

ESTERLINE TECHNOLOGIES CORP  
Form 10-Q  
June 06, 2006

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

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**FORM 10-Q**

**QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the quarterly period ended April 28, 2006

OR

**TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission file number 1-6357

**ESTERLINE TECHNOLOGIES CORPORATION**

(Exact name of registrant as specified in its charter)

**Delaware**  
(State or other Jurisdiction  
of incorporation or organization)

**13-2595091**  
(I.R.S. Employer  
Identification No.)

**500 108<sup>th</sup> Avenue N.E., Bellevue, Washington 98004**  
(Address of principal executive offices) (Zip Code)  
**Registrant's telephone number, including area code 425/453-9400**

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

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Large accelerated filer  Accelerated filer  Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes  No

As of June 2, 2006, 25,426,170 shares of the issuer's common stock were outstanding.

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## PART 1 FINANCIAL INFORMATION

**Item 1. Financial Statements**

## ESTERLINE TECHNOLOGIES CORPORATION

## CONSOLIDATED BALANCE SHEET

As of April 28, 2006 and October 28, 2005

(In thousands, except share amounts)

|   | April 28,<br>2006<br>(Unaudited) | October 28,<br>2005 |
|---|----------------------------------|---------------------|
| <b>ASSETS</b>   |                                  |                     |
| Current Assets  |                                  |                     |
| Cash and cash equivalents   | \$ 46,256                        | \$ 118,304          |
| Cash in escrow  | 4,315                            | 11,918              |
| Short-term investments  |                                  | 62,656              |
| Accounts receivable, net of allowances of \$4,435 and \$4,462               | 171,236                          | 149,751             |
| Inventories   |                                  |                     |
| Raw materials and purchased parts   | 80,500                           | 64,377              |
| Work in process   | 62,740                           | 45,798              |
| Finished goods  | 25,439                           | 20,294              |
|   | 168,679                          | 130,469             |
| Deferred income tax benefits  | 26,672                           | 26,868              |
| Prepaid expenses  | 10,469                           | 7,533               |
| Total Current Assets  | 427,627                          | 507,499             |
| Property, Plant and Equipment   |                                  |                     |
| Property, Plant and Equipment   | 322,490                          | 282,110             |
| Accumulated depreciation  | 155,811                          | 143,896             |
|   | 166,679                          | 138,214             |
| Other Non-Current Assets  |                                  |                     |
| Goodwill  | 360,784                          | 261,167             |
| Intangibles, net  | 245,845                          | 166,118             |
| Debt issuance costs, net of accumulated amortization of \$1,939 and \$1,602 | 4,806                            | 5,144               |
| Deferred income tax benefits  | 17,773                           | 13,320              |
| Other assets  | 26,573                           | 23,786              |
|   | \$ 1,250,087                     | \$ 1,115,248        |

## ESTERLINE TECHNOLOGIES CORPORATION

## CONSOLIDATED BALANCE SHEET

As of April 28, 2006 and October 28, 2005

(In thousands, except share amounts)

|  | April 28,<br>2006<br>(Unaudited) | October 28,<br>2005 |
|--|----------------------------------|---------------------|
| <b>LIABILITIES AND SHAREHOLDERS EQUITY</b>   |                                  |                     |
| <b>Current Liabilities</b>   |                                  |                     |
| Accounts payable   | \$ 59,975                        | \$ 41,453           |
| Accrued liabilities  | 108,790                          | 119,115             |
| Credit facilities  | 18,413                           | 2,031               |
| Current maturities of long-term debt   | 3,077                            | 70,934              |
| Federal and foreign income taxes   | 5,751                            | 8,798               |
| <b>Total Current Liabilities</b>   | <b>196,006</b>                   | <b>242,331</b>      |
| <b>Long-Term Liabilities</b>   |                                  |                     |
| Long-term debt, net of current maturities  | 279,756                          | 175,682             |
| Deferred income taxes  | 74,806                           | 46,421              |
| Other liabilities  | 34,527                           | 27,237              |
| <b>Commitments and Contingencies</b>   |                                  |                     |
| Minority Interest  | 3,158                            | 2,713               |
| <b>Shareholders Equity</b>   |                                  |                     |
| Common stock, par value \$.20 per share, authorized 60,000,000 shares, issued and outstanding 25,419,920 and 25,319,892 shares | 5,084                            | 5,064               |
| Additional paid-in capital   | 265,434                          | 260,095             |
| Retained earnings  | 371,393                          | 345,370             |
| Accumulated other comprehensive income   | 19,923                           | 10,335              |
| <b>Total Shareholders Equity</b>   | <b>661,834</b>                   | <b>620,864</b>      |
|  | <b>\$ 1,250,087</b>              | <b>\$ 1,115,248</b> |

## ESTERLINE TECHNOLOGIES CORPORATION

## CONSOLIDATED STATEMENT OF OPERATIONS

For the Three and Six Month Periods Ended April 28, 2006 and April 29, 2005

(Unaudited)

(In thousands, except per share amounts)

|  | Three Months Ended |                   | Six Months Ended  |                   |
|--|--------------------|-------------------|-------------------|-------------------|
|  | April 28,<br>2006  | April 29,<br>2005 | April 28,<br>2006 | April 29,<br>2005 |
| Net Sales  | \$ 247,939         | \$ 211,592        | \$ 453,604        | \$ 401,384        |
| Cost of Sales  | 167,200            | 143,054           | 310,006           | 274,746           |
|  | 80,739             | 68,538            | 143,598           | 126,638           |
| Expenses   |                    |                   |                   |                   |
| Selling, general & administrative                          | 40,973             | 35,837            | 76,863            | 66,445            |
| Research, development & engineering                        | 12,939             | 9,866             | 23,272            | 19,113            |
| Total Expenses   | 53,912             | 45,703            | 100,135           | 85,558            |
| Operating Earnings From Continuing Operations              | 26,827             | 22,835            | 43,463            | 41,080            |
| Other (income) expense                                     | (263)              | 28                | (462)             | 66                |
| Interest income  | (998)              | (1,025)           | (1,857)           | (1,560)           |
| Interest expense   | 5,790              | 4,097             | 10,295            | 8,779             |
| Loss on extinguishment of debt                             |                    |                   | 2,156             |                   |
| Other Expense, Net   | 4,529              | 3,100             | 10,132            | 7,285             |
| Income From Continuing Operations Before Income Taxes      | 22,298             | 19,735            | 33,331            | 33,795            |
| Income Tax Expense   | 4,307              | 5,974             | 6,863             | 9,938             |
| Income From Continuing Operations Before Minority Interest | 17,991             | 13,761            | 26,468            | 23,857            |
| Minority Interest  | (332)              | (35)              | (445)             | (48)              |
| Income From Continuing Operations                          | 17,659             | 13,726            | 26,023            | 23,809            |
| Income (Loss) From Discontinued Operations, Net of Tax     |                    | (562)             |                   | 6,965             |
| Net Earnings   | \$ 17,659          | \$ 13,164         | \$ 26,023         | \$ 30,774         |

ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED STATEMENT OF OPERATIONS

For the Three and Six Month Periods Ended April 28, 2006 and April 29, 2005

(Unaudited)

(In thousands, except per share amounts)

|                                    | Three Months Ended |                   | Six Months Ended  |                   |
|------------------------------------|--------------------|-------------------|-------------------|-------------------|
|                                    | April 28,<br>2006  | April 29,<br>2005 | April 28,<br>2006 | April 29,<br>2005 |
| Earnings (Loss) Per Share Basic:   |                    |                   |                   |                   |
| Continuing operations              | \$ .70             | \$ .55            | \$ 1.03           | \$ .97            |
| Discontinued operations            |                    | (.03)             |                   | .28               |
| Earnings per share basic           | \$ .70             | \$ .52            | \$ 1.03           | \$ 1.25           |
| Earnings (Loss) Per Share Diluted: |                    |                   |                   |                   |
| Continuing operations              | \$ .68             | \$ .54            | \$ 1.01           | \$ .95            |
| Discontinued operations            |                    | (.02)             |                   | .28               |
| Earnings per share diluted         | \$ .68             | \$ .52            | \$ 1.01           | \$ 1.23           |

## ESTERLINE TECHNOLOGIES CORPORATION

## CONSOLIDATED STATEMENT OF CASH FLOWS

For the Six Month Periods Ended April 28, 2006 and April 29, 2005

(Unaudited)

(In thousands)

|   | Six Months Ended  |                   |
|---|-------------------|-------------------|
|   | April 28,<br>2006 | April 29,<br>2005 |
| <b>Cash Flows Provided (Used) by Operating Activities</b> |                   |                   |
| Net earnings  | \$ 26,023         | \$ 30,774         |
| Minority interest   | 445               | 49                |
| Depreciation and amortization                             | 19,838            | 18,508            |
| Deferred income taxes                                     | 585               | 1,830             |
| Stock-based compensation                                  | 2,649             | 680               |
| Gain on sale of discontinued operations                   |                   | (9,456)           |
| Gain on sale of short-term investments                    | (610)             |                   |
| Loss on sale of building                                  |                   | 59                |
| Working capital changes, net of effect of acquisitions    |                   |                   |
| Accounts receivable                                       | 919               | 3,040             |
| Inventories   | (22,089)          | (14,535)          |
| Prepaid expenses  | (2,108)           | 773               |
| Accounts payable  | 6,354             | 4,214             |
| Accrued liabilities                                       | (9,692)           | 754               |
| Federal and foreign income taxes                          | (5,224)           | 472               |
| Other liabilities   | 1,115             | 1,300             |
| Other, net  | (735)             | (682)             |
|   | 17,470            | 37,780            |
| <b>Cash Flows Provided (Used) by Investing Activities</b> |                   |                   |
| Purchases of capital assets                               | (12,392)          | (9,342)           |
| Proceeds from sale of discontinued operations             |                   | 21,421            |
| Proceeds from sale of building                            |                   | 2,319             |
| Proceeds from sale of capital assets                      | 458               | 146               |
| Proceeds from sale of short-term investments              | 63,266            |                   |
| Purchase of short-term investments                        |                   | (45,486)          |
| Acquisitions of businesses, net of cash acquired          | (189,667)         | (3,346)           |
|   | (138,335)         | (34,288)          |

ESTERLINE TECHNOLOGIES CORPORATION

CONSOLIDATED STATEMENT OF CASH FLOWS

For the Six Month Periods Ended April 28, 2006 and April 29, 2005

(Unaudited)

