

EASTERN CO
Form 10-Q
July 30, 2007

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

FORM 10-Q

(Mark One)

X QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED June 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 Number: **0599**

THE EASTERN COMPANY
(Exact name of registrant as specified in its charter)

<u>Connecticut</u> (State or other jurisdiction of incorporation or organization)	<u>06-0330020</u> (I.R.S. Employer Identification No.)
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<u>112 Bridge Street, Naugatuck, Connecticut</u> (Address of principal executive offices)	<u>06770</u> (Zip Code)
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(203) 729-2255
(Registrant's telephone number, including area code)

Not applicable
(Former name, former address and former fiscal year, if changed since last report)

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

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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):

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 ☒

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

Class

Common Stock, No par value

Outstanding as of June 30, 2007

5,614,895

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PART 1 FINANCIAL INFORMATION**ITEM 1 FINANCIAL STATEMENTS****THE EASTERN COMPANY AND SUBSIDIARIES****CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)**

ASSETS	June 30, 2007	December 30, 2006
Current Assets		
Cash and cash equivalents	\$ 8,217,855	\$ 3,101,458
Accounts receivable, less allowances: \$357,000 - 2007; \$319,000 - 2006	20,222,319	24,859,152
Inventories	27,098,039	28,042,566
Prepaid expenses and other assets	2,868,768	2,391,425
Deferred income taxes	1,128,225	931,641
Total Current Assets	59,535,206	59,326,242
Property, Plant and Equipment	48,539,627	46,858,651
Accumulated depreciation	(23,228,624)	(21,042,934)
	25,311,003	25,815,717
Goodwill	13,849,340	13,742,160
Trademarks	117,959	117,959
Patents, technology, and licenses, less accumulated amortization	4,099,082	4,216,508
Interest rate swap asset	50,603	
Prepaid pension cost	303,428	266,358
	18,420,412	18,342,985
TOTAL ASSETS	\$ 103,266,621	\$ 103,484,944
LIABILITIES AND SHAREHOLDERS' EQUITY		
Current Liabilities		
Accounts payable	\$ 7,785,122	\$ 13,170,491
Accrued compensation	2,034,891	3,098,525
Other accrued expenses	1,944,386	4,399,358
Current portion of long-term debt	3,117,752	3,111,908
Total Current Liabilities	14,882,151	23,780,282
Deferred income taxes	1,123,537	1,123,537
Other long-term liabilities	1,745,863	
Long-term debt, less current portion	15,946,447	17,506,802
Accrued postretirement benefits	1,227,226	1,221,156
Accrued pension cost	4,691,759	5,323,550
Interest rate swap obligation		138,412
Shareholders' Equity		
Preferred Stock, no par value: Authorized and unissued 2,000,000 shares		
Common Stock, no par value: Authorized: 50,000,000 shares		
Issued: 8,155,920 shares in 2007 and 8,012,550 shares in 2006	20,050,965	17,974,115
Treasury Stock: 2,540,862 shares in 2007 and 2,533,089 shares in 2006	(16,878,126)	(16,655,041)
Retained earnings	64,583,498	58,279,371
Accumulated other comprehensive income (loss):		
Foreign currency translation	1,614,634	756,452
Unrecognized net pension and postretirement benefit costs, net of tax	(5,753,435)	(5,875,261)

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Derivative financial instruments, net of taxes	32,102	(88,431	)
Accumulated other comprehensive loss	(4,106,699	)	(5,207,240
Total Shareholders' Equity	63,649,638		54,391,205
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$ 103,266,621		\$ 103,484,944

See accompanying notes.

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THE EASTERN COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF INCOME (UNAUDITED)

