KAMAN CORP
Form 10-Q
May 03, 2007

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

FORM 10-Q

x Quarterly Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934
For The Quarterly Period Ended **March 30, 2007**

OR

o Transition Report Pursuant To Section 13 or 15(d) of the Securities Exchange Act of 1934 for the
Transition Period From ___ to ___

Commission File No. 0-1093

KAMAN CORPORATION

(Exact name of registrant as specified in its charter)

Connecticut	06-0613548
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

1332 Blue Hills Avenue
Bloomfield, Connecticut 06002
(Address of principal executive offices)

(860) 243-7100
Registrant's telephone number, including area code

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

Yes _X_ No ___

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

Large accelerated filer [ ] Accelerated filer [X] Non-accelerated filer [ ]

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

Yes [ ]	No [X]

Indicate the number of shares outstanding of each of the issuer's classes of common stock as of May 1, 2007:

Common Stock	24,345,838

Part I - Financial Information

Item 1. **Financial Statements:**

Condensed Consolidated Balance Sheets
(In thousands) (unaudited)

		March 30, 2007		December 31, 2006
Assets:				
Current assets:				
Cash and cash equivalents		$ 9,930		$ 12,720
Accounts receivable, net		203,104		189,328
Inventories		231,823		231,350
Deferred income taxes		28,571		25,425
Other current assets		18,536		19,097
Total current assets		491,964		477,920
Property, plant & equip., at cost	171,533		168,875	
Less accumulated depreciation and amortization	117,167		114,710	
Net property, plant & equipment		54,366		54,165
Goodwill		57,478		56,833
Other intangible assets, net		19,180		19,264
Deferred income taxes		15,791		14,000
Other assets, net		8,386		8,231
Total assets		$ 647,165		$ 630,413
Liabilities and Shareholders' Equity:				
Current liabilities:				
Notes payable		$ 609		$ -
Current portion of long-term debt		1,551		1,551
Accounts payable - trade		93,353		95,059
Accrued salaries and wages		17,094		26,129
Accrued pension costs		8,928		2,965
Accrued contract losses		10,486		11,542
Advances on contracts		9,575		10,215
Other accruals and payables		40,108		42,661
Income taxes payable		6,359		8,215
Total current liabilities		188,063		198,337
Long-term debt, excl. current portion		88,732		72,872
Other long-term liabilities		63,521		62,643
Commitments and contingencies (Note 12)		-		-
Shareholders' equity		306,849		296,561
Total liabilities and shareholders' equity		$ 647,165		$ 630,413

See accompanying notes to condensed consolidated financial statements.

Condensed Consolidated Statements of Operations
(In thousands except per share amounts)
(unaudited)

	For the Three Months Ended	
	March 30, 2007	March 31, 2006
Net sales	$ 317,318	$ 296,637
Costs and expenses:		
Cost of sales	228,189	215,292
Selling, general and administrative expense	72,099	70,074
Net (gain) loss on sale of assets	42	(13)
Other operating income	(532)	(371)
Interest expense, net	1,518	1,258
Other expense (income), net	(42)	260
	301,274	286,500
Earnings before income taxes	16,044	10,137
Income tax expense	(5,969)	(4,217)
Net earnings	10,075	5,920
Net earnings per share:		
Basic	0.42	0.25
Diluted	0.41	0.24
Average shares outstanding:		
Basic	24,140	23,937
Diluted	25,105	24,887
Dividends declared per share	$ 0.125	$ 0.125

See accompanying notes to condensed consolidated financial statements.

Condensed Consolidated Statements of Cash Flows
(In thousands except share and per share amounts) (Unaudited)