(In thousands)

|  | <b>Six Months Ended</b>   |                           |
|--|---------------------------|---------------------------|
|  | <b>April 28,<br/>2006</b> | <b>April 29,<br/>2005</b> |
| <b>Cash Flows Provided (Used) by Financing Activities</b>      |                           |                           |
| Proceeds provided by stock issuance under employee stock plans | \$ 2,351                  | \$ 2,435                  |
| Excess tax benefits from stock option exercises                | 359                       |                           |
| Proceeds provided by sale of common stock                      |                           | 108,490                   |
| Net change in credit facilities                                | 16,188                    | (4,424)                   |
| Proceeds from issuance of long-term debt                       | 100,000                   |                           |
| Repayment of long-term obligations                             | (70,556)                  | (1,474)                   |
|  | 48,342                    | 105,027                   |
| Effect of Foreign Exchange Rates on Cash                       | 475                       | (294)                     |
| Net Increase (Decrease) in Cash and Cash Equivalents           | (72,048)                  | 108,225                   |
| Cash and Cash Equivalents    Beginning of Period               | 118,304                   | 29,479                    |
| Cash and Cash Equivalents    End of Period                     | \$ 46,256                 | \$ 137,704                |
| <b>Supplemental Cash Flow Information</b>                      |                           |                           |
| Cash Paid for Interest   | \$ 11,635                 | \$ 7,966                  |
| Cash Paid for Taxes  | 3,655                     | 8,446                     |



ESTERLINE TECHNOLOGIES CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

For the Three and Six Month Periods Ended April 28, 2006 and April 29, 2005

1. The consolidated balance sheet as of April 28, 2006, the consolidated statement of operations for the three and six month periods ended April 28, 2006 and April 29, 2005, and the consolidated statement of cash flows for the six month periods ended April 28, 2006 and April 29, 2005 are unaudited, but in the opinion of management, all of the necessary adjustments, consisting of normal recurring accruals, have been made to present fairly the financial statements referred to above in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, the above statements do not include all of the footnotes required for complete financial statements. The results of operations and cash flows for the interim periods presented are not necessarily indicative of results that can be expected for the full year.
2. The notes to the consolidated financial statements in the Company's Annual Report on Form 10-K for the fiscal year ended October 28, 2005 provide a summary of significant accounting policies and additional financial information that should be read in conjunction with this Form 10-Q.
3. The timing of the Company's revenues is impacted by the purchasing patterns of customers and, as a result, revenues are not generated evenly throughout the year. Moreover, the Company's first fiscal quarter, November through January, includes significant holiday vacation periods in both Europe and North America.
4. Basic earnings per share is computed on the basis of the weighted average number of shares outstanding during the period. Diluted earnings per share includes the dilutive effect of stock options. The weighted average number of shares outstanding used to compute basic earnings per share was 25,385,000 and 25,120,000 for the three month periods ended April 28, 2006 and April 29, 2005, respectively. The weighted average number of shares outstanding used to compute diluted earnings per share was 25,817,000 and 25,484,000 for the three month periods ended April 28, 2006 and April 29, 2005, respectively. The weighted average number of shares outstanding used to compute basic earnings per share was 25,361,000 and 24,577,000 for the six month periods ended April 28, 2006, and April 29, 2005, respectively. The weighted average number of shares outstanding used to compute diluted earnings per share was 25,780,000 and 24,953,000 for the six month periods ended April 28, 2006 and April 29, 2005, respectively.
5. New Accounting Standard  
Prior to October 29, 2005, the Company accounted for its stock-based compensation in accordance with Accounting Principles Board Opinion No. 25, Accounting for Stock Issued to Employees. The variable method of accounting was used to account for stock option plans where the option holders were permitted to exercise options by surrendering the option

subject to the grant in payment of exercise price of the option and the related statutory taxes. No compensation expense was recognized at the date of grant because the exercise price of all stock option grants is equal to the market price of the Company's common stock as of the date of grant. However, subsequent changes in the market price of the Company's stock to the date of exercise or forfeiture resulted in a change in the measurement of compensation costs. Effective October 29, 2005, the Company adopted Statement of Financial Accounting Standards No. 123 (revised 2004), Share-Based Payment (Statement No. 123R), which requires the Company to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. The Company adopted Statement 123R using the modified prospective method effective October 29, 2005. The cumulative effect of the change in accounting principle upon adoption of Statement 123R was included in selling, general and administrative expense as the amount was not significant.

6. The Company's comprehensive income is as follows:

| (In thousands)   | Three Months Ended |                   | Six Months Ended  |                   |
|--|--------------------|-------------------|-------------------|-------------------|
|  | April 28,<br>2006  | April 29,<br>2005 | April 28,<br>2006 | April 29,<br>2005 |
| Net Earnings   | \$ 17,659          | \$ 13,164         | \$ 26,023         | \$ 30,774         |
| Change in Fair Value of Derivative Financial Instruments, Net of Tax | 1,255              | 612               | 831               | 1,435             |
| Minimum Pension Liability, Net of Tax                                | (3,682)            |                   | (3,682)           |                   |
| Foreign Currency Translation Adj.                                    | 12,113             | (738)             | 12,439            | 3,453             |
| Comprehensive Income   | \$ 27,345          | \$ 13,038         | \$ 35,611         | \$ 35,662         |

7. On March 24, 2006, the Company acquired all of the outstanding capital stock of Wallop Defence Systems Limited (Wallop), a manufacturer of military pyrotechnic countermeasure devices for U.K. £33.2 million in cash (approximately \$57.9 million including acquisition costs and an adjustment based on the amount of indebtedness and net working capital of Wallop as of closing). In addition, the Company may pay an additional purchase price up to U.K. £10.0 million, or approximately \$18.2 million, depending on the future financial performance of Wallop. The acquisition strengthens the Company's international position in countermeasure devices. Wallop is included in the Advanced Materials segment and the results of its operations were included from the effective date of the acquisition. A preliminary estimate of the fair value of assets acquired and liabilities assumed was made at April 28, 2006, which will be revised during the third quarter of fiscal 2006 when the independent valuation is completed.
8. On December 16, 2005, the Company acquired all of the outstanding capital stock of Darchem Holdings Limited (Darchem), a manufacturer of thermally engineered components for critical aerospace applications for U.K. £68.6 million in cash (approximately

\$121.6 million including acquisition costs and an adjustment based on the amount of cash and net working capital of Darchem as of closing). Darchem holds a leading position in its niche market and fits the Company's engineered-to-order model. Darchem is included in the Advanced Materials segment and the results of its operations were included from the effective date of the acquisition. The following summarizes the estimated fair market value of the assets acquired and liabilities assumed at the date of acquisition. The allocation of the purchase price was based upon a preliminary independent valuation report. The amount allocated to goodwill is not expected to be deductible for income tax purposes.

(In thousands)

As of December 16, 2005

|  |                   |
|--|-------------------|
| Current Assets   | \$ 22,361         |
| Property, plant and equipment                                | 8,499             |
| Intangible assets subject to amortization                    |                   |
| Programs (20 year weighted average useful life)              | 45,691            |
| Customer relationships (8 year weighted average useful life) | 2,215             |
| Patents (11 year weighted average useful life)               | 3,083             |
| Other (1 year useful life)                                   | 284               |
|  | 51,273            |
| Trade name   | 6,219             |
| Other  | 171               |
| Goodwill   | 60,689            |
| <b>Total assets acquired</b>                                 | <b>149,212</b>    |
| Current liabilities assumed                                  | 8,523             |
| Deferred tax liabilities                                     | 19,083            |
| <b>Net assets acquired</b>                                   | <b>\$ 121,606</b> |

9. On January 28, 2005, the Company completed the sale of the outstanding stock of its wholly owned subsidiary Fluid Regulators Corporation (Fluid Regulators), which was included in the Company's Sensors & Systems segment, for approximately \$21.4 million. As a result of the sale, the Company recorded a gain of \$7.0 million, net of tax of \$2.4 million, in the first fiscal quarter of 2005. Sales and net earnings were \$3.4 million and \$0.3 million during the six-month period ended April 29, 2005. Fluid Regulators is reported as discontinued operations and the consolidated financial statements for all prior periods have been adjusted to reflect this presentation.
10. The effective income tax rate for the first six months of fiscal 2006 was 29.3% (before a \$2.9 million reduction of previously estimated tax liabilities) compared with 29.4% for the first six months of fiscal 2005. The effective tax rate differed from the statutory rate, as both years benefited from various tax credits and certain foreign interest expense deductions. On April 25, 2006, the Company received a Notice of Proposed Adjustment (NOPA) from the

State of California Franchise Tax Board covering, among other items, the examination of research and development tax credits for fiscal years 1997 through 2002. As a result of receiving the NOPA the Company reduced previously estimated tax liabilities by \$2.0 million. Additionally, as a result of a favorable tax audit which was concluded on December 23, 2005, the Company also reduced previously estimated tax liabilities by \$0.9 million. While the effective tax rate in the first six months of fiscal 2006 was impacted by the expiration of the U.S. Research and Experimentation Credit at December 31, 2005, the impact was partially offset by increased benefits from various tax credits and foreign interest deductions.

11. As of April 28, 2006, the Company has two share-based compensation plans, which are described below. The compensation cost that has been charged against income for those plans for the first six months of fiscal 2006 was \$2.6 million. The total income tax benefit recognized in the income statement for share-based compensation arrangements was \$0.8 million.

In March 2002, the Company's shareholders approved the establishment of an Employee Stock Purchase Plan (ESPP) under which 300,000 shares of the Company's common stock are reserved for issuance to employees. On March 1, 2006, the Company's shareholders authorized an additional 150,000 shares of the Company's stock under the ESPP. The plan qualifies as a noncompensatory employee stock purchase plan under Section 423 of the Internal Revenue Code. Employees are eligible to participate through payroll deduction subject to certain limitations. At the end of each offering period, usually six months, shares are purchased by the participants at 85% of the lower of the fair market value on the first day of the offering period or the purchase date. During the first six months of fiscal 2006, employees purchased 34,452 shares at a fair market value price of \$36.55 per share, leaving a balance of 238,526 shares available for issuance in the future. As of April 28, 2006, deductions aggregating \$815,520 were accrued for the purchase of shares on June 15, 2006.

The Company also has an equity incentive plan for officers and key employees. On March 1, 2006, the Company's shareholders authorized the issuance of an additional 1,000,000 shares of the Company's common stock under the equity incentive plan. At April 28, 2006, the Company had 2,620,450 shares reserved for issuance to officers and key employees, of which 1,121,950 shares were available to be granted in the future. The Board of Directors authorized the Compensation Committee to administer awards granted under the equity incentive plan, including option grants, and to establish the terms of such awards. Awards under the equity incentive plan may be granted to eligible employees of the Company over the 10-year period ending March 3, 2014. Options granted become exercisable ratably over a period of four years following the date of grant and expire on the tenth anniversary of the grant. Option exercise prices are equal to the fair market value of the Company's common stock on the date of grant. The weighted-average grant date fair value of options granted during the six-month periods ended April 28, 2006 and April 29, 2005, was \$22.10 per share and \$18.10 per share, respectively.