	Six Months Ended		Three Months Ended	
	June 30, 2007	July 1, 2006	June 30, 2007	July 1, 2006
Net sales	\$ 86,492,645	\$ 57,529,342	\$ 34,175,471	\$ 29,669,159
Cost of products sold	(64,320,519)	(44,570,597)	(28,033,038)	(23,194,158)
Gross margin	22,172,126	12,958,745	6,142,433	6,475,001
Selling and administrative expenses	(9,911,556)	(8,722,668)	(4,742,145)	(4,261,200)
Operating profit	12,260,570	4,236,077	1,400,288	2,213,801
Interest expense	(692,461)	(471,101)	(317,485)	(231,525)
Other income	89,962	47,630	76,986	17,707
Income before income taxes	11,658,071	3,812,606	1,159,789	1,999,983
Income taxes	4,171,477	1,456,284	431,433	787,426
Net income	\$ 7,486,594	\$ 2,356,322	\$ 728,356	\$ 1,212,557
Earnings per Share:				
Basic	\$ 1.35	\$.43	\$.13	\$.22
Diluted	\$ 1.25	\$.41	\$.12	\$.21
Cash dividends per share:	\$.16	\$.15	\$.08	\$.08

See accompanying notes.

THE EASTERN COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Six Months Ended		Three Months Ended	
	June 30, 2007	July 1, 2006	June 30, 2007	July 1, 2006
Net income	\$ 7,486,594	\$ 2,356,322	\$ 728,356	\$ 1,212,557
Other comprehensive income:				
Change in foreign currency translation	858,182	200,957	804,054	122,476
Change in unrecognized net pension and postretirement benefit costs, net of taxes of \$70,208 and \$35,104	121,826		60,913	
Change in fair value of derivative financial instruments, net of income taxes of:	120,533	86,557	156,672	33,379

2007 \$68,482 and

\$90,290, respectively

2006 \$49,087 and

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\$17,925, respectively

	1,100,541	287,514	1,021,639	155,855
Comprehensive income	\$ 8,587,135	\$ 2,643,836	\$ 1,749,995	\$ 1,368,412

See accompanying notes.

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THE EASTERN COMPANY AND SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended June 30, 2007	July 1, 2006
Operating Activities		
Net income	\$ 7,486,594	\$ 2,356,322
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,343,878	1,736,285
Provision for doubtful accounts	27,438	3,464
Loss on sale of equipment and other assets	11,997	
Issuance of Common Stock for directors' fees	27,586	38,451
Changes in operating assets and liabilities:		
Accounts receivable	4,772,823	(1,289,683)
Inventories	1,197,849	(2,870,071)
Prepaid expenses and other	(463,481)	213,018
Prepaid pension cost	(607,948)	78,656
Other assets	(108,725)	(84,492)
Accounts payable	(5,452,369)	1,434,903
Accrued compensation	(1,077,091)	(161,194)
Other accrued expenses	(1,276,335)	(347,850)
Net cash provided by operating activities	6,882,216	1,107,809
Investing Activities		
Purchases of property, plant and equipment	(1,368,963)	(2,364,583)
Proceeds from sale of equipment and other assets	21,350	15,035
Net cash used in investing activities	(1,347,613)	(2,349,548)
Financing Activities		
Principal payments on long-term debt	(1,554,511)	(1,710,919)
Proceeds from sales of Common Stock	1,157,023	203,700
Tax benefit from exercise of incentive stock options	892,241	
Purchases of Common Stock for treasury	(223,085)	
Dividends paid	(886,539)	(838,436)
Net cash used in financing activities	(614,871)	(2,345,655)
Effect of exchange rate changes on cash	196,665	(19,112)
Net change in cash and cash equivalents	5,116,397	(3,606,506)
Cash and cash equivalents at beginning of period	3,101,458	6,345,947
Cash and cash equivalents at end of period	\$ 8,217,855	\$ 2,739,441

See accompanying notes.

THE EASTERN COMPANY

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

JUNE 30, 2007

Note A - Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by generally accepted accounting principles in the United States for complete financial statements. Refer to the Company's consolidated financial statements and notes thereto included in its Form 10-K for the year ended December 30, 2006 for additional information.

The accompanying condensed consolidated financial statements are unaudited. However, in the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of the results of operations for interim periods have been reflected therein. All intercompany accounts and transactions are eliminated. Operating results for interim periods are not necessarily indicative of the results that may be expected for the full year.

Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications had no effect on previously reported net income.

The condensed consolidated balance sheet as of December 30, 2006 has been derived from the audited consolidated balance sheet at that date.

As discussed in Note K, effective December 31, 2006, the Company adopted Financial Accounting Standards Board Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48).