	For the Three Months Ended	
	March 30, 2007	March 31, 2006
Cash flows from operating activities:		
Net earnings	$ 10,075	$ 5,920
Depreciation and amortization	2,898	2,533
Change in allowance for doubtful accounts	(773)	(104)
Net (gain) loss on sale of assets	42	(13)
Stock compensation expense	539	1,639
Deferred income taxes	(4,409)	814
Changes in assets and liabilities, excluding effects of acquisitions/divestitures:		
Accounts receivable	(13,043)	(13,531)
Inventories	(31)	(5,048)
Other current assets	820	(1,160)
Accounts payable	4,186	(11,605)
Accrued contract losses	(1,165)	(3,225)
Advances on contracts	(641)	(3,542)
Accrued expenses and payables	(11,843)	(11,785)
Income taxes payable	(1,186)	(696)
Pension liabilities	1,266	3,126
Other long-term liabilities	5,642	1,403
Cash provided by (used in) operating activities	(7,623)	(35,274)
Cash flows from investing activities:		
Proceeds from sale of assets	41	24
Expenditures for property, plant & equipment	(2,948)	(1,715)
Acquisition of businesses including earn out adjustment	(1,296)	(53)
Other, net	(580)	(178)
Cash provided by (used in) investing activities	(4,783)	(1,922)
Cash flows from financing activities:		
Net borrowings (repayments) under revolving credit agreements	18,019	40,305
Debt repayment	(1,543)	(1,665)
Net change in book overdraft	(5,857)	1,131
Proceeds from exercise of employee stock plans	1,758	983
Dividends paid	(3,018)	(2,988)
Debt issuance costs	(150)	-
Windfall tax benefit	307	55
Other	-	(11)
Cash provided by (used in) financing activities	9,516	37,810
Net increase (decrease) in cash and cash equivalents	(2,890)	614
	100	97

Effect of exchange rate changes on cash and cash equivalents				
Cash and cash equivalents at beginning of period		12,720		12,998
Cash and cash equivalents at end of period	$	9,930	$	13,709

Supplemental Disclosure: Non-cash financing activity for the first quarter of 2007 and 2006 includes the conversion of 16 and 114 debentures with a total value of $16 and $114 into 684 and 4,868 shares of common stock, respectively, issued from treasury.

See accompanying notes to condensed consolidated financial statements.

Notes to Condensed Consolidated Financial Statements
(In thousands except share and per share amounts) (Unaudited)

1. Basis of Presentation

The December 31, 2006 condensed consolidated balance sheet amounts have been derived from the previously audited consolidated balance sheet of Kaman Corporation and subsidiaries. In the opinion of management, the balance of the condensed financial information reflects all adjustments which are necessary for a fair presentation of the financial position, results of operations and cash flows for the interim periods presented and are of a normal recurring nature, unless otherwise disclosed in this report. Certain amounts in prior period condensed consolidated financial statements have been reclassified to conform to current year presentation. The statements should be read in conjunction with the consolidated financial statements and notes included in the company's annual report on Form 10-K for the year ended December 31, 2006. The results of operations for the interim period presented are not necessarily indicative of trends or of results to be expected for the entire year.

The company has a calendar year-end; however, its first three fiscal quarters follow a 13-week convention, with each quarter ending on a Friday. The first quarter for 2007 and 2006 ended on March 30, 2007 and March 31, 2006, respectively.

Recently Issued Accounting Pronouncements

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, "The Fair Value Option for Financial Assets and Financial Liabilities" (SFAS 159), including an amendment to Statement of Financial Accounting Standards No. 115. Under SFAS 159, entities may elect to measure specified financial instruments and warranty and insurance contracts at fair value on a contract-by-contract basis, with changes in fair value recognized in earnings each reporting period. The election, called the fair value option, will enable entities to achieve an offsetting accounting effect for changes in fair value of certain related assets and liabilities without having to apply complex hedge accounting provisions. SFAS 159 is effective as of the beginning of a company's first fiscal year that begins after November 15, 2007. The company is still in the process of evaluating the impact that adoption of SFAS 159 will have on our future consolidated financial statements.

On January 1, 2007, the company adopted FASB Interpretation No. 48 ("FIN 48"), "Accounting for Uncertainty in Income Taxes." The cumulative effect of the adoption of FIN 48 was a decrease of $415 in the liability for unrecognized tax benefits and a corresponding increase to retained earnings. The total liability for unrecognized tax benefits upon adoption was $5,118, including interest and penalties of $1,152. It is the company's policy to record interest and penalties on unrecognized tax benefits as income taxes.

Included in the total unrecognized tax benefits are items approximating $1,500 that, if recognized, would favorably affect the company's effective tax rate in future periods. The company does not anticipate that total unrecognized tax benefits will change significantly before March 31, 2008. The company files tax returns in numerous U.S. and foreign jurisdictions. U.S. federal tax returns are subject to examination back to and including 2002. U.S. state and foreign tax returns are subject to examination for varying periods, but generally back to and including 2002 or 2003.