The fair value of each option granted by the Company was estimated using a Black-Scholes pricing model which uses the assumptions noted in the following table. The Company uses historical data to estimate volatility of the Company's common stock and option exercise and employee termination assumptions. The range of the expected term reflects the results from certain groups of employees exhibiting different behavior. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury zero coupon issues in effect at the time of the grant.

|  | Six Months Ended  |       |                   |       |
|--|-------------------|-------|-------------------|-------|
|  | April 28,<br>2006 |       | April 29,<br>2005 |       |
| Risk-free interest rate (U.S. Treasury zero coupon issues) | 4.53              | 4.72% | 4.48              | 4.71% |
| Expected dividend yield                                    |                   |       |                   |       |
| Expected volatility  |                   | 45.0% |                   | 45.3% |
| Expected life (years)                                      | 6.5               | 9.5   | 5.6               | 8.6   |

The following table summarizes the changes in outstanding options granted under the Company's stock option plans for the six-month period ended April 28, 2006:

|                                  | Shares<br>Subject to<br>Option | Weighted Average                         |                   |
|----------------------------------|--------------------------------|--|-------------------|
|                                  |                                | Remaining<br>Contractual<br>Term (years) | Exercise<br>Price |
| Outstanding, beginning of period | 1,401,100                      |  | \$ 23.56          |
| Granted                          | 166,400                        |  | 38.98             |
| Exercised                        | (57,000)                       |  | 16.28             |
| Canceled or expired              | (12,000)                       |  | 25.85             |
| Outstanding, end of period       | 1,498,500                      | 6.7                                      | \$ 25.53          |
| Exercisable, end of period       | 807,200                        | 5.0                                      | \$ 19.27          |

The aggregate intrinsic value of option shares outstanding and exercisable at April 28, 2006 was \$29.2 million and \$20.8 million, respectively.

The table below presents stock activity related to stock options exercised in the periods ended April 28, 2006 and April 29, 2005:

| (In thousands)                                  | Six Months Ended  |                   |
|---|-------------------|-------------------|
|   | April 28,<br>2006 | April 29,<br>2005 |
| Proceeds from stock options exercised           | \$ 928            | \$ 1,345          |
| Tax benefits related to stock options exercised | 564               | 977               |
| Intrinsic value of stock options exercised      | 1,511             | 3,055             |

Total unrecognized compensation expense for options that have not vested as of April 28, 2006, is \$6.6 million, which will be recognized over a weighted average period of 1.52 years.

The following table illustrates the effect on net income and earnings per share as if the Company had applied the fair value method for the prior-year three and six month periods:

| (In thousands)  | Three and Six Months Ended |           |
|---|----------------------------|-----------|
|   | April 29, 2005             |           |
| Net earnings, as reported   | \$ 13,164                  | \$ 30,774 |
| Stock-based compensation expense reversal, net of income tax benefit included in net earnings as reported | 911                        | 457       |
| Stock-based compensation costs net of income tax under the fair value method of accounting                | (476)                      | (917)     |
| Pro forma net earnings  | \$ 13,599                  | \$ 30,314 |
| <b>Basic earnings per share:</b>  |                            |           |
| As reported   | \$ .52                     | \$ 1.25   |
| Pro forma   | .54                        | 1.23      |
| <b>Diluted earnings per share:</b>  |                            |           |
| As reported   | \$ .52                     | \$ 1.23   |
| Pro forma   | .53                        | 1.21      |

12. The Company's pension plans principally include a U.S. pension plan maintained by Esterline and U.S. and non-U.S. plans maintained by Leach Holding Corporation, a wholly-owned subsidiary of the Company. Components of net periodic pension cost consisted of the following:

| (In thousands)                                 | Three Months Ended |                | Six Months Ended |                 |
|--|--------------------|----------------|------------------|-----------------|
|  | April 28, 2006     | April 29, 2005 | April 28, 2006   | April 29, 2005  |
| <b>Components of Net Periodic Pension Cost</b> |                    |                |                  |                 |
| Service cost                                   | \$ 880             | \$ 1,065       | \$ 1,760         | \$ 2,133        |
| Interest cost                                  | 2,494              | 2,352          | 4,988            | 5,720           |
| Expected return on plan assets                 | (3,180)            | (2,955)        | (6,359)          | (6,753)         |
| Amortization of prior service cost             | 5                  | 5              | 9                | 9               |
| Amortization of actuarial loss                 | 406                | 165            | 812              | 335             |
| <b>Net Periodic Cost</b>                       | <b>\$ 605</b>      | <b>\$ 632</b>  | <b>\$ 1,210</b>  | <b>\$ 1,444</b> |

13. Segment information:

Business segment information for continuing operations includes the segments of Avionics & Controls, Sensors & Systems and Advanced Materials.

| (In thousands)                           | Three Months Ended |                   | Six Months Ended  |                   |
|--|--------------------|-------------------|-------------------|-------------------|
|  | April 28, 2006     | April 29, 2005    | April 28, 2006    | April 29, 2005    |
| <b>Sales</b>                             |                    |                   |                   |                   |
| Avionics & Controls                      | \$ 71,864          | \$ 64,990         | \$ 134,306        | \$ 125,845        |
| Sensors & Systems                        | 83,177             | 84,541            | 156,647           | 158,915           |
| Advanced Materials                       | 92,898             | 62,061            | 162,651           | 116,624           |
| <b>Total Sales</b>                       | <b>\$ 247,939</b>  | <b>\$ 211,592</b> | <b>\$ 453,604</b> | <b>\$ 401,384</b> |
| <b>Income from Continuing Operations</b> |                    |                   |                   |                   |
| Avionics & Controls                      | \$ 11,296          | \$ 9,204          | \$ 20,671         | \$ 18,603         |
| Sensors & Systems                        | 7,300              | 11,166            | 13,083            | 17,563            |
| Advanced Materials                       | 15,696             | 8,747             | 23,816            | 15,228            |
| <b>Segment Earnings</b>                  | <b>34,292</b>      | <b>29,117</b>     | <b>57,570</b>     | <b>51,394</b>     |
| Corporate expense                        | (7,465)            | (6,282)           | (14,107)          | (10,314)          |
| Other income (expense)                   | 263                | (28)              | 462               | (66)              |
| Interest income                          | 998                | 1,025             | 1,857             | 1,560             |
| Interest expense                         | (5,790)            | (4,097)           | (10,295)          | (8,779)           |
| Loss on extinguishment of debt           |                    |                   | (2,156)           |                   |
|  | <b>\$ 22,298</b>   | <b>\$ 19,735</b>  | <b>\$ 33,331</b>  | <b>\$ 33,795</b>  |

14. On November 24, 2004, the Company completed a public offering of 3.7 million shares of common stock, including shares sold under the underwriters over-allotment option, priced at \$31.25 per share, generating net proceeds of approximately \$108.5 million, of which \$5.0 million was used to pay off existing credit facilities. The funds provide additional financial resources for acquisitions and general corporate purposes. The Company issued 100,028 and 154,411 shares under its employee stock plans during the six month periods ended April 28, 2006 and April 29, 2005, respectively.
  
15. On November 15, 2005, the \$30.0 million 6.4% Senior Notes matured and were paid. Additionally, on November 15, 2005, the Company prepaid the outstanding principal amount of the \$40.0 million 6.77% Senior Notes due November 15, 2008. Under the terms of the Note Purchase Agreement, the Company paid an additional \$2.2 million make-whole payment, which was recorded as a loss on extinguishment of debt in the first fiscal quarter of 2006. On February 10, 2006, the Company amended its credit agreement to provide a \$100.0 million term loan facility, which may be drawn in U.S. dollars, U.K. pounds or euros. In addition, the amendment provides that up to \$25.0 million of the credit facility and up to \$50.0 million of the letter of credit may be drawn in U.K. pounds or euros in addition to U.S. dollars. On February 10, 2006, the Company borrowed U.K. £57.0 million, or approximately \$100.0 million, under the term loan facility. The Company used the proceeds from the loan as working capital for its U.K. operations and to repay a portion of its outstanding borrowings under the revolving credit facility. The principal amount of the loan is payable quarterly commencing on March 31, 2007 through the termination date of November 14, 2010, according to a payment schedule by which 1.25% of the principal amount is paid in each quarter of 2007, 2.50% in each quarter of 2008, 5.00% in each quarter of 2009 and 16.25% in each quarter of 2010. The loan accrues interest at a variable rate based on the British Bankers Association Interest Settlement Rate for deposits in U.K. pounds plus an additional margin amount that ranges from 1.125% to 0.500% depending upon the Company's leverage ratio. As of February 10, 2006, the initial interest rate on the term loan was 5.33%. The Company entered into an interest rate swap agreement on the full principal amount by which the variable interest rate was exchanged for a fixed interest rate of 4.755% plus an additional margin amount determined by reference to the Company's leverage ratio. In addition, in November 2005, the Company collateralized a \$9.9 million letter of credit with an equivalent amount of cash and cash equivalents.
  
16. The following schedules set forth condensed consolidating financial information as required by Rule 3-10 of Securities and Exchange Commission Regulation S-X as of April 28, 2006, and October 28, 2005, and for the applicable periods ended April 28, 2006, and April 29, 2005, for (a) Esterline Technologies Corporation (the Parent); (b) on a combined basis, the subsidiary guarantors (Guarantor Subsidiaries) of the Senior Subordinated Notes which include Advanced Input Devices, Inc., Amtech Automated Manufacturing Technology, Angus Electronics Co., Armtec Countermeasures Co., Armtec Countermeasures TNO Co., Armtec Defense Products Co., AVISTA, Incorporated, BVR Technologies Co., Equipment Sales Co., EA Technologies Corporation, Esterline Sensors Services Americas, Inc., Esterline Technologies Holdings Limited, H.A. Sales Co., Hauser Inc., Hytek Finishes Co., Janco



Corporation, Kirkhill-TA Co., Korry Electronics Co., Leach Holding Corporation, Leach International Corporation, Leach Technology Group, Inc., Mason Electric Co., MC Tech Co., Memtron Technologies Co., Norwich Aero Products, Inc., Palomar Products, Inc., Pressure Systems, Inc., Pressure Systems International, Inc., Surftech Finishes Co., UMM Electronics Inc., and (c) on a combined basis, the subsidiary non-guarantors (Non-Guarantor Subsidiaries), which include Auxitrol S.A., Auxitrol Technologies S.A., Darchem Holdings Ltd., Esterline Sensors Services Asia PTD, Ltd., Esterline Technologies Denmark Aps (Denmark), Esterline Technologies Ltd. (England), Esterline Technologies Ltd. (Hong Kong), Guizhou Leach-Tianyi Aviation Electrical Company Ltd. (China), Leach International Asia-Pacific Ltd. (Hong Kong), Leach International Europe S.A. (France), Leach International Germany GmbH (Germany), Leach International Mexico S. de R.L. de C.V. (Mexico), Leach International U.K. (England), LRE Medical GmbH (Germany), Muirhead Aerospace Ltd., Norcroft Dynamics Ltd., Pressure Systems International Ltd., Wallop Defence Systems Limited, Weston Aero Ltd. (England), and Weston Aerospace Ltd. (England). The guarantor subsidiaries are direct and indirect wholly-owned subsidiaries of Esterline Technologies and have fully and unconditionally, jointly and severally, guaranteed the Senior Subordinated Notes.