Note B Earnings Per Share

The denominators used in the earnings per share computations follow:

	Six Months Ended		Three Months Ended	
	June 30, 2007	July 1, 2006	June 30, 2007	July 1, 2006
Basic:				
Weighted average shares outstanding	5,550,219	5,470,373	5,593,073	5,476,055
Diluted:				
Weighted average shares outstanding	5,550,219	5,470,373	5,593,073	5,476,055
Dilutive stock options	439,866	250,903	455,060	264,271
Denominator for diluted earnings per share	5,990,085	5,721,276	6,048,133	5,740,326

Note C - Inventories

The components of inventories follow:

	June 30, 2007	December 30, 2006
Raw material and component parts	\$ 7,750,039	\$ 8,008,603
Work in process	6,151,255	6,366,354
Finished goods	13,196,745	13,667,609
	\$ 27,098,039	\$ 28,042,566

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Note D Segment Information

Segment financial information follows:

	Six Months Ended June 30, 2007	July 1, 2006	Three Months Ended June 30, 2007	July 1, 2006
Revenues:				
Sales to unaffiliated customers:				
Industrial Hardware	\$ 49,352,544	\$ 27,348,308	\$ 14,554,727	\$ 14,468,868
Security Products	29,946,726	23,505,178	15,817,115	11,895,829
Metal Products	7,193,375	6,675,856	3,803,629	3,304,462
	\$ 86,492,645	\$ 57,529,342	\$ 34,175,471	\$ 29,669,159
Income before income taxes:				
Industrial Hardware	\$ 11,134,087	\$ 2,198,731	\$ 898,665	\$ 1,187,819
Security Products	2,393,370	2,421,964	1,289,202	1,270,298
Metal Products	(1,266,888)	(384,618)	(787,579)	(244,316)
Operating Profit	12,260,569	4,236,077	1,400,288	2,213,801
Interest expense	(692,461)	(471,101)	(317,485)	(231,525)
Other income	89,962	47,630	76,986	17,707
	\$ 11,658,070	\$ 3,812,606	\$ 1,159,789	\$ 1,999,983

Note E Recent Accounting Pronouncements

In September 2006, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards No. 157, *Fair Value Measurements* (SFAS No. 157). This standard clarifies the principle that fair value should be based on the assumptions that market participants would use when pricing an asset or liability. Additionally, it establishes a fair value hierarchy that prioritizes the information used to develop those assumptions. The Company has not yet determined the impact, if any, that the adoption of SFAS No. 157 will have on our results of operations or financial condition. SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities Including an Amendment of FASB Statement No. 115* (SFAS No. 159). SFAS No 159, which amends SFAS No. 115 allows certain financial assets and liabilities to be recognized, at the company's election, at fair market value, with any gains or losses for the period recorded in the statement of income. This gives a company the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Currently, the Company records the gains or losses for the period in the statement of comprehensive income and in the equity section of the balance sheet. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company has not determined the impact, if any, of the adoption of SFAS No. 159.

Note F - Debt

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The interest rates on the term and the revolving credit portions of the Loan Agreement vary. The interest rates may vary based on the LIBOR rate plus a margin spread of 1.0% to 1.65% for the term portion and 1.0% to 1.6% for the revolving credit portion. The margin rate spread is based on operating results calculated on a rolling-four-quarter basis. The Company may also borrow funds at the lender's prime rate. On June 30, 2007, the interest rate on the term portion of the Loan Agreement was 6.35%. The interest rate on interim borrowings during the first quarter of 2007 under the revolving loan was 8.5%, the bank's prime rate. The Company did not utilize the revolver during the second quarter of 2007 or the first half of 2006.

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Note G Goodwill

The following is a roll-forward of goodwill from year-end 2006 to the end of the second quarter 2007:

	Industrial Hardware Segment	Security Products Segment	Metal Products Segment	Total
Beginning balance	\$ 1,908,344	\$ 11,833,816	\$	\$ 13,742,160
Foreign exchange	107,180			107,180
Ending balance	\$ 2,015,524	\$ 11,833,816	\$	\$ 13,849,340

Note H Intangibles

Patents are recorded at cost and are amortized using the straight-line method over the lives of the patents. Technology and licenses are recorded at cost and are generally amortized on a straight-line basis over periods ranging from 5 to 17 years. Non-compete agreements and customer relationships are being amortized using the straight-line method over a period of 5 years. Trademarks are not amortized as their lives are deemed to be indefinite.