Cash Flow Items

Cash payments for interest were $1,577 and $1,435 for the three months ended March 30, 2007 and March 31, 2006, respectively. Cash payments for income taxes, net of refunds, for the comparable periods were $6,175 and $3,608, respectively.

Comprehensive Income

Comprehensive income was $10,767 and $5,787 for the three months ended March 30, 2007 and March 31, 2006, respectively. The changes to net earnings used to determine comprehensive income are comprised of foreign currency translation adjustments and net changes in pension & post-retirement benefit plans.

Revolving Credit Agreement
The company has a $150,000 revolving credit facility (Revolving Credit Agreement) expiring August 4, 2010. The facility includes the availability of funding in foreign currencies as well as an “accordion” feature that provides the company the opportunity to request, subject to bank approval, an expansion of up to $50,000 in the overall size of the facility. On January 31, 2007, the company executed an amendment to activate the accordion thereby expanding the Revolving Credit Agreement to $200,000. In conjunction with this exercise, the credit agreement was amended to add another $50,000 accordion feature for possible future activation bringing the total potential arrangement to $250,000.

Sale of Product Line Assets
The company has entered into an agreement with DSE, Inc., former owner of the Dayron operation, under which DSE will purchase the 40mm production line assets, including principally equipment, contracts and inventory. The sale price is approximately $4,500 plus the value of inventory and the transaction, which is subject to customary closing conditions, is expected to occur on or before December 31, 2007.

2. Accounts Receivable, net

Accounts receivable consist of the following:

	March 30, 2007	December 31, 2006
Trade receivables	$ 105,368	$ 97,752
U.S. Government contracts:		
Billed	25,299	26,938
Costs and accrued profit - not billed	5,002	4,544
Commercial and other government contracts:		
Billed	28,406	21,479
Costs and accrued profit - not billed	41,615	41,968
Less allowance for doubtful accounts	(2,586)	(3,353)
Total	$ 203,104	$ 189,328

Included in the commercial and other government contracts - not billed as of December 31, 2006 was $41,295 related to the production contract for the Australian SH-2G(A) program. Of this balance, $40,942 remained unbilled as of March 30, 2007. A total of $340 was billed during the first quarter of 2007 of which $176 has been collected to date. Based upon the terms of the existing contract, the company estimates that $1,345 of the currently unbilled amount will be billed after one year. If the company performs additional work scope for the customer pursuant to currently proposed terms of a potential contract modification, certain milestone billings permitted under the existing contract will be deferred and approximately $18,000 of the currently unbilled amount will be billed after one year.

3. Inventories

Inventories consist of the following:

	March 30, 2007	December 31, 2006
Merchandise for resale	$ 126,093	$ 130,694
Contracts and other work in process	92,233	87,137
Finished goods (including certain general stock materials)	13,497	13,519
Total	$ 231,823	$ 231,350

4. Shareholders' Equity

Changes in shareholders' equity for the three months ended March 30, 2007 were as follows:

Balance, January 1, 2007	$ 296,561
Net earnings	10,075
Change in pension & post-retirement benefit plans, net	648
Foreign currency translation adjustment	44
Comprehensive income	10,767
Dividends declared	(3,038)
Employee stock plans and related tax benefit	2,128
Adoption of FIN 48 - adjustment to retained earnings	415
Debentures	16
Balance, March 30, 2007	$ 306,849

Shareholders' equity consists of the following:

	March 30, 2007	December 31, 2006
Common stock	$ 24,565	$ 24,565
Additional paid in capital	60,722	60,631
Retained earnings	226,589	219,137
Other shareholders' equity	(5,027)	(7,772)
Total	$ 306,849	$ 296,561

5. Earnings Per Share

The following table presents a reconciliation of the numerators and denominators of basic and diluted earnings per share:

(In thousands except per share amounts)	For the Three Months Ended March 30, 2007		For the Three Months Ended March 31, 2006	
Basic:				
Net earnings	$	10,075	$	5,920
Weighted average number of shares outstanding		24,140		23,937
Net earnings per share - basic	$	0.42	$	0.25
Diluted:				
Net earnings	$	10,075	$	5,920
Elimination of interest expense on 6% subordinated convertible debentures (net after taxes)		152		157
Net earnings (as adjusted)	$	10,227	$	6,077
Weighted average number of shares outstanding		24,140		23,937
Weighted averages shares issuable on conversion of 6% subordinated convertible debentures		689		767
Weighted average shares issuable on exercise of dilutive stock options		276		183
Total		25,105		24,887
Net earnings per share - diluted	$	0.41	$	0.24

Excluded from the net earnings per share - diluted calculation are 108 and 293 anti-dilutive share options, based on average stock price, granted to employees for the three months ended March 30, 2007 and March 31, 2006, respectively.