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Condensed Consolidating Balance Sheet as of April 28, 2006.

| (In thousands)                     | Parent              | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations          | Total               |
|------------------------------------|---------------------|---------------------------|-----------------------------------|-----------------------|---------------------|
| <b>Assets</b>                      |                     |                           |                                   |                       |                     |
| <b>Current Assets</b>              |                     |                           |                                   |                       |                     |
| Cash and cash equivalents          | \$ 19,951           | \$ 6,089                  | \$ 20,216                         | \$                    | \$ 46,256           |
| Cash in escrow                     | 4,315               |                           |                                   |                       | 4,315               |
| Accounts receivable, net           | 1,068               | 89,891                    | 80,277                            |                       | 171,236             |
| Inventories                        |                     | 100,500                   | 68,179                            |                       | 168,679             |
| Deferred income tax benefits       | 23,084              | 4                         | 3,584                             |                       | 26,672              |
| Prepaid expenses                   | 195                 | 5,376                     | 4,898                             |                       | 10,469              |
| <b>Total Current Assets</b>        | <b>48,613</b>       | <b>201,860</b>            | <b>177,154</b>                    |                       | <b>427,627</b>      |
| Property, Plant & Equipment, Net   | 2,557               | 102,307                   | 61,815                            |                       | 166,679             |
| Goodwill                           |                     | 195,474                   | 165,310                           |                       | 360,784             |
| Intangibles, Net                   | 107                 | 79,082                    | 166,656                           |                       | 245,845             |
| Debt Issuance Costs, Net           | 4,806               |                           |                                   |                       | 4,806               |
| Deferred Income Tax Benefits       | 13,900              | 1,637                     | 2,236                             |                       | 17,773              |
| Other Assets                       | 3,531               | 16,794                    | 6,248                             |                       | 26,573              |
| Amounts Due (To) From Subsidiaries | 235,371             | 73,061                    |                                   | (308,432)             |                     |
| Investment in Subsidiaries         | 719,030             |                           |                                   | (719,030)             |                     |
| <b>Total Assets</b>                | <b>\$ 1,027,915</b> | <b>\$ 670,215</b>         | <b>\$ 579,419</b>                 | <b>\$ (1,027,462)</b> | <b>\$ 1,250,087</b> |

| (In thousands)                                   | Parent              | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations          | Total               |
|--|---------------------|---------------------------|-----------------------------------|-----------------------|---------------------|
| <b>Liabilities and Shareholders Equity</b>       |                     |                           |                                   |                       |                     |
| <b>Current Liabilities</b>                       |                     |                           |                                   |                       |                     |
| Accounts payable                                 | \$ 2,299            | \$ 20,928                 | \$ 36,748                         | \$                    | \$ 59,975           |
| Accrued liabilities                              | 27,459              | 51,030                    | 30,301                            |                       | 108,790             |
| Credit facilities                                | 14,000              |                           | 4,413                             |                       | 18,413              |
| Current maturities of long-term debt             | 1,300               | 1,026                     | 751                               |                       | 3,077               |
| Federal and foreign income taxes                 | 3,925               | 70                        | 1,756                             |                       | 5,751               |
| <b>Total Current Liabilities</b>                 | <b>48,983</b>       | <b>73,054</b>             | <b>73,969</b>                     |                       | <b>196,006</b>      |
| Long-Term Debt, Net                              | 275,314             | 2,862                     | 1,580                             |                       | 279,756             |
| Deferred Income Taxes                            | 31,346              | (13)                      | 43,473                            |                       | 74,806              |
| Other Liabilities                                | 10,438              | 17,139                    | 6,950                             |                       | 34,527              |
| Amounts Due To (From) Subsidiaries               |                     |                           | 291,939                           | (291,939)             |                     |
| Minority Interest                                |                     |                           | 3,158                             |                       | 3,158               |
| Shareholders Equity                              | 661,834             | 577,173                   | 158,350                           | (735,523)             | 661,834             |
| <b>Total Liabilities and Shareholders Equity</b> | <b>\$ 1,027,915</b> | <b>\$ 670,215</b>         | <b>\$ 579,419</b>                 | <b>\$ (1,027,462)</b> | <b>\$ 1,250,087</b> |

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Condensed Consolidating Statement of Operations for the three month period ended April 28, 2006.

| (In thousands)  | Parent    | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Total      |
|---|-----------|---------------------------|-----------------------------------|--------------|------------|
| Net Sales   | \$        | \$ 161,486                | \$ 88,604                         | \$ (2,151)   | \$ 247,939 |
| Cost of Sales   |           | 107,985                   | 61,366                            | (2,151)      | 167,200    |
|   |           | 53,501                    | 27,238                            |              | 80,739     |
| Expenses  |           |                           |                                   |              |            |
| Selling, general and administrative                               |           | 23,984                    | 16,989                            |              | 40,973     |
| Research, development and engineering                             |           | 5,488                     | 7,451                             |              | 12,939     |
| Total Expenses  |           | 29,472                    | 24,440                            |              | 53,912     |
| Operating Earnings From Continuing Operations                     |           | 24,029                    | 2,798                             |              | 26,827     |
| Other (income) expense  |           |                           | (263)                             |              | (263)      |
| Interest income   | (4,957)   | (631)                     | (977)                             | 5,567        | (998)      |
| Interest expense  | 5,581     | 1,067                     | 4,709                             | (5,567)      | 5,790      |
| Loss on extinguishment of debt                                    |           |                           |                                   |              |            |
| Other Expense, Net  | 624       | 436                       | 3,469                             |              | 4,529      |
| Income (Loss) From Continuing Operations Before Taxes             | (624)     | 23,593                    | (671)                             |              | 22,298     |
| Income Tax Expense (Benefit)                                      | (153)     | 4,500                     | (40)                              |              | 4,307      |
| Income (Loss) From Continuing Operations Before Minority Interest | (471)     | 19,093                    | (631)                             |              | 17,991     |
| Minority Interest   |           |                           | (332)                             |              | (332)      |
| Income (Loss) From Continuing Operations                          | (471)     | 19,093                    | (963)                             |              | 17,659     |
| Equity in Net Income of Consolidated Subsidiaries                 | 18,130    |                           |                                   | (18,130)     |            |
| Net Income (Loss)   | \$ 17,659 | \$ 19,093                 | \$ (963)                          | \$ (18,130)  | \$ 17,659  |

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Condensed Consolidating Statement of Operations for the six month period ended April 28, 2006.

| (In thousands)  | Parent    | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Total      |
|---|-----------|---------------------------|-----------------------------------|--------------|------------|
| Net Sales   | \$        | \$ 304,882                | \$ 155,872                        | \$ (7,150)   | \$ 453,604 |
| Cost of Sales   |           | 207,459                   | 109,697                           | (7,150)      | 310,006    |
|   |           | 97,423                    | 46,175                            |              | 143,598    |
| Expenses  |           |                           |                                   |              |            |
| Selling, general and administrative                               |           | 47,880                    | 28,983                            |              | 76,863     |
| Research, development and engineering                             |           | 10,590                    | 12,682                            |              | 23,272     |
| Total Expenses  |           | 58,470                    | 41,665                            |              | 100,135    |
| Operating Earnings From Continuing Operations                     |           | 38,953                    | 4,510                             |              | 43,463     |
| Other (income) expense  |           |                           | (462)                             |              | (462)      |
| Interest income   | (9,157)   | (1,265)                   | (1,880)                           | 10,445       | (1,857)    |
| Interest expense  | 9,989     | 2,093                     | 8,658                             | (10,445)     | 10,295     |
| Loss on extinguishment of debt                                    | 2,156     |                           |                                   |              | 2,156      |
| Other Expense, Net  | 2,988     | 828                       | 6,316                             |              | 10,132     |
| Income (Loss) From Continuing Operations Before Taxes             | (2,988)   | 38,125                    | (1,806)                           |              | 33,331     |
| Income Tax Expense (Benefit)                                      | (817)     | 8,925                     | (1,245)                           |              | 6,863      |
| Income (Loss) From Continuing Operations Before Minority Interest | (2,171)   | 29,200                    | (561)                             |              | 26,468     |
| Minority Interest   |           |                           | (445)                             |              | (445)      |
| Income (Loss) From Continuing Operations                          | (2,171)   | 29,200                    | (1,006)                           |              | 26,023     |
| Equity in Net Income of Consolidated Subsidiaries                 |           | 28,194                    |                                   | (28,194)     |            |
| Net Income (Loss)   | \$ 26,023 | \$ 29,200                 | \$ (1,006)                        | \$ (28,194)  | \$ 26,023  |

Condensed Consolidating Statement of Cash Flows for the six month period ended April 28, 2006.

| (In thousands)  | Parent    | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Total     |
|---|-----------|---------------------------|-----------------------------------|--------------|-----------|
| <b>Cash Flows Provided (Used) by Operating Activities</b> |           |                           |                                   |              |           |
| Net earnings (loss)                                       | \$ 26,023 | \$ 29,200                 | \$ (1,006)                        | \$ (28,194)  | \$ 26,023 |
| Minority interest   |           |                           | 445                               |              | 445       |
| Depreciation & amortization                               |           | 11,937                    | 7,901                             |              | 19,838    |
| Deferred income taxes                                     | (1,488)   | 95                        | 1,978                             |              | 585       |
| Stock-based compensation                                  |           | 1,775                     | 874                               |              | 2,649     |
| Gain on sale of short-term investments                    | (610)     |                           |                                   |              | (610)     |
| Working capital changes, net of effect of acquisitions    |           |                           |                                   |              |           |
| Accounts receivable                                       | (397)     | 7,156                     | (5,840)                           |              | 919       |
| Inventories   |           | (15,043)                  | (7,046)                           |              | (22,089)  |
| Prepaid expenses  | (16)      | (883)                     | (1,209)                           |              | (2,108)   |
| Accounts payable  | 1,309     | 669                       | 4,376                             |              | 6,354     |
| Accrued liabilities                                       | (4,895)   | (2,617)                   | (2,180)                           |              | (9,692)   |
| Federal & foreign income taxes                            | 291       | (6)                       | (5,509)                           |              | (5,224)   |
| Other liabilities   | 1,115     | 58                        | (58)                              |              | 1,115     |
| Other, net  | 123       | (434)                     | (424)                             |              | (735)     |
|   | 21,455    | 31,907                    | (7,698)                           | (28,194)     | 17,470    |
| <b>Cash Flows Provided (Used) by Investing Activities</b> |           |                           |                                   |              |           |
| Purchases of capital assets                               | (126)     | (7,115)                   | (5,151)                           |              | (12,392)  |
| Proceeds from sale of capital assets                      | 5         | 379                       | 74                                |              | 458       |
| Proceeds from sale of short-term investments              | 63,266    |                           |                                   |              | 63,266    |
| Acquisitions of businesses, net                           |           | (9,889)                   | (179,778)                         |              | (189,667) |
|   | 63,145    | (16,625)                  | (184,855)                         |              | (138,335) |

| (In thousands)   | Parent    | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Total     |
|--|-----------|---------------------------|-----------------------------------|--------------|-----------|
| <b>Cash Flows Provided (Used) by Financing Activities</b>      |           |                           |                                   |              |           |
| Proceeds provided by stock issuance under employee stock plans | 2,351     |                           |                                   |              | 2,351     |
| Excess tax benefits from stock option exercises                | 359       |                           |                                   |              | 359       |
| Net change in credit facilities                                | 14,000    |                           | 2,188                             |              | 16,188    |
| Proceeds from issuance of long-term debt                       | 100,000   |                           |                                   |              | 100,000   |
| Repayment of long-term debt                                    | (66,037)  | (324)                     | (4,195)                           |              | (70,556)  |
| Net change in intercompany financing                           | (190,686) | (10,945)                  | 173,437                           | 28,194       |           |
|  | (140,013) | (11,269)                  | 171,430                           | 28,194       | 48,342    |
| Effect of Foreign Exchange Rates on Cash                       |           | (78)                      | 553                               |              | 475       |
| Net Increase (Decrease) in Cash and Cash Equivalents           | (55,413)  | 3,935                     | (20,570)                          |              | (72,048)  |
| Cash and Cash Equivalents Beginning of Period                  | 75,364    | 2,154                     | 40,786                            |              | 118,304   |
| Cash and Cash Equivalents End of Period                        | \$ 19,951 | \$ 6,089                  | \$ 20,216                         | \$           | \$ 46,256 |

