	1,039,646	44.40%	461,603	110,307
September-09	7.00%	184,098	44.40%	81,739	55,340
October-09	7.25%	152,850	44.40%	67,865	41,076
March-10	7.46%	1,824,774	44.40%	810,200	619,130
March-10	7.46%	749,308	44.40%	332,693	265,679
March-10	7.46%	423,224	44.40%	187,911	172,758
March-10	7.46%	216,141	44.40%	95,967	88,408
		\$ 7,380,921		\$ 3,277,129	\$ 1,669,426

Under terms of the guarantees, the Company and RealD would be required to fulfill the guarantee should the joint venture be in default of its loans or contract terms. The guarantees will expire at the time each loan is paid off. The fair value of the obligations undertaken by issuing the guarantees was not material to the condensed consolidated financial statements as of September 30, 2010.

7. Investments

During 2009, the Company had certain investments in auction-rate securities which were classified as available-for-sale securities and accounted for in accordance with SFAS No. 115, Accounting for Certain Investments in Debt and Equity Securities. In June 2009, the Company entered into a settlement agreement with a financial institution with whom the Company had a banking relationship to sell, at the Company's option, all or a portion of its outstanding auction-rate securities (ARS) at par, plus accrued interest. The settlement agreement provided for a provision on confidentiality and a release of the financial institution from claims related to the Company's purchase, ownership and sale of the securities. In June 2009 the Company sold its remaining outstanding ARS under the terms of the settlement agreement which amounted to \$9,375,000 plus interest accrued. During 2009, the Company also liquidated, at par, outstanding ARS which amounted to \$650,000 of which \$50,000 were sold through the normal auction process and \$600,000 were redeemed by the fund itself.

8. Fair Value of Financial Instruments

The fair value of the Company's cash and cash equivalents, accounts receivable, accounts payable and accrued expenses equal or approximate their fair values due to the short-term nature of these instruments. The estimated fair values and related assumptions used to estimate fair value of the Company's financial instruments are disclosed below. The Company's instruments were considered Level 1 as of September 30, 2010 and December 31, 2009.

ASC 820 establishes a hierarchy for fair value measurements based upon observable independent market inputs and unobservable market assumptions. Inputs refer broadly to the assumptions that market participants would use in pricing the asset or liability, including assumptions about risk. Considerable judgment is required in interpreting market data used to develop the estimates of fair value. The following represents the three categories of inputs used in determining the fair value of financial assets and liabilities:

Table of Contents**Ballantyne Strong, Inc. and Subsidiaries****Notes to the Condensed Consolidated Financial Statements****Nine Months Ended September 30, 2010 and 2009**

- Level 1: Quoted market prices in active markets for identical assets or liabilities.
- Level 2: Observable market based inputs or unobservable inputs that are corroborated by market data.
- Level 3: Unobservable inputs that are used in the measurement of assets and liabilities. Unobservable inputs require management to make certain projections and assumptions about the information that would be used by market participants in pricing the asset or liability.

9. Accounts Receivable

Accounts receivable is comprised of the following:

	September 30, 2010		December 31, 2009	
Trade accounts receivable, net	\$	16,656,655	\$	8,877,980
Other receivable		1,081,550		
	\$	17,738,205	\$	8,877,980

10. Inventories

Inventories consist of the following:

	September 30, 2010		December 31, 2009	
Raw materials and components	\$	6,066,560	\$	4,714,956
Work in process		921,650		169,707
Finished goods		19,593,240		8,102,385
	\$	26,581,450	\$	12,987,048

The inventory balances are net of reserves of approximately \$3.0 million and \$2.7 million as of September 30, 2010 and December 31, 2009, respectively.

11. Income Taxes

Income taxes are accounted for under the asset and liability method. The Company uses an estimate of its annual effective rate based on the facts and circumstances at the time to record interim income tax expense. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. In assessing the realizability of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized and a related valuation allowance is deemed necessary. As of September 30, 2010, a valuation allowance has not been recorded. However, if the Company experiences difficulties in achieving its forecasts of taxable income, the Company may be required to record a valuation allowance against the deferred tax assets recorded which would impact the Company's results of operations. The Company has recorded a receivable for the amount of an income tax refund due to the Company as a result of the carry back of certain operating losses to previous year's taxable income.

The effective tax rate (calculated as a ratio of income tax expense to pre-tax earnings, inclusive of equity method investment earnings) was 32.2% and 32.0% for the three and nine months ended September 30, 2010, respectively, as compared to 28.1% and 26.4% for the three and nine months ended September 30, 2009, respectively. The effective rate change from year to year is a result of differing foreign and U.S. tax rates applied to respective pre-tax earnings by tax jurisdiction. During the three and nine months ended September 30, 2010 the Company experienced more U.S. taxable income which carries a higher effective rate. Our anticipated full year effective tax rate is estimated to be 31.7%.

Federal and state income taxes have not been provided on accumulated but undistributed earnings of foreign subsidiaries aggregating approximately \$10.2 million at September 30, 2010 and as such, earnings have been permanently reinvested in the business. The determination of the amount of the unrecognized deferred tax liability related to the undistributed earnings is not practicable.