The gross carrying amount and accumulated amortization of amortizable intangible assets:

	Industrial Hardware Segment	Security Products Segment	Metal Products Segment	Total	Weighted-Average Amortization Period (Years)
2007 Gross Amount:					
Patents and developed					
technology	\$ 2,563,016	\$ 1,039,197	\$ 82,747	\$ 3,684,960	15.7
Customer relationships	-	1,921,811	-	1,921,811	5.0
Non-compete agreements	-	90,735	-	90,735	5.0
Other	-	3,941	-	3,941	-
Total Gross Intangibles	\$ 2,563,016	\$ 3,055,684	\$ 82,747	\$ 5,701,447	11.6

2007 Accumulated**Amortization:**

Patents and developed

technology	\$ 970,428	\$ 226,229	\$ 65,027	\$ 1,261,684
Customer relationships	-	285,315	-	285,315
Non-compete agreements	-	55,366	-	55,366
Accumulated Amortization	\$ 970,428	\$ 566,910	\$ 65,027	\$ 1,602,365

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Net June 30, 2007 per

Balance Sheet	\$ 1,592,588	\$ 2,488,774	\$ 17,720	\$ 4,099,082
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	Industrial	Security	Metal		Weighted-Average
	Hardware	Products	Products		Amortization Period
	Segment	Segment	Segment	Total	(Years)
2006 Gross Amount:					
Patents and developed					
technology	\$ 2,411,468	\$ 1,005,390	\$ 82,747	\$ 3,499,605	16.1
Customer relationships	-	1,921,811	-	1,921,811	5.0
Non-compete agreements	-	90,735	-	90,735	5.0
Other	-	3,941	-	3,941	-
Total Gross Intangibles	\$ 2,411,468	\$ 3,021,877	\$ 82,747	\$ 5,516,092	11.5
2006 Accumulated					
Amortization:					
Patents and developed					
technology	\$ 902,854	\$ 192,250	\$ 62,553	\$ 1,151,657	
Customer relationships	-	93,133	-	93,133	
Non-compete agreements	-	48,794	-	48,794	
Accumulated Amortization	\$ 902,854	\$ 334,177	\$ 62,553	\$ 1,299,584	
Net December 30, 2006					
per Balance Sheet	\$ 1,508,614	\$ 2,687,700	\$ 20,194	\$ 4,216,508	

Note I - Retirement Benefit Plans

The Company has non-contributory defined benefit pension plans covering certain U.S. employees. Plan benefits are generally based upon age at retirement, years of service and, for its salaried plan, the level of compensation. The Company also sponsors unfunded nonqualified supplemental retirement plans that provide certain current and former officers with benefits in excess of limits imposed by federal tax law. The measurement date for the obligations disclosed below is September 30 of each year.

The Company also provides health care and life insurance for retired salaried employees in the United States who meet specific eligibility requirements.

Significant disclosures relating to these benefit plans for the second quarter and first six months of Fiscal 2007 and 2006 follow:

	Pension Benefits			
	Six Months Ended	July 1,	Three Months Ended	July 1,
	June 30,		June 30,	
	2007	2006	2007	2006
Service cost	\$ 885,563	\$ 800,332	\$ 442,781	\$ 398,875
Interest cost	1,241,000	1,166,466	620,500	545,892

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Expected return on plan assets	(1,643,436)	(1,512,097)	(821,718)	(756,048)
Amortization of prior service cost	40,896	74,221	20,448	37,110
Amortization of transition obligation	(5,924)	(17,304)	(2,962)	(8,652)
Amortization of the net loss	178,532	242,371	89,266	121,185
Net periodic benefit cost	\$ 696,631	\$ 753,989	\$ 348,315	\$ 338,362

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	Postretirement Benefits			
	Six Months Ended		Three Months Ended	
	June 30,	July 1,	June 30,	July 1,
	2007	2006	2007	2006
Service cost	\$ 52,536	\$ 43,282	\$ 26,268	\$ 21,641
Interest cost	61,500	52,112	30,750	26,056
Expected return on plan assets	(38,302)	(43,252)	(19,151)	(21,626)
Amortization of prior service cost	(11,944)	(29,822)	(5,972)	(14,911)
Amortization of the net gain	(9,526)	(11,936)	(4,763)	(5,968)
Net periodic benefit cost	\$ 54,264	\$ 10,384	\$ 27,132	\$ 5,192