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Condensed Consolidating Balance Sheet as of October 28, 2005.

| (In thousands)                     | Parent            | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations        | Total               |
|------------------------------------|-------------------|---------------------------|-----------------------------------|---------------------|---------------------|
| <b>Assets</b>                      |                   |                           |                                   |                     |                     |
| <b>Current Assets</b>              |                   |                           |                                   |                     |                     |
| Cash and cash equivalents          | \$ 75,364         | \$ 2,154                  | \$ 40,786                         | \$                  | \$ 118,304          |
| Cash in escrow                     | 11,918            |                           |                                   |                     | 11,918              |
| Short-term investments             | 62,656            |                           |                                   |                     | 62,656              |
| Accounts receivable, net           | 671               | 96,931                    | 52,149                            |                     | 149,751             |
| Inventories                        |                   | 84,351                    | 46,118                            |                     | 130,469             |
| Deferred income tax benefits       | 25,115            | 102                       | 1,651                             |                     | 26,868              |
| Prepaid expenses                   | 179               | 4,481                     | 2,873                             |                     | 7,533               |
| Other current assets               |                   |                           |                                   |                     |                     |
| <b>Total Current Assets</b>        | <b>175,903</b>    | <b>188,019</b>            | <b>143,577</b>                    |                     | <b>507,499</b>      |
| Property, Plant & Equipment, Net   | 2,687             | 95,001                    | 40,526                            |                     | 138,214             |
| Goodwill                           |                   | 191,919                   | 69,248                            |                     | 261,167             |
| Intangibles, Net                   | 107               | 82,196                    | 83,815                            |                     | 166,118             |
| Debt Issuance Costs, Net           | 5,144             |                           |                                   |                     | 5,144               |
| Deferred Income Tax Benefits       | 11,257            |                           | 2,063                             |                     | 13,320              |
| Other Assets                       | 2,638             | 16,266                    | 4,882                             |                     | 23,786              |
| Amounts Due (To) From Subsidiaries | 134,964           | 64,835                    |                                   | (199,799)           |                     |
| Investment in Subsidiaries         | 615,599           | 129                       | (128)                             | (615,600)           |                     |
| <b>Total Assets</b>                | <b>\$ 948,299</b> | <b>\$ 638,365</b>         | <b>\$ 343,983</b>                 | <b>\$ (815,399)</b> | <b>\$ 1,115,248</b> |



| (In thousands)                                   | Parent            | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations        | Total               |
|--|-------------------|---------------------------|-----------------------------------|---------------------|---------------------|
| <b>Liabilities and Shareholders Equity</b>       |                   |                           |                                   |                     |                     |
| <b>Current Liabilities</b>                       |                   |                           |                                   |                     |                     |
| Accounts payable                                 | \$ 990            | \$ 19,877                 | \$ 20,586                         | \$                  | \$ 41,453           |
| Accrued liabilities                              | 38,620            | 53,246                    | 27,249                            |                     | 119,115             |
| Credit facilities                                |                   |                           | 2,031                             |                     | 2,031               |
| Current maturities of long-term debt             | 70,000            |                           | 934                               |                     | 70,934              |
| Federal and foreign income taxes                 | 3,634             | 76                        | 5,088                             |                     | 8,798               |
| <b>Total Current Liabilities</b>                 | <b>113,244</b>    | <b>73,199</b>             | <b>55,888</b>                     |                     | <b>242,331</b>      |
| Long-Term Debt, Net                              | 173,988           |                           | 1,694                             |                     | 175,682             |
| Deferred Income Taxes                            | 30,880            | (10)                      | 15,551                            |                     | 46,421              |
| Other Liabilities                                | 9,323             | 11,209                    | 6,705                             |                     | 27,237              |
| Amounts Due To (From) Subsidiaries               |                   |                           | 195,829                           | (195,829)           |                     |
| Minority Interest                                |                   |                           | 2,713                             |                     | 2,713               |
| Shareholders Equity                              | 620,864           | 553,967                   | 65,603                            | (619,570)           | 620,864             |
| <b>Total Liabilities and Shareholders Equity</b> | <b>\$ 948,299</b> | <b>\$ 638,365</b>         | <b>\$ 343,983</b>                 | <b>\$ (815,399)</b> | <b>\$ 1,115,248</b> |

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Condensed Consolidating Statement of Operations for the three month period ended April 29, 2005.

| (In thousands)  | Parent    | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Total      |
|---|-----------|---------------------------|-----------------------------------|--------------|------------|
| Net Sales   | \$        | \$ 141,165                | \$ 75,528                         | \$ (5,101)   | \$ 211,592 |
| Cost of Sales   |           | 97,380                    | 50,775                            | (5,101)      | 143,054    |
|   |           | 43,785                    | 24,753                            |              | 68,538     |
| Expenses  |           |                           |                                   |              |            |
| Selling, general and administrative                               |           | 24,143                    | 11,694                            |              | 35,837     |
| Research, development and engineering                             |           | 4,191                     | 5,675                             |              | 9,866      |
| Total Expenses  |           | 28,334                    | 17,369                            |              | 45,703     |
| Operating Earnings From Continuing Operations                     |           | 15,451                    | 7,384                             |              | 22,835     |
| Other (income) expense  | 50        | 16                        | (38)                              |              | 28         |
| Interest income   | (4,027)   | (571)                     | (666)                             | 4,239        | (1,025)    |
| Interest expense  | 4,492     | 1,033                     | 2,811                             | (4,239)      | 4,097      |
| Other Expense, Net  | 515       | 478                       | 2,107                             |              | 3,100      |
| Income (Loss) From Continuing Operations Before Taxes             | (515)     | 14,973                    | 5,277                             |              | 19,735     |
| Income Tax Expense (Benefit)                                      | (165)     | 4,470                     | 1,669                             |              | 5,974      |
| Income (Loss) From Continuing Operations Before Minority Interest | (350)     | 10,503                    | 3,608                             |              | 13,761     |
| Minority Interest   |           |                           | (35)                              |              | (35)       |
| Income (Loss) From Continuing Operations                          | (350)     | 10,503                    | 3,573                             |              | 13,726     |
| Loss From Discontinued Operations, Net of Tax                     |           | (562)                     |                                   |              | (562)      |
| Equity in Net Income of Consolidated Subsidiaries                 | 13,514    |                           |                                   | (13,514)     |            |
| Net Income (Loss)   | \$ 13,164 | \$ 9,941                  | \$ 3,573                          | \$ (13,514)  | \$ 13,164  |

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Condensed Consolidating Statement of Operations for the six month period ended April 29, 2005.

| (In thousands)  | Parent    | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Total      |
|---|-----------|---------------------------|-----------------------------------|--------------|------------|
| Net Sales   | \$        | \$ 266,494                | \$ 143,846                        | \$ (8,956)   | \$ 401,384 |
| Cost of Sales   |           | 187,164                   | 96,538                            | (8,956)      | 274,746    |
|   |           | 79,330                    | 47,308                            |              | 126,638    |
| Expenses  |           |                           |                                   |              |            |
| Selling, general and administrative                               |           | 42,422                    | 24,023                            |              | 66,445     |
| Research, development and engineering                             |           | 7,722                     | 11,391                            |              | 19,113     |
| Total Expenses  |           | 50,144                    | 35,414                            |              | 85,558     |
| Operating Earnings From Continuing Operations                     |           | 29,186                    | 11,894                            |              | 41,080     |
| Other expense   | 50        | 16                        |                                   |              | 66         |
| Interest income   | (7,580)   | (1,696)                   | (1,274)                           | 8,990        | (1,560)    |
| Interest expense  | 8,981     | 2,565                     | 6,223                             | (8,990)      | 8,779      |
| Other Expense, Net  | 1,451     | 885                       | 4,949                             |              | 7,285      |
| Income (Loss) From Continuing Operations Before Taxes             | (1,451)   | 28,301                    | 6,945                             |              | 33,795     |
| Income Tax Expense (Benefit)                                      | (426)     | 8,278                     | 2,086                             |              | 9,938      |
| Income (Loss) From Continuing Operations Before Minority Interest | (1,025)   | 20,023                    | 4,859                             |              | 23,857     |
| Minority Interest   |           |                           | (48)                              |              | (48)       |
| Income (Loss) From Continuing Operations                          | (1,025)   | 20,023                    | 4,811                             |              | 23,809     |
| Income From Discontinued Operations, Net of Tax                   |           | 6,965                     |                                   |              | 6,965      |
| Equity in Net Income of Consolidated Subsidiaries                 | 31,799    |                           |                                   | (31,799)     |            |
| Net Income (Loss)   | \$ 30,774 | \$ 26,988                 | \$ 4,811                          | \$ (31,799)  | \$ 30,774  |

Condensed Consolidating Statement of Cash Flows for the six month period ended April 29, 2005.