6. Exit Activity

The following table displays the activity and balances of various exit activities as of and for the three months ended March 30, 2007:

Balance at January 1, 2007	$	3,467
Additions to accrual		-
Cash payments		(234)
Release to income		-
Balance at March 30, 2007	$	3,233

In connection with the acquisition of Musicorp in August 2005, the company accrued $3,500 for certain exit costs. These costs relate primarily to lease consolidation and employee severance payments for reductions primarily in administrative and warehousing personnel. The total Musicorp accrual as of March 30, 2007 was $643.

The accrual related to the Moosup, CT plant closure as of March 30, 2007 was $2,590, which consists primarily of the estimated cost of ongoing voluntary environmental investigating and remediation activities. During the three months ended March 30, 2007, the company paid $108 against this accrual for costs associated with environmental remediation activities for the facility. Ongoing maintenance costs of $131 for the three months ended March 30, 2007 related to this idle facility are included in selling, general and administrative expenses.

These exit activity accruals are included in other current liabilities on the condensed consolidated balance sheets for the periods presented.

7. Product Warranty Costs

The following table presents the activity and balances of accrued product warranty costs included in other accruals and payables on the condensed consolidated balance sheets as of March 30, 2007:

Balance at January 1, 2007	$	2,028
Product warranty accrual		28
Warranty costs incurred		(237)
Release to income		-
Balance at March 30, 2007	$	1,819

The company continues to work to resolve two warranty-related matters that primarily impact our FMU-143 program at the Dayron facility that have been previously reported. The net reserve as of the end of the first quarter of 2007 related to these two matters was $873.

As previously disclosed, in March 2005 the U.S. Attorney's Office for the Middle District of Florida and the Defense Criminal Investigative Service (DCIS) initiated an investigation into one of these warranty matters. Dayron has cooperated fully with the authorities, working to resolve the matter in a mutually satisfactory manner. As of the date of this report, the company has not received any notification from the authorities regarding conclusion of the investigation.

The company also has a warranty reserve for $677 for a matter related to our Aerostructures facility in Wichita, Kansas as previously reported. There has been no activity with respect to this matter during the three-month period ended March 30, 2007.

8. Accrued Contract Losses

The following is a summary of activity and balances of accrued contract losses as of and for the quarter ended March 30, 2007:

Balance at January 1, 2007	$	11,542
Additions to loss accrual		2,900
Costs incurred		(3,919)
Release to income		(37)
Balance at March 30, 2007	$	10,486

During the first quarter of 2007, the company recorded an additional $2,466 pretax charge for the SH-2G(A) Helicopter Program for Australia based upon additional work that is necessary to complete the production portion of the program. This contract has been in a loss position since 2002. The remaining accrued contract loss for the Australia program as of March 30, 2007 was $10,062. This contract loss accrual continues to be monitored and adjusted as necessary to reflect the anticipated cost of the complex integration process and the results of the software testing.

9. Pension Cost

Components of net pension cost for the qualified pension plan and Supplemental Employees' Retirement Plan (SERP) are as follows:

	Qualified Pension Plan For the Three Months Ended				SERP For the Three Months Ended			
		March 30, 2007		March 31, 2006		March 30, 2007		March 31, 2006
Service cost for benefits earned	$	3,329	$	3,142	$	116	$	528
Interest cost on projected benefit obligation		6,931		6,603		505		432
Expected return on plan assets		(8,074)		(7,362)		-		-
Net amortization and deferral		225		752		883		389
Net pension cost	$	2,411	$	3,135	$	1,504	$	1,349

For the 2007 plan year, the company expects to contribute $10,000 to the qualified pension plan and $2,438 to the SERP. For the 2007 plan year, no payments with respect to the qualified pension plan were made during the three months ended March 30, 2007.