The Company's funding policy with respect to its qualified plans is to contribute at least the minimum amount required by applicable laws and regulations. In 2007, the Company is required to contribute \$1,769,000 into its salaried plan and \$273,000 into one of its hourly plans. As of June 30, 2007, the Company has made contributions totaling \$1,000,000 to the salaried plan and \$266,000 to the hourly plan and will make the remaining contributions prior to filing its federal income tax return due on September 15, 2007.

The Company has a contributory savings plan under Section 401(k) of the Internal Revenue Code covering substantially all U.S. non-union employees. The plan allows participants to make voluntary contributions of up to 100% of their annual compensation on a pretax basis, subject to IRS limitations. The plan provides for contributions by the Company at its discretion. The Company made contributions of \$44,564 and \$88,340 in the second quarter and first six months of 2007, respectively, and \$43,910 and \$86,153 in the second quarter and first six months of 2006, respectively.

Note J Stock Based Compensation and Stock Options

On January 1, 2006, the Company adopted the fair value recognition provisions of FASB Statement of Financial Standards No. 123R, *Share Based Payment (as amended)*, using the modified prospective method. As no stock options were granted in 2007 or 2006 and, as all options granted prior to January 1, 2006 were fully vested, there was no impact on the financial statements since adoption.

The Company has stock option plans for officers, other key employees, and non-employee directors: the 1989, 1995, 1997 and 2000 plans. Options granted under the 1989 plan and incentive stock options granted under the 1995 and 2000 plans must have exercise prices that are not less than 100% of the fair market value of the stock on the dates the options are granted. Restricted stock awards may also be granted to participants under the 1995 and 2000 plans with restrictions determined by the Compensation Committee of the Company's Board of Directors. Under the 1995, 1997, and 2000 plans, nonqualified stock options granted to participants will have exercise prices determined by the Compensation Committee of the Company's Board of Directors. No options were granted in 2007 or 2006. No restricted stock was granted in 2007 or 2006.

As of June 30, 2007, there were 446,250 shares available for future grant under the above noted plans: 2000 367,500 shares; 1997 78,750. As of June 30, 2007, there were 1,306,750 shares of common stock reserved under all option plans for future issuance.

Six Months Ended

Year Ended

June 30, 2007

December 30, 2006

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	Shares	Weighted - Average Exercise Price	Shares	Weighted - Average Exercise Price
Outstanding at beginning of period	1,002,750	\$ 9.233	1,017,750	\$ 9.297
Granted				
Exercised	(142,250)	\$ 8.134	(15,000)	\$ 13.580
Outstanding at end of period	860,500	\$ 9.415	1,002,750	\$ 9.233

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Options Outstanding and Exercisable

Range of Exercise Prices		Weighted Average Remaining Contractual Life		Weighted Average Exercise Price
		Outstanding as of June 30, 2007		
\$ 6.61	\$ 7.95	197,500	0.3	\$ 7.119
\$ 9.33	\$10.20	588,750	2.5	9.700
\$12.33	\$13.58	74,250	6.1	13.264
		860,500	2.3	9.415

At June 30, 2007, outstanding and exercisable options had an intrinsic value of \$16,904,478. The total intrinsic value of stock options exercised in the first six months of 2007 was \$2,794,203. For the six month period ended June 30, 2007, the Company recognized a tax benefit of \$892,241 resulting from the exercise of non-qualified stock options and the disqualification of incentive stock options that were exercised and sold prior to the required holding period.

Note K Income Taxes

The Company adopted the provisions of FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes*, on December 31, 2006, the first day of the Company's 2007 fiscal year. As a result of the implementation of Interpretation 48, the Company recognized a \$631,000 increase in the liability for unrecognized tax benefits, \$264,000 of which was accounted for as a reduction to the December 31, 2006 balance of retained earnings. The Company has recorded a liability of approximately \$1,561,000 for unrecognized tax benefits as of December 31, 2006.