| (In thousands)  | Parent    | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Total     |
|---|-----------|---------------------------|-----------------------------------|--------------|-----------|
| <b>Cash Flows Provided (Used) by Operating Activities</b> |           |                           |                                   |              |           |
| Net earnings (loss)                                       | \$ 30,774 | \$ 26,988                 | \$ 4,811                          | \$ (31,799)  | \$ 30,774 |
| Minority interest   |           |                           | 49                                |              | 49        |
| Depreciation & amortization                               |           | 11,059                    | 7,449                             |              | 18,508    |
| Deferred income taxes                                     | 4,294     |                           | (2,464)                           |              | 1,830     |
| Stock-based compensation                                  |           | 519                       | 161                               |              | 680       |
| Gain on sale of discontinued operation                    |           | (9,456)                   |                                   |              | (9,456)   |
| Loss on sale of building                                  |           | 59                        |                                   |              | 59        |
| Working capital changes, net of effect of acquisitions    |           |                           |                                   |              |           |
| Accounts receivable                                       | 1,549     | 8,019                     | (6,528)                           |              | 3,040     |
| Inventories   |           | (11,112)                  | (3,423)                           |              | (14,535)  |
| Prepaid expenses  | 107       | (1,895)                   | 2,561                             |              | 773       |
| Accounts payable  | (285)     | 144                       | 4,355                             |              | 4,214     |
| Accrued liabilities                                       | 442       | 1,226                     | (914)                             |              | 754       |
| Federal & foreign income taxes                            | (4,837)   | 5                         | 5,304                             |              | 472       |
| Other liabilities   | 1,109     | 44                        | 147                               |              | 1,300     |
| Other, net  | 665       | (651)                     | (696)                             |              | (682)     |
|   | 33,818    | 24,949                    | 10,812                            | (31,799)     | 37,780    |
| <b>Cash Flows Provided (Used) by Investing Activities</b> |           |                           |                                   |              |           |
| Purchases of capital assets                               | (208)     | (6,669)                   | (2,465)                           |              | (9,342)   |
| Proceeds from sale of discontinued operation              |           | 21,421                    |                                   |              | 21,421    |
| Proceeds from sale of building                            |           | 2,319                     |                                   |              | 2,319     |
| Proceeds from sale of capital assets                      | 5         | 74                        | 67                                |              | 146       |
| Purchase of short-term investments                        | (45,486)  |                           |                                   |              | (45,486)  |
| Acquisitions of businesses, net                           |           | (3,346)                   |                                   |              | (3,346)   |
|   | (45,689)  | 13,799                    | (2,398)                           |              | (34,288)  |

| (In thousands)   | Parent     | Guarantor<br>Subsidiaries | Non-<br>Guarantor<br>Subsidiaries | Eliminations | Total      |
|--|------------|---------------------------|-----------------------------------|--------------|------------|
| <b>Cash Flows Provided (Used) by Financing Activities</b>      |            |                           |                                   |              |            |
| Proceeds provided by stock issuance under employee stock plans | 2,435      |                           |                                   |              | 2,435      |
| Proceeds provided by sale of common stock                      | 108,490    |                           |                                   |              | 108,490    |
| Net change in credit facilities                                | (5,000)    |                           | 576                               |              | (4,424)    |
| Repayment of long-term debt                                    | (1,002)    | (57)                      | (415)                             |              | (1,474)    |
| Net change in intercompany financing                           | 86         | (39,445)                  | 7,560                             | 31,799       |            |
|  | 105,009    | (39,502)                  | 7,721                             | 31,799       | 105,027    |
| Effect of Foreign Exchange Rates on Cash                       | 211        | (7)                       | (498)                             |              | (294)      |
| Net Increase (Decrease) in Cash and Cash Equivalents           | 93,349     | (761)                     | 15,637                            |              | 108,225    |
| Cash and Cash Equivalents Beginning of Period                  | 6,859      | 2,353                     | 20,267                            |              | 29,479     |
| Cash and Cash Equivalents End of Period                        | \$ 100,208 | \$ 1,592                  | \$ 35,904                         | \$           | \$ 137,704 |

**Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations**  
**Overview**

We view and operate our businesses in three segments: Avionics & Controls, Sensors & Systems and Advanced Materials. The Avionics & Controls segment designs and manufactures technology interface systems for military and commercial aircraft and land- and sea-based military vehicles, secure communications systems, specialized medical equipment, and other industrial applications. The Sensors & Systems segment produces high-precision temperature and pressure sensors, electrical power switching, control and data communication devices, micro-motors, motion control sensors, and other related systems, principally for aerospace and defense customers. The Advanced Materials segment develops and manufactures high-performance elastomer products used in a wide range of commercial aerospace and military applications and combustible ordnance components and electronic warfare countermeasure devices for military customers. Sales in all segments include domestic, international, defense and commercial customers.

Our current business and strategic plan focuses on the continued development of our products in three key technology segments: avionics and controls, sensors and systems and specialized high-performance elastomers and other complex materials, principally for the aerospace and defense markets. We are concentrating our efforts to expand our capabilities in these markets and to anticipate the global needs of our customers and respond to such needs with comprehensive solutions. These efforts focus on continuous research and new product development, acquisitions and establishing strategic realignments of operations to expand our capabilities as a more comprehensive supplier to our customers across our entire product offering. On March 24, 2006, we acquired all of the outstanding capital stock of Wallop Defence Systems Limited (Wallop), a manufacturer of military pyrotechnic countermeasure devices for U.K. £33.2 million in cash (approximately \$57.9 million including acquisition costs and an adjustment based on the amount of indebtedness and net working capital as of closing). In addition, we may pay an additional purchase price up to U.K. £10.0 million or approximately \$18.2 million, depending on the future financial performance of Wallop. The acquisition strengthens our international position in countermeasure devices. Wallop is included in our Advanced Materials segment. On December 16, 2005, we acquired all of the outstanding capital stock of Darchem Holdings Limited (Darchem), a manufacturer of thermally engineered components for critical aerospace applications for U.K. £68.6 million in cash (approximately \$121.6 million including acquisition costs and an adjustment based on the amount of cash and net working capital of Darchem as of closing). Darchem holds a leading position in its niche market and fits our engineered-to-order model and is included in our Advanced Materials segment.

On January 28, 2005, we completed the sale of the outstanding stock of our wholly owned subsidiary Fluid Regulators Corporation (Fluid Regulators), which was included in our Sensors & Systems segment, for approximately \$21.4 million. As a result of the sale, we

recorded a gain of approximately \$7.0 million, net of tax of \$2.4 million, in the first fiscal quarter of 2005.

On May 13, 2005, we closed a small unit in our Other segment and incurred \$0.4 million in severance, net of \$0.2 million in tax, in the second quarter of fiscal 2005.

The dispositions and closure described above are reported as discontinued operations and the consolidated financial statements for all prior periods have been adjusted to reflect this presentation.

**Results of Continuing Operations**

*Three Month Period Ended April 28, 2006 Compared to Three Month Period Ended April 29, 2005*

Sales for the second fiscal quarter increased 17.2% compared with the prior-year period. Sales by segment were as follows:

| (In thousands)      | Incr./(Decr.)<br>from prior<br>year period | Three Months Ended |                   |
|---------------------|--|--------------------|-------------------|
|                     |  | April 28,<br>2006  | April 29,<br>2005 |
| Avionics & Controls | 10.6%                                      | \$ 71,864          | \$ 64,990         |
| Sensors & Systems   | (1.6)%                                     | 83,177             | 84,541            |
| Advanced Materials  | 49.7%                                      | 92,898             | 62,061            |
| Total Net Sales     |  | \$ 247,939         | \$ 211,592        |

The 10.6% increase in Avionics & Controls principally reflected incremental sales from the Palomar acquisition in the third fiscal quarter of 2005 and increased sales volumes of cockpit controls due to new OEM programs. These sales increases were partially offset by a decrease in sales of medical devices due to one customer's decision to source its requirements from a low-cost country. We expect to replace this business with new or existing customers who meet our targeted profile of requiring highly engineered solutions, generally lower production volumes and higher product mix.

The 1.6% decrease in sales of Sensors & Systems principally reflected lower motion control distribution sales to the British Ministry of Defence (British MoD). In addition, pressure sensor sales in the second fiscal quarter of 2005 were enhanced by a retrofit program. Sensors & Systems sales also reflected a weaker U.K. pound and euro relative to the U.S. dollar, as the average exchange rate from the U.K. pound and euro to the U.S. dollar decreased from 1.89 and 1.31 in the second quarter of fiscal 2005 to 1.76 and 1.21 in the second quarter of fiscal 2006. These decreases in sensors sales were partially offset by increased sales of electrical power switching devices from new OEM programs.

The 49.7% increase in Advanced Materials reflected \$20.1 million in incremental sales from the acquisitions of Darchem and Wallop and higher sales of combustible ordnance, countermeasure devices and elastomer material to aerospace and defense customers.

Overall, for the second quarter of fiscal 2006, gross margin as a percentage of sales was 32.6% compared with 32.4% for the second quarter of fiscal 2005. Avionics & Controls segment gross margin was 35.1% and 33.7% for the second fiscal quarter of 2006 and 2005, respectively. Avionics & Controls gross margin increased from the prior-year period due to a higher mix of cockpit control sales and stronger medical equipment gross margins due to improved cost control and higher unit prices. Sensors & Systems segment gross margin was 34.0% and 35.3% for the second fiscal quarter of 2006 and 2005, respectively. The decrease in gross margin reflected



lower after-market spares sales, production inefficiencies and increased rent, maintenance and energy expenses at our pressure and temperature sensor operations. Gross margin was also impacted by the effect of our hedging activities related to U.S. dollar denominated sales. Advanced Materials segment gross margin was 29.3% and 27.0% for the second fiscal quarter of 2006 and 2005, respectively. Gross margin was favorably impacted by increased sales of our higher gross margin combustible ordnance and elastomer clamping devices as well as improved operating efficiencies at our flare countermeasure operations. The prior-year period gross margin was negatively impacted by lower sales volumes of combustible ordnance and incremental start-up costs on certain flare countermeasure devices.

Selling, general and administrative expenses (which include corporate expenses) totaled \$41.0 million and \$35.8 million for the second fiscal quarter of 2006 and 2005, respectively, or 16.5% of sales for the second fiscal quarter of 2006 compared with 16.9% for the prior-year period. Selling, general and administrative expenses include stock option expense of \$1.3 million in the second fiscal quarter of 2006, resulting from accounting for stock option expense under Financial Accounting Standards No. 123(R), Share-Based Payment, (Statement 123(R)). For information on our adoption of Statement 123(R), see Note 11 of the condensed consolidated financial statements. In the second fiscal quarter of 2005, we recorded \$1.4 million of stock option expense under the variable method of accounting. The overall increase in the amount of selling, general and administrative expenses primarily reflected incremental selling, general and administrative expenses as a result of the Darchem and Palomar acquisitions. The decrease in selling, general and administrative expenses as a percentage of sales principally reflected higher sales volumes without a proportional increase in the expense during the current fiscal quarter. Our selling, general and administrative expenses are typically fixed.

Research, development and engineering spending was \$12.9 million, or 5.2% of sales, for the second fiscal quarter of 2006 compared with \$9.9 million, or 4.7% of sales, for the second fiscal quarter of 2005. Darchem's research, development and engineering spending is relatively low as a percentage of sales compared to our other operating units. If research, development and engineering spending as a percentage of sales is calculated excluding Darchem, the percentage is 5.6%, which is considered by management to be a better comparison to the prior year. The increase in research, development and engineering principally reflected spending on new programs including the A400 primary power distribution assembly, TP400 engine sensors, 787 overhead panel control and 787 environmental control programs. Research, development and engineering is net of a \$0.5 million government subsidy due from France in the second quarter of fiscal 2006. Research, development and engineering spending is expected to increase for the balance of the year before returning to historical levels.

Segment earnings (operating earnings excluding corporate expenses) for the second fiscal quarter of 2006 totaled \$34.3 million, compared with \$29.1 million for the second fiscal quarter in 2005. Avionics & Controls segment earnings were \$11.3 million for the second fiscal quarter of 2006 compared with \$9.2 million for the second fiscal quarter of 2005, principally reflecting strong results from our cockpit control and medical equipment operations. We believe that the earnings growth acceleration we experienced from our medical equipment operations during the second

fiscal quarter of 2006 may moderate in the second half of the fiscal year. Stock option expense was \$0.2 million in the second fiscal quarter of 2006 compared with \$0.4 million in the second fiscal quarter of 2005.