10. Business Segments

Summarized financial information by business segment is as follows:

	For the Three Months Ended	
	March 30, 2007	March 31, 2006
Net sales:		
Aerospace	$ 93,116	$ 73,636
Industrial Distribution	173,414	170,577
Music	50,788	52,424
	$ 317,318	$ 296,637
Operating income:		
Aerospace	$ 16,615	$ 10,001
Industrial Distribution [1]	8,694	10,807
Music	1,596	1,278
Net gain (loss) on sale of assets	(42)	13
Corporate expense	(9,343)	(10,444)
Operating income	17,520	11,655
Interest expense, net	(1,518)	(1,258)
Other income (expense), net	42	(260)
Earnings before income taxes	$ 16,044	$ 10,137

[1] During 2006, for our Industrial Distribution segment, it was determined that in-bound freight costs were not being included in inventory consistent with our other businesses. This resulted in an adjustment that increased the first quarter 2006 earnings by $1,589.

11. Share-Based Arrangements

The following table summarizes share-based compensation expense recorded during each period presented:

	Three Months Ended	
	March 30, 2007	March 31, 2006
Stock options	$ 217	$ 232
Restricted stock awards	100	99
Stock appreciation rights	170	1,257
Employee stock purchase plan	52	51
Total share-based compensation expense	$ 539	$ 1,639

Stock option activity was as follows:

Stock options outstanding:	Options		Weighted-Average Exercise Price
Balance at January 1, 2007	900,639	$	14.49
Options granted	109,800		23.68
Options exercised	(114,995)		13.57
Options cancelled	(7,250)		17.85
Balance at March 30, 2007	888,194	$	15.72

The fair value of each option award is estimated on the date of grant using the Black-Scholes option valuation model. The following table indicates the weighted average assumptions used in estimating fair value for the first quarter of 2007 and 2006.

	Three Months Ended			
		March 30, 2007		March 31, 2006
Expected option term		6.5 years		6.5 years
Expected volatility		36.2%		41.5%
Risk-free interest rate		4.6%		4.5%
Expected dividend yield		2.5%		2.5%
Per share fair value of options granted	$	8.04	$	7.99

RSA activity is as follows:

Restricted Stock outstanding:	RSA		Weighted-Average Grant Date Fair Value
Nonvested at January 1, 2007	53,695	$	16.52
RSA granted	49,675		23.68
Vested	(23,135)		14.41
Cancelled	(981)		22.32
Nonvested at March 30, 2007	79,254	$	21.20

SAR activity is as follows:

SARs outstanding:	SARs		Weighted-Average Exercise Price
Balance at January 1, 2007	139,060	$	10.65
SARs granted	-		-
SARs exercised	(36,880)		11.00
SARs cancelled	-		-
Balance at March 30, 2007	102,180	$	10.53

Total cash paid to settle SARs (at intrinsic value) during the first quarter of 2007 and 2006 was $470 and $1,227, respectively.

As of March 30, 2007, future compensation costs related to nonvested stock options and restricted stock grants was $3,086. Management anticipates that this cost will be recognized over a weighted average period of 1.96 years.

12. Contingencies

On July 31, 2006, the company submitted an Offer to Purchase (OTP) to NAVAIR and the General Services Administration to purchase the portion of the Bloomfield campus that the company currently leases from NAVAIR and has operated for several decades for the principal purpose of performing U.S. government contracts. Currently, the OTP is valid through July 31, 2007 and is subject to negotiation of terms mutually acceptable to the company and the government that include, in consideration for the transfer of title, the company's assumption of responsibility for environmental remediation at the facility as necessary to meet the requirements of state law that will apply upon the transfer. As of the date of this report, the company is in discussions with the U.S. government regarding these terms and the company anticipates that the process may take several more months. Thereafter, upon completion of the government's final approval processes and requirements, the company anticipates that transfer of title to the property will take place. In preparation for this, the company is in discussions with the Connecticut Department of Environmental Protection (CTDEP) in order to define the scope of such remediation.

In preparation for disposal of the Moosup, Connecticut facility, CTDEP has given the company conditional approval for reclassification of groundwater in the vicinity of the facility consistent with the character of the area. The company has substantially completed the process of connecting neighboring properties to public drinking water in accordance with such approval and in coordination with the CTDEP and local authorities. The company anticipates that this project will be completed in 2007.