Included in the balance at December 31, 2006, are \$1,226,000 of unrecognized tax benefits that would affect the annual effective tax rate. In 2007 and 2006, the Company recognized interest and penalties accrued related to unrecognized tax benefits in income tax expense. The Company had approximately \$225,000 of accrued interest and penalties at December 31, 2006.

The Company files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2003 and non-U.S. income tax examinations by tax authorities prior to 2001.

The total amount of unrecognized tax benefits could increase or decrease within the next twelve months for a number of reasons, including the closure of federal, state and foreign tax years by expiration of the statute of limitations and the recognition and measurement considerations under FIN 48. There have been no significant changes to the total amount of unrecognized tax benefits during the six months ended June 30, 2007. The Company believes that it is reasonably possible that approximately \$500,000 of unrecognized tax benefits related to the earnings of our Hong Kong subsidiary will be recognized over the next twelve months.

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

The following discussion is intended to highlight significant changes in the Company's financial position and results of operations for the twenty-six weeks ended June 30, 2007. The interim financial statements and this Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Consolidated Financial Statements and Notes thereto for the fiscal year ended December 30, 2006 and the related Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2006.

Certain statements set forth in this discussion and analysis of financial condition and results of operations are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. They use such words as may, will, expect, believe, plan and other similar terminology. These statements reflect management's current expectations regarding future events and operating performance and speak only as of the date of this release. These forward-looking statements involve a number of risks and uncertainties and actual future results and trends may differ materially depending on a variety of factors, including changing customer preferences, lack of success of new products, loss of customers, competition, increased raw material prices, problems associated with foreign sourcing of parts and products, changes within our industry segments and in the overall economy, litigation and legislation. In addition, terrorist threats and the possible responses by the U.S. government, the effects on consumer demand, the financial markets, the travel industry, the trucking industry and other conditions increase the uncertainty inherent in forward-looking statements. Forward-looking statements reflect the expectations of the Company at the time they are made, and investors should rely on them only as expressions of opinion about what may happen in the future and only at the time they are made. The Company undertakes no obligation to update any forward-looking statement. Although the Company believes it has an appropriate business strategy and the resources necessary for its operations, future revenue and margin trends cannot be reliably predicted and the Company may alter its business strategies to address changing conditions.

In addition, the Company makes estimates and assumptions that may materially affect reported amounts and disclosures. These relate to valuation allowances for accounts receivable and for excess and obsolete inventories, accruals for pensions and other postretirement benefits (including forecasted future cost increases and returns on plan assets), provisions for depreciation (estimating useful lives), uncertain tax positions, and, on occasion, accruals for contingent losses.

Overview

During the second quarter of 2007, the Company experienced a 15% increase in sales as compared to the second quarter of 2006. All of the Company's business segments increased their sales over the prior year period. In the second quarter of 2007 Industrial Hardware sales increased 1%, Security Products sales increased 33% and Metal Products experienced a 15% increase in sales compared to the prior year period.

Gross margin as a percentage of sales for the three months ended June 30, 2007 was 18% compared to 22% in the comparable period a year ago. The decrease in the gross margin was primarily the result of higher costs for raw materials. Additional items having a negative impact on gross margin in 2007 were increased expenses for payroll and payroll related charges, equipment maintenance and supplies and tools.

Sales in the first six months of 2007 increased 50% compared to the 2006 period. Sales increased in all business segments compared to the first six months of 2006: Industrial Hardware 80%, Security Products 27% and Metal Products 8%. The increase in sales of Industrial Hardware products was primarily the result of the military contract to produce door latching components for a military project to up-armor existing Humvees, which was completed in the first quarter of 2007. The increase in Security Products sales was mainly the result of the acquisitions of Royal Lock and Summit Manufacturing during the latter part of 2006. The increase in the Metal Products segment was the result of increased sales of both mine roof anchor products and contract castings.

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Gross margin as a percentage of sales for the six months ended June 30, 2007 was 26% compared to 23% in the comparable period a year ago. Higher sales volume, particularly the door latching components for a military project to up-armor existing Humvees which was completed in the first quarter of 2007, resulted in better utilization of our production capacity mainly in the Industrial Hardware segment and was the primary reason for

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the gross margin improvement. The six month gross margin was also impacted negatively by the same factors that caused the decrease in gross margin during the second quarter; increases in raw material, payroll and payroll related charges, equipment maintenance and tools and supplies.