Sensors & Systems segment earnings were \$7.3 million for the second quarter of fiscal 2006 compared with \$11.2 million for the second quarter of fiscal 2005. The decrease in earnings reflects a production ramp up of industrial sensors for a relatively new program and manufacturing inefficiencies and delayed shipments due to employee turnover. Management expects these matters to be resolved by the fourth quarter of fiscal 2006. Sensors & Systems earnings were also impacted by an estimated \$1.0 million charge as a result of a customer contract termination. Stock option expense was \$0.1 million in the second fiscal quarter of 2006 compared with \$0.2 million in the second fiscal quarter of 2005.

Advanced Materials segment earnings were \$15.7 million for the second fiscal quarter of 2006 compared with \$8.7 million for the second fiscal quarter of 2005. Advanced Materials earnings were principally enhanced by increased earnings at our combustible ordnance operations due to strong demand and improved recovery of fixed overhead expenses. Additionally, Advanced Materials earnings reflected incremental earnings from the Darchem acquisition and improved results at our elastomer clamping devices operations. In the second quarter of fiscal 2005, earnings at our combustible ordnance and countermeasure operations were impacted by production inefficiencies on new countermeasure flare products and higher operating expenses. Stock option expense was \$0.1 million in the second fiscal quarter of 2006 compared with \$0.5 million in the second fiscal quarter of 2005.

Interest expense for the second fiscal quarter of 2006 was \$5.8 million compared with \$4.1 million for the second fiscal quarter of 2005, reflecting increased borrowings to finance acquisitions.

The effective income tax rate for the second fiscal quarter of 2006 was 28.3% (before a \$2.0 million reduction of previously estimated tax liabilities) compared with 30.3% for the second fiscal quarter of 2005. On April 25, 2006 we received a Notice of Proposed Adjustment (NOPA) from the State of California Franchise Tax Board covering, among other items, the examination of research and development tax credits for fiscal years 1997 through 2002. As a result of receiving the NOPA we reduced previously estimated tax liabilities by \$2.0 million. The effective tax rate differed from the statutory rate, as both years benefited from various tax credits and benefits and certain foreign interest expense deductions. While the second fiscal quarter of 2006 effective tax rate was impacted by the expiration of the U.S. Research and Experimentation Credit at December 31, 2005, the impact was partially offset by increased benefits from various tax credits and foreign interest deductions.

New orders for the second fiscal quarter of 2006 were \$335.1 million compared with \$263.4 million for the same period in 2005, an increase of 27.2%. The increase in orders principally reflects increased orders for Avionics & Controls and the Darchem and Wallop acquisitions.

Six Month Period Ended April 28, 2006 Compared to Six Month Period Ended April 29, 2005

Year-to-date sales increased 13.0% compared with the prior-year period. Sales by segment were as follows:

| (In thousands)      | Incr./(Decr.)<br>from prior<br>year period | Six Months Ended  |                   |
|---------------------|--|-------------------|-------------------|
|                     |  | April 28,<br>2006 | April 29,<br>2005 |
| Avionics & Controls | 6.7%                                       | \$ 134,306        | \$ 125,845        |
| Sensors & Systems   | (1.4)%                                     | 156,647           | 158,915           |
| Advanced Materials  | 39.5%                                      | 162,651           | 116,624           |
| Total Net Sales     |  | \$ 453,604        | \$ 401,384        |

The 6.7% increase in sales of Avionics & Controls principally reflected incremental sales from the Palomar acquisition and increased sales of cockpit control devices. These sales increases were partially offset by a decrease in sales of medical devices due to one customer's decision to source its requirements from a low-cost country. We expect to replace this business with new or existing customers who meet our targeted profile of requiring highly engineered solutions, generally lower production volumes, and higher product mix.

The 1.4% decrease in sales of Sensors & Systems principally reflected lower motion control distribution sales to the British Ministry of Defence (British MoD). In addition, pressure sensor sales in the first six months of fiscal 2005 were enhanced by a retrofit program. Sensors & Systems sales also reflected a weaker U.K. pound and euro relative to the U.S. dollar, as the average exchange rate from the U.K. pound and euro to the U.S. dollar decreased from 1.89 and 1.31 in the six month period ended April 29, 2005 to 1.75 and 1.20 in the six month period ended April 28, 2006. These decreases in sensors sales were partially offset by increased sales of electrical power switching devices from new OEM programs.

The 39.5% increase in Advanced Materials reflected \$27.4 million in incremental sales from the acquisitions of Darchem and Wallop and higher sales of combustible ordnance, countermeasure devices and elastomer material to aerospace and defense customers.

Overall, gross margin as a percentage of sales was 31.7% and 31.6% for the first six months of fiscal 2006 and 2005, respectively. Avionics & Controls segment gross margin was 35.4% and 32.6% for the first six months of fiscal 2006 and 2005, respectively, reflecting a higher mix of cockpit control sales, increased pricing and an improved recovery of fixed expenses. Sensors & Systems segment gross margin was 33.2% and 35.0% for the first six months of fiscal 2006 and 2005, respectively. The decrease in gross margin reflected lower after-market spares sales, production inefficiencies and increased rent, maintenance and energy expenses at our pressure and temperature sensor operations. Gross margin was also impacted by the effect of our hedging activities related to U.S. dollar-denominated sales. Advanced Materials segment gross margin was 27.0% and 25.7% for the first six months of fiscal 2006 and 2005, respectively. Gross

margin was favorably impacted by higher sales of combustible ordnance and elastomer clamping devices as well as improved operating efficiencies at our flare countermeasure operations.

Selling, general and administrative expenses (which include corporate expenses) totaled \$76.9 million and \$66.4 million for the first six months of fiscal 2006 and 2005, respectively, or 16.9% of sales, for the first six months of fiscal 2006 compared with 16.6% for the prior-year period. Selling, general and administrative expenses include stock option expense of \$2.6 million in the first six months of fiscal 2006, resulting from accounting for stock option expense under Statement 123(R). For information on our adoption of Statement 123(R), see Note 11 of the condensed consolidated financial statements. In the first six months of fiscal 2005, we recorded \$0.7 million in stock option expense under the variable method of accounting. The overall increase in the amount of selling, general and administrative expenses primarily reflected incremental selling, general and administrative expenses as a result of the Darchem and Palomar acquisitions. Our selling, general and administrative expenses are typically fixed.

Research, development and engineering expenses were \$23.3 million, or 5.1% of sales for the first six months of fiscal 2006 compared with \$19.1 million, or 4.8% of sales, for the first six months of fiscal 2005. Darchem's research, development and engineering spending is relatively low as a percentage of sales compared to other operating units. If research, development and engineering spending as a percentage of sales is calculated excluding Darchem, the percentage is 5.4%, which is considered by management to be a better comparison to the prior year. The increase in research, development and engineering principally reflected spending on new programs including the A400 primary power distribution assembly, TP400 engine sensors, 787 overhead panel control and 787 environmental control programs. Research, development and engineering is net of a \$2.3 million government subsidy due from France in the first six months of fiscal 2006. Research, development and engineering spending is expected to increase for the balance of the year before returning to historical levels.

Segment earnings (operating earnings excluding corporate expenses) for the first six months of fiscal 2006 totaled \$57.6 million, compared with \$51.4 million for the prior-year period. Avionics & Controls segment earnings were \$20.7 million for the first six months of fiscal 2006 compared with \$18.6 million in the prior-year period and reflected strong earnings from our cockpit control operations and lower earnings from our medical device operations due to decreased sales volumes as described above. Stock option expense was \$0.4 million and \$0.2 million in the first six months of fiscal 2006 and 2005, respectively.

Sensors & Systems segment earnings were \$13.1 million for the first six months of fiscal 2006 compared with \$17.6 million in the prior-year period. The decrease in earnings reflects a production ramp up of industrial sensors for a relatively new program and manufacturing inefficiencies and delayed shipments due to employee turnover. Sensors & Systems earnings were also impacted by an estimated \$1.0 million charge as a result of a customer contract termination. Additionally, fiscal 2005 results benefited from a retrofit program. Stock option expense was \$0.3 million and \$0.1 million in the first six months of fiscal 2006 and 2005, respectively.

Advanced Materials segment earnings were \$23.8 million for the first six months of fiscal 2006 compared with \$15.2 million for the prior-year period. Advanced Materials earnings were principally enhanced by increased earnings at our combustible ordnance operations due to strong demand and improved recovery of fixed overhead expenses. Additionally, Advanced Materials earnings reflected incremental earnings from the Darchem acquisition and improved results at our elastomer clamping devices operations. Stock option expense was \$0.3 million in the first six months of fiscal 2006 and 2005.

Interest expense for the first six months of fiscal 2006 was \$10.3 million compared with \$8.8 million for the prior-year period, reflecting increased borrowings to finance acquisitions.

The effective income tax rate for the first six months of fiscal 2006 was 29.3%, (before a \$2.9 million reduction of previously estimated tax liabilities) compared with 29.4% for the first six months of fiscal 2005. The effective tax rate differed from the statutory rate, as both years benefited from various tax credits and certain foreign interest expense deductions. On April 25, 2006 we received a Notice of Proposed Adjustment (NOPA) from the State of California Franchise Tax Board covering, among other items, the examination of research and development tax credits for fiscal years 1997 through 2002. As a result of receiving the NOPA we reduced \$2.0 million of previously estimated tax liabilities. Additionally, as a result of a favorable tax audit which was concluded on December 23, 2005, we reduced previously estimated tax liabilities by \$0.9 million. While the effective tax rate in the first six months of fiscal 2006 was impacted by the expiration of the U.S. Research and Experimentation Credit at December 31, 2005, the impact was partially offset by increased benefits from various tax credits and foreign interest deductions.

New orders for the first six months of fiscal 2006 were \$604.2 million compared with \$467.2 million for the same period in fiscal 2005. Backlog at April 28, 2006, was \$633.4 million compared with \$489.6 million at April 29, 2005. The increase in backlog principally reflected the Darchem, Wallop and Palomar acquisitions. Approximately \$270.1 million in backlog is scheduled for delivery after fiscal 2006. Most orders in backlog are subject to cancellation until delivery.