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

Management's Discussion and Analysis of Financial Condition and Results of Operations (MD&A) is intended to provide readers of our consolidated financial statements with the perspectives of management in the form of a narrative regarding our financial condition, results of operations, liquidity and certain other factors that may affect our future results. The MD&A is presented in seven sections:

I.	Overview of Business
II.	First Quarter 2007 Highlights
III.	Results of Operations
IV.	Critical Accounting Estimates
V.	Liquidity and Capital Resources
VI.	Contractual Obligations and Off-Balance Sheet Arrangements
VII.	Recent Accounting Standards

Our MD&A should be read in conjunction with our Annual Report for the year ended December 31, 2006.

I. OVERVIEW OF BUSINESS

Kaman Corporation is composed of three business segments: Aerospace, Industrial Distribution, and Music.

AEROSPACE SEGMENT

This segment has four operating units: Aerostructures, Fuzing, Helicopters and Kamatics.

The Aerostructures Division produces aircraft subassemblies and other parts for commercial and military airliners and helicopters. Its principal customers are Boeing and Sikorsky Aircraft Corporation. Operations involving the use of metals are conducted principally at the company's Jacksonville, Florida facility, while operations involving composite materials are conducted principally at the company's Wichita, Kansas (Plastic Fabricating Company) facility.

The Fuzing Division manufactures products for military and commercial markets, primarily related to military safe, arm and fuzing devices for several missile and bomb programs; as well as precision non-contact measuring systems for industrial and scientific use; and high reliability memory systems for airborne, shipboard, and ground-based programs. Principal customers include the U.S. military, Boeing, Lockheed Martin and Raytheon. In September 2006, the division assumed responsibility for the company’s Electro-Optics Development Center (EODC). Operations are conducted at the Middletown, Connecticut, Orlando, Florida (Dayron) and Tucson, Arizona (EODC) facilities.

The Helicopters Division markets its helicopter engineering expertise and performs subcontract work for other manufacturers. It also refurbishes, provides upgrades and supports Kaman SH-2G maritime helicopters operating with foreign militaries as well as K-MAX® “aerial truck” helicopters operating with government and commercial customers in several countries. The SH-2G aircraft is currently in service with the Egyptian Air Force and the New Zealand and Polish navies. Operations are primarily conducted at the Bloomfield, Connecticut facility.

Kamatics primarily manufactures proprietary self-lubricating bearings used in aircraft flight controls, turbine engines and landing gear. These bearings are currently used in nearly all military and commercial aircraft in production in North and South America and Europe and are market-leading products for applications requiring a highly sophisticated level of engineering and specialization in the airframe bearing market. Kamatics also manufactures market leading proprietary power transmission couplings for helicopters and other applications in Bloomfield and custom designed and manufactured rolling element and self-lubricating bearings at RWG for aerospace applications. Operations for the Kamatics subsidiary are conducted at the Bloomfield, Connecticut and Dachsbach, Germany

(RWG) facilities.

INDUSTRIAL DISTRIBUTION SEGMENT

The Industrial Distribution segment is the third largest power transmission/motion control industrial distributor in North America. We provide services and products including bearings, electrical/mechanical power transmission, fluid power, motion control and materials handling components to a broad spectrum of industrial markets throughout North America. Our locations consist of nearly 200 branches, distribution centers and call centers across the United States and in Canada and Mexico. We offer almost two million items, as well as value-added services, to a base of more than 50,000 customers representing a highly diversified cross-section of North American industry.

MUSIC SEGMENT

The Music segment is the largest independent U.S. distributor of musical instruments and accessories, offering more than 20,000 products for amateurs and professionals. Our premium branded products, many of which are brought to the market on an exclusive basis, and our market-leading business-to-business systems for our customer base of over 10,000 retailers nationwide, contribute to the performance of the business. Our array of fretted instruments includes proprietary products, such as the Ovation® and Hamer® guitars, as well as premier products including Takamine® guitars, which are distributed in the United States under an exclusive distribution agreement. We offer an extended line of percussion products and accessories through Latin Percussion®, the leading supplier of hand percussion instruments. Additionally, our exclusive distribution agreements with Gretsch® drums, Sabian® cymbals, along with our own CB®, Toca® and Gibraltar® lines, have further enhanced our array of products offered.

While the vast majority of our sales are to North American customers, we continue to build our presence in key international markets including Europe, Asia, South America and Australia. Operations are headquartered in Bloomfield, Connecticut and conducted from manufacturing plants in New Hartford, Connecticut, Scottsdale, Arizona and Ridgeland, South Carolina and strategically placed warehouse facilities that primarily cover the North American market.