The Company follows Financial Accounting Standards Board ASC 740, Income Taxes as it pertains to uncertain tax positions. ASC 740 requires that uncertain tax positions are evaluated in a two-step process, whereby 1) the Company determines whether it is more likely than not that the tax positions will be sustained based on the technical merits of the position and 2) for those tax positions

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that meet the more likely than not recognition threshold, the Company would recognize the largest amount of tax benefit that is greater than fifty percent likely to be realized upon ultimate settlement with the related tax authority. The Company's uncertain tax positions are related to tax years that remain subject to examination by the relevant taxable authorities. The Company has examinations not yet initiated for Federal purposes for fiscal years 2006 through 2009. In most cases, the Company has examinations open for State or local jurisdictions based on the particular jurisdiction's statute of limitations. The Company does not currently have any examinations in process. As of September 30, 2010, total unrecognized tax benefits amounted to approximately \$0.1 million.

Amounts related to estimated underpayment of income taxes, including interest and penalties, are classified as a component of tax expense in the consolidated statements of operations and were not material for the three and nine month periods ended September 30, 2010 and 2009. Amounts accrued for estimated underpayment of income taxes amounted to \$0.1 million as of September 30, 2010 and December 31, 2009. The accruals largely related to state tax matters.

12. Supplemental Cash Flow Information

Supplemental disclosures to the condensed consolidated statements of cash flows are as follows:

	Nine Months Ended September 30,	
	2010	2009
Cash paid during the year for:		
Interest	\$ 6,920	\$ 3,424
Income taxes	\$ 2,709,488	\$ 1,218,556

13. Stock Compensation

The Company accounts for awards of share-based compensation in accordance with ASC 718, *Stock Compensation - Overall*, which requires the measurement and recognition of compensation expense for all share-based payment awards made to employees and directors based on estimated fair values. Share-based compensation expense recorded amounted to approximately \$67,000 and \$226,000 for the three and nine months ended September 30, 2010, respectively, and approximately \$55,000 and \$162,000 for the three and nine months ended September 30, 2009, respectively. The Company recorded associated tax benefits of approximately \$26,000 and \$81,000 during the three and nine months ended September 30, 2010, respectively, compared to approximately \$15,000 and \$49,000 during the three and nine months ended September 30, 2009, respectively.

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During the second quarter of 2010, the Company adopted and, at the 2010 Annual Meeting of Stockholders, the stockholders approved the 2010 Long-Term Incentive Plan (2010 Plan). Subject to the terms of the 2010 Plan, the Compensation Committee has the discretion to determine the terms of each award, including which award, if any, may be subject to vesting upon a change in control of the Company, as such term is defined in the 2010 Plan. The Committee may grant stock options, stock appreciation rights, restricted shares, restricted stock units or performance shares and performance units. The total number of shares reserved for issuance under the 2010 Plan was 600,000 shares. No shares were granted during the nine months ended September 30, 2010.

Options

The Company maintains a 2005 Outside Directors Stock Option Plan which was approved by the Company's stockholders. During fiscal 2008, the Board of Directors made the decision to discontinue granting further stock options under this Plan, however, there are grants of stock options that remain outstanding under this Plan. The Company also maintained a 1995 Employee Stock Option Plan which expired in 2005, however, there are stock options that remain outstanding under this expired Plan.

All past and future grants under the Company's stock option plans were granted at exercise prices based on the fair market value of the Company's common stock on the date of grant. The outstanding options generally vested over periods ranging from zero to three years from the grant date and expire between 5 and 10 years after the grant date. No stock options were granted during the nine months ended September 30, 2010 and 2009, respectively.

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All stock options outstanding were fully vested as of January 1, 2009. Therefore no share-based compensation expense was recorded during the nine months ended September 30, 2010 and 2009, respectively, and no unrecognized compensation cost related to non-vested stock option awards remained at September 30, 2010.

The following table summarizes the Company's activities with respect to its stock options for the nine months ended September 30, 2010 as follows:

	Number of Options	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2009	278,125	\$ 2.29	1.69	\$ 480,450
Granted				
Exercised	(105,875)	3.39		
Forfeited				
Outstanding at September 30, 2010	172,250	\$ 1.62	1.33	\$ 1,243,516
Exercisable at September 30, 2010	172,250	\$ 1.62	1.33	\$ 1,243,516

The aggregate intrinsic value in the table above represents the total that would have been received by the option holders if all in-the-money options had been exercised on September 30, 2010.

The following table summarizes information about stock options outstanding and exercisable at September 30, 2010:

Range of option exercise price	Options Outstanding at September 30, 2010			Options Exercisable at September 30, 2010		
	Number of options	Weighted average remaining contractual life	Weighted average exercise price per option	Number of options	Weighted average remaining contractual life	Weighted average exercise price per option
\$0.62	125,000	1.58	\$ 0.62	125,000	1.58	\$ 0.62
\$4.25	47,250	0.67	4.25	47,250	0.67	4.25
\$0.62 to 4.25	172,250	1.33				