### **Liquidity and Capital Resources**

Cash and cash equivalents and short-term investments at April 28, 2006 totaled \$46.3 million, a decrease of \$134.7 million from October 28, 2005. Net working capital decreased to \$231.6 million at April 28, 2006 from \$265.2 million at October 28, 2005. Sources of cash flows from operating activities principally consist of cash received from the sale of products offset by cash payments for material, labor and operating expenses. Cash flows from operating activities were \$17.5 million and \$37.8 million in the first six months of fiscal 2006 and 2005, respectively. The decrease principally reflected lower cash flows from operating activities of our non-U.S. units, the \$2.3 million research and development subsidy from France not yet received in cash and lower cash collections related to our recent U.K.-based acquisitions. Repayment terms on U.K. trade accounts receivable are generally longer than U.S.-based companies. Additionally, the decrease in cash received from customers reflected slower cash receipts from a China-based customer. The decrease in cash flows from operating activities also reflects increased purchases of inventory, higher payments of interest, the \$2.2 million make-whole payment, and increased cash payments for incentive compensation, which is paid annually in December. The increase in cash for investing activities mainly reflected cash paid for acquisitions of businesses. Additionally, the prior-year period included \$21.4 million in proceeds from the sale of our discontinued operations. The decrease in cash provided by financing activities principally reflected the net proceeds of \$108.5 million from our public offering of 3.7 million shares of common stock completed in the prior-year period. Additionally, the decrease reflected the repayment of our \$30.0 million 6.40% Senior Notes in accordance with terms and the \$40.0 million prepayment of our 6.77% Senior Notes in the first fiscal quarter of 2006.

Capital expenditures, consisting of machinery, equipment and computers, are anticipated to be approximately \$22.0 million during fiscal 2006, compared with \$23.8 million expended in fiscal 2005. Capital expenditures for the first six months of fiscal 2006 totaled \$12.4 million, primarily for machinery and equipment and enhancements to information systems.

Total debt at April 28, 2006 was \$301.2 million and consisted of \$175.0 million of Senior Subordinated Notes, \$104.0 million term loan facility, \$14.0 million under our U.S. credit facility, and \$8.2 million of various foreign currency debt agreements, including capital lease obligations. The Senior Subordinated Notes mature June 15, 2013, bear interest at 7.75% and contain customary covenants, including restrictions on incurrence of additional debt in certain circumstances, repurchase of our common stock, declaration of dividends, retirement or redemption of subordinated debt, creation of liens and certain asset dispositions. We are in compliance with these covenants and do not view the restrictions as limiting our planned activities. In September 2003 we entered into an interest rate swap agreement on \$75 million of our Senior Subordinated Notes due in 2013. The swap agreement exchanged the fixed rate for a variable interest rate on \$75 million of the \$175 million principal amount outstanding. On November 15, 2005, the \$30.0 million 6.4% Senior Notes matured and were paid. Additionally, on November 15, 2005, we prepaid the outstanding principal amount of \$40.0 million of our 6.77% Senior Notes due November 15, 2008. Under the terms of the Note Purchase Agreement, we paid an additional \$2.2 million make-whole payment, which was recorded as a loss on

extinguishment of debt in the first quarter of fiscal 2006. On February 10, 2006, we amended our credit agreement to provide a \$100.0 million term loan facility, which may be drawn in U.S. dollars, U.K. pounds or euros. In addition, the amendment provides that up to \$25.0 million of the credit facility and up to \$50.0 million of the letter of credit may be drawn in U.K. pounds or euros in addition to U.S. dollars. On February 10, 2006 we borrowed U.K. £57.0 million, or approximately \$100 million, under the term loan facility. We used the proceeds from the loan as working capital for our U.K. operations and to repay a portion of our outstanding borrowings under our revolving credit facility. The principal amount of the loan is payable quarterly commencing on March 31, 2007 through the termination date of November 14, 2010 according to a payment schedule by which 1.25% of the principal amount is paid in each quarter of 2007, 2.50% in each quarter of 2008, 5.00% in each quarter of 2009 and 16.25% in each quarter of 2010. The loan accrues interest at a variable rate based on the British Bankers Association Interest Settlement Rate for deposits in U.K. pounds plus an additional margin amount that ranges from 1.125% to 0.500% depending upon our leverage ratio. At February 10, 2006, the initial interest rate on the term loan was 5.33%. We also entered into an interest rate swap agreement on the full principal amount of the term loan, exchanging the variable interest rate for a fixed interest rate of 4.755% plus an additional margin amount determined by reference to the Company's leverage ratio. In addition, in November 2005, we collateralized a \$9.9 million letter of credit with an equivalent amount of cash and cash equivalents.

We believe cash on hand and funds generated from operations are adequate to service operating cash requirements and capital expenditures through April 2007. In addition, we believe that we have adequate access to capital markets to fund future acquisitions.

### **Forward-Looking Statements**

This quarterly report on Form 10-Q contains forward-looking statements. These statements relate to future events or our future financial performance. In some cases you can identify forward-looking statements by terminology such as anticipate, believe, continue, could, estimate, expect, intend, may, might, plan, potential, predict, should or will or the negative of such terms or other comparable terminology. Forward-looking statements are only predictions and involve known and unknown risks, uncertainties and other factors, including the risk factors set forth in

Forward-Looking Statements and Risk Factors in our Annual Report on Form 10-K for the fiscal year ended October 28, 2005, that may cause our or the industry's actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by such forward-looking statements. You should not place undue reliance on these forward-looking statements. Although we believe that the expectations reflected in the forward-looking statements are reasonable, we cannot guarantee future results, performance or achievements. Given these risks and uncertainties, you are cautioned not to place undue reliance on such forward-looking statements. The forward-looking statements included or incorporated by reference into this report are made only as of the date hereof. We do not undertake and specifically decline any obligation to update any such statements or to publicly announce the results of any revisions to any such statements to reflect future events or developments.

**Item 3. Quantitative and Qualitative Disclosures about Market Risk**

To the extent that sales are transacted in a foreign currency, we are subject to foreign currency fluctuation risk. Furthermore, we have assets denominated in foreign currencies that are not offset by liabilities in such foreign currencies. Although we own significant operations in France, Germany and the United Kingdom, historically we have not experienced material gains or losses due to interest rate or foreign exchange fluctuations. As more fully described in the Liquidity and Capital Resources section set forth in Part I, Item 2 Management Discussion and Analysis of Financial Condition and Results of Operations of this report, on February 10, 2006 we borrowed U.K. £57.0 million, or approximately \$100.0 million, under the term loan facility. In addition, we designated the obligation as a derivative instrument to hedge our net investment in Darchem, a U.K. operation. Darchem has \$17.3 million in firmly committed sales contracts denominated in U.S. dollars, with maturities of \$7.3 million and \$10.0 million in fiscal years ended 2006 and 2007, respectively. Darchem also uses forward foreign currency exchange agreements to hedge these U.S. dollar-denominated sales. The notional amount for contracts maturing in fiscal 2006 and 2007 aggregated \$4.6 million and \$5.0 million, respectively, at April 28, 2006. The average contract rate for contracts maturing in fiscal 2006 and 2007 was 1.79 and 1.80, respectively.

**Item 4. Controls and Procedures**

Our principal executive and financial officers evaluated our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) as of April 28, 2006. Based upon that evaluation, they concluded as of April 28, 2006 that our disclosure controls and procedures were effective to ensure that information we are required to disclose in the reports that we file under the Exchange Act is recorded, processed, summarized and reported within time periods specified in Securities and Exchange Commission rules and forms. In addition, our principal executive and financial officers concluded as of April 28, 2006 that our disclosure controls and procedures are also effective to ensure that information required to be disclosed in reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including to our Chief Executive Officer and Chief Financial Officer, to allow timely decisions regarding required disclosure.

During the time period covered by this report, there were no changes in our internal control over financial reporting that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.



**PART II OTHER INFORMATION**

**Item 1. Legal Proceedings**

From time to time we are involved in legal proceedings arising in the ordinary course of business. We believe that adequate reserves for these liabilities have been made and that there is no litigation pending that could have a material adverse effect on our results of operations and financial condition.

**Item 4. Submission of Matters to a Vote of Security Holders**

At our annual meeting of shareholders held on March 1, 2006, the shareholders acted on the following proposals:

- a) The election of the following directors for three-year terms expiring at the 2009 annual meeting:

| Name             | Votes Cast |           |
|------------------|------------|-----------|
|                  | For        | Withheld  |
| Ross J. Centanni | 19,972,891 | 2,031,020 |
| Robert S. Cline  | 19,301,611 | 2,702,300 |
| James L. Pierce  | 19,917,994 | 2,085,917 |

Current directors whose terms are continuing after the 2006 annual meeting are Lewis E. Burns, John F. Clearman, Robert W. Cremin, Anthony P. Franceschini, Charles R. Larson, and Jerry D. Leitman.

- b) The approval of amendments to the Company's 2004 Equity Incentive Plan to, among other things, authorize the issuance of an additional 1,000,000 shares of the Company's Common Stock:

| For        | Votes Cast |           |
|------------|------------|-----------|
|            | Against    | Abstained |
| 15,907,900 | 3,705,920  | 5,389,929 |

There were 5,389,929 broker non-votes on the above proposal.

- c) The approval of amendments to the Company's 2002 Employee Stock Purchase Plan (the ESPP) to authorize the issuance of an additional 150,000 shares of the Company's Common Stock:

|  | <b>For</b> | <b>Votes Cast<br/>Against</b> | <b>Abstained</b> |
|--|------------|-------------------------------|------------------|
|  | 19,309,788 | 307,673                       | 347,954          |

There were 5,389,929 broker non-votes on the above proposal.

**Item 6.**    **Exhibits**

- 10.2    Amendment No. 4 to Credit Agreement dated as of February 10, 2006 by and among Esterline Technologies Corporation, the financial institutions identified therein and Wachovia Bank, National Association, as Administrative Agent. (Incorporated by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K dated February 10, 2006 [Commission File Number 1-6357].)
- 10.33   Esterline Technologies Corporation 2002 Stock Purchase Plan. (Incorporated by reference to Annex D in the definitive form of the Company's Proxy Statement relating to its 2006 Annual Meeting of Shareholders held on March 1, 2006 filed on January 24, 2006 [Commission File Number 1-6357].)
- 10.36   Esterline Technologies Corporation 2004 Equity Incentive Plan. (Incorporated by reference to Annex C in the definitive form of the Company's Proxy Statement relating to its 2006 Annual Meeting of Shareholders held on March 1, 2006 filed on January 24, 2006 [Commission File Number 1-6357].)
- 10.38   Lease Agreement, dated November 29, 2005 between Lordbay Investments Limited, Darchem Engineering Limited and Darchem Holdings Limited relating to premises located at Units 4 and 5 Eastbrook Road, London Borough of Gloucestershire Gloucester.
- 10.41   Amendment No. 1 dated as of November 23, 2005 to Lease Agreement dated as of March 1, 1994 between Highland Industrial Park, Inc. and Armtec Countermeasures Company.
- 11       Schedule setting forth computation of basic and diluted earnings per common share for the three and six month periods ended April 28, 2006 and April 29, 2005.
- 31.1    Certification of Chief Executive Officer.
- 31.2    Certification of Chief Financial Officer.
- 32.1    Certification (of Robert W. Cremin) pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
- 32.2    Certification (of Robert D. George) pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

SIGNATURES

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

ESTERLINE TECHNOLOGIES CORPORATION  
(Registrant)

Dated: June 6, 2006

By: /s/ Robert D. George

Robert D. George  
*Vice President, Chief Financial Officer,  
Secretary and Treasurer  
(Principal Financial Officer)*