II. FIRST QUARTER 2007 HIGHLIGHTS

The following is a summary of key events that occurred during the first quarter of 2007:

- Our net sales increased 7.0 percent in the first quarter of 2007 compared to the first quarter of 2006.
- Our net earnings increased 70.2 percent in the first quarter of 2007 compared to the first quarter of 2006.
- Earnings per share diluted increased 70.8 percent to $0.41 per share diluted in the first quarter of 2007 compared to the first quarter of 2006.
- We recorded an additional $2.5 million charge related to the increase in anticipated costs to complete the SH-2G(A) program for the Royal Australian Navy during the first quarter of 2007.
- The Aerospace segment experienced a strong quarter with respect to sales and operating income primarily as a result of several key programs.
- The Industrial Distribution segment had modest sales growth during the first quarter of 2007 despite a softening in certain of the industries served by the segment.
- Music segment sales were lower than the first quarter of 2006 primarily as a result of lower spending within our current primary consumer base.

Subsequent Events

The company held its 62nd Annual Meeting on April 17, 2007 where shareholders re-elected two current Directors for a three-year term and ratified the appointment of KPMG LLP as the company's independent registered public accounting firm. Please refer to Item II, Part 4 on Form 10-Q for additional information.

III. RESULTS OF OPERATIONS

CONSOLIDATED RESULTS -

The following table presents selected financial data of the company for the first quarter of 2007 compared to the first quarter of 2006:

Selected Consolidated Financial Information

	For the Three Months Ended			
In millions, except per share data		March 30, 2007		March 31, 2006
Net sales	$	317.3	$	296.6
% change		7.0%		12.7%
Gross profit	$	89.1	$	81.3
% of net sales		28.1%		27.4%
Selling, general & administrative expenses (SG&A)	$	72.1	$	70.1
% of net sales		22.7%		23.6%
Operating income	$	17.5	$	11.7
% of net sales		5.5%		3.9%
Interest expense, net		(1.5)		(1.3)
Other expense, net		-		(.3)
Net earnings	$	10.1	$	5.9
Net earnings per share - basic	$	.42	$	.25
Net earnings per share - diluted		.41		.24

Note - all percentages in the MD&A are calculated based upon financial information in thousands.

Results of Operations - Consolidated

NET SALES
Total consolidated sales increased $20.7 million in the first quarter of 2007 compared to the first quarter of 2006. The increase was mainly attributable to several key programs in the Aerospace segment reflecting the improved economic environment in the aerospace industry. Additionally, the Industrial Distribution segment experienced modest sales growth as a result of stability in certain markets served by the segment. Sales for the Music segment decreased primarily due to lower purchases by our customer base during the first quarter of 2007 following a weaker than anticipated holiday selling season.

GROSS PROFIT
Total gross profit increased $7.8 million, or 9.6 percent, for the first quarter of 2007 compared to the first quarter of 2006. The increase in gross profit is primarily due to sales growth within our Aerospace segment for the first quarter of 2007 compared to the first quarter of 2006. Additionally, gross profit as a percentage of sales (gross margin) has improved by 0.7 percentage points as a result of higher sales volume, increased efficiencies and a growing business base at most of the Aerospace segment operating units.

SELLING, GENERAL & ADMINISTRATIVE EXPENSES
Total selling, general and administrative (SG&A) expenses as a percent of net sales decreased 0.9 percentage points in the first quarter of 2007 compared to 2006. This reduction in total SG&A expense as a percent of net sales was primarily due to an increase in sales volume as well as lower corporate expenses. Total SG&A expense increased $2.0 million or 2.9 percent in the first quarter of 2007 as compared to the first quarter of 2006. SG&A expense in our three reporting segments increased $3.1 million offset by a $1.1 million decrease in corporate expense. The changes were specifically due to the following items:

o Aerospace segment SG&A increased 9.6 percent, or $1.1 million, primarily due to increased expenses as a result of higher sales volume and higher personnel costs due to an increase in headcount.

o Industrial Distribution segment SG&A expense increased 6.9 percent, or $2.4 million, primarily due to higher operating expenses related to higher sales volume and higher personnel costs partially attributable to an increase in headcount and normal wage increases.

o Music segment SG&A expense decreased 2.8 percent or $0.4 million. This decrease was a result of the variety of initiatives implemented in 2006 to reduce redundant costs, specifically at Musicorp. These efforts improved profitability and should be more fully realized throughout 2007 and thereafter.

o The decrease in corporate expense was primarily driven by a reduction in employee compensation costs of $2.3 million, which includes stock appreciation rights, incentive compensation and pension expense. This decrease was offset to some extent by an increase in group insurance claims of $1.4 million during the first quarter of 2007.

OPERATING INCOME
Operating income increased $5.9 million, or 50.3 percent, for the first quarter of 2007 compared to the first quarter of 2006. The improvement in operating income was primarily attributable to stronger operating results as a result of several key programs in the Aerospace segment driven by the currently strong aerospace industry. The Music segment also experienced an increase in operating income primarily as a result of lower SG&A costs for the first quarter of 2007 as discussed above. The Industrial Distribution segment's operating income decreased for the first quarter of 2007 compared to the first quarter of 2006. In the first quarter of 2006, the segment had recorded a one time adjustment for $1.6 million that increased earnings to properly capitalize in-bound freight charges to inventory; there was no such adjustment during the first quarter of 2007. The decrease in corporate SG&A expense discussed above also contributed to the improvement in operating income for the first quarter of 2007.

ADDITIONAL CONSOLIDATED RESULTS
Interest expense, net, increased 20.7 percent to $1.5 million for the first quarter of 2007 compared to $1.3 million for the first quarter of 2006. Net interest expense generally consists of interest charged on the revolving credit facility and the convertible debentures offset by interest income. The increase in net interest expense is primarily due to higher borrowings as well as higher interest rates charged on borrowings during the first quarter of 2007 as compared to the same period of 2006.

For the first quarter of 2007, the effective income tax rate was 37.2 percent as compared to the effective tax rate of 41.6 percent for the first quarter of 2006. The change in the effective tax rate for the first quarter of 2007 as compared to the first quarter of 2006 was primarily due to lower nondeductible expenses and certain favorable international taxation differences. The effective tax rate represents the combined estimated federal, state and foreign tax effects attributable to pretax earnings for the year.

AEROSPACE SEGMENT RESULTS

The following table presents selected financial data for the Aerospace segment:

In millions	For the three months ended			
		March 30, 2007		March 31, 2006
Net sales	$	93.1	$	73.6
% change		26.5%		12.1%
Operating income	$	16.6	$	10.0
% of net sales		17.8%		13.6%
% change		66.1%		31.1%

AEROSPACE SEGMENT

NET SALES
Net sales for the Aerospace segment represented 29.4 percent and 24.8 percent of the total consolidated sales for the first quarter of 2007 and 2006, respectively. The segment has four operating units: Aerostructures, Fuzing, Helicopters and the Kamatics subsidiary. In the paragraphs that follow you will find further information with respect to sales growth and significant programs for these four operating units.

OPERATING INCOME
Operating income for the first quarter of 2007 increased $6.6 million as compared to the first quarter of 2006. In both periods presented, the segment recorded a $2.5 million charge related to the Australian SH-2G(A) program. The increase in operating income for 2007 was primarily due to an increase in sales volume at the Aerostructures Division, largely due to the Sikorsky cockpit program, and at the Kamatics subsidiary as a result of favorable product mix.

2007 AEROSPACE SEGMENT TRENDS

THE MARKET
Both the commercial and military aerospace markets were strong during 2006 and it is anticipated that this positive trend will continue through 2007. Several major prime contractors are anticipating a large amount of shipments of commercial and military aircraft over the next few years.

OUR STRATEGY
Before 2005, our Aerospace segment was one in which many of our activities were designed to support our prime helicopter operations. We were not able to compete effectively in our target markets in part due to higher operating expenses as a result of a lower than sufficient business base. In 2005, the Aerospace segment realigned and created separate divisions within the Aerospace segment. This realignment allowed for greater transparency and accountability through a more focused management structure. This realignment along with upgrades to our facilities, lean initiatives and strategic positioning as a subcontractor to the prime aerospace contractors has allowed us to build our business base and develop our reputation as a lower cost, high quality domestic partner. We have been able to successfully build upon several key programs, which are discussed in the following paragraphs. Each operating unit within the Aerospace segment continues to work on attracting and retaining qualified personnel in order to be able to effectively carry out the new work that we have been awarded.

AEROSTRUCTURES DIVISION

In millions	For the three months ended	
	March 30, 2007	March 31, 2006
Net sales	$ 25.2	$ 16.9