Raw material prices have continued to increase during the second quarter of 2007, primarily for zinc, brass and stainless steel. The Company is recovering these increases from our customers, wherever possible. Currently, there is no indication that the Company will not be able to obtain supplies of all the materials that it requires. Raw material costs have reduced our gross margins and will continue to be a challenge unless prices for raw materials stabilize.

Cash flow from operations in the first six months of 2007 has improved significantly compared to the same period in 2006, mainly due to the increased sales volume from the military up-armor project, which was completed in the first quarter. The Company's line of credit, along with controlling discretionary expenditures, should provide sufficient cash flow to enable the Company to meet all its existing obligations.

A more detailed analysis of the Company's results of operations and financial condition follows:

Results of Operations

The following table shows, for the periods indicated, selected line items from the condensed consolidated statements of income as a percentage of net sales, by segment:

Three Months Ended June 30, 2007

	Industrial Hardware	Security Products	Metal Products	Total
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	78.8%	77.8%	111.7%	82.0%
Gross margin	21.2%	22.2%	-11.7%	18.0%
Selling and administrative expense	15.0%	14.0%	9.0%	13.9%
Operating profit	6.2%	8.2%	-20.7%	4.1%

Three Months Ended July 1, 2006

	Industrial Hardware	Security Products	Metal Products	Total
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	78.3%	72.6%	97.6%	78.2%
Gross margin	21.7%	27.4%	2.4%	21.8%
Selling and administrative expense	13.4%	16.8%	9.8%	14.3%

Operating profit	8.3%	10.6%	-7.4%	7.5%
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The following table shows the amount of change for the second quarter of 2007 compared to the second quarter of 2006 in sales, cost of products sold, gross margin, selling and administrative expenses and operating profit, by segment (dollars in thousands):

	Industrial Hardware	Security Products	Metal Products	Total
Net sales	\$ 86	\$ 3,921	\$ 499	\$ 4,506
Volume	-20.4%	27.7%	10.8%	2.3%
Prices	0.3%	0.4%	4.3%	0.8%
New products	<u>20.7%</u>	<u>4.9%</u>	<u>0.0%</u>	<u>12.1%</u>
	0.6%	33.0%	15.1%	15.2%
Cost of products sold	\$ 138	\$ 3,679	\$ 1,022	\$ 4,839
	1.2%	42.6%	31.7%	20.9%
Gross margin	\$ (52)	\$ 242	\$ (523)	\$ (333)
	-1.7%	7.4%	-667.9%	-5.1%
Selling and administrative expenses	\$ 237	\$ 223	\$ 21	\$ 481
	12.2%	11.2%	6.5%	11.3%
Operating profit	\$ (289)	\$ 19	\$ (544)	\$ (814)
	-24.3%	1.5%	-222.4%	-36.7%

The following table shows, for the periods indicated, selected line items from the condensed consolidated statements of income as a percentage of net sales, by segment:

Six Months Ended June 30, 2007

	Industrial Hardware	Security Products	Metal Products	Total
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	67.4%	77.6%	108.6%	74.4%
Gross margin	32.6%	22.4%	-8.6%	25.6%
Selling and administrative expense	10.0%	14.4%	9.0%	11.4%
Operating profit	22.6%	8.0%	-17.6%	14.2%

Six Months Ended July 1, 2006

	Industrial Hardware	Security Products	Metal Products	Total
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	77.2%	72.5%	96.0%	77.5%
Gross margin	22.8%	27.5%	4.0%	22.5%

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Selling and administrative expense	14.8%	17.1%	9.7%	15.2%
Operating profit	8.0%	10.4%	-5.7%	7.3%

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The following table shows the amount of change for the first six months of 2007 compared to the first six months of 2006 in sales, cost of products sold, gross margin, selling and administrative expenses and operating profit, by segment (dollars in thousands):

	Industrial Hardware	Security Products	Metal Products	Total
Net sales	\$ 22,004	\$ 6,442	\$ 517	\$ 28,963
Volume	-7.8%	22.6%	4.9%	6.1%
Prices	0.2%	0.0%	2.2%	0.3%
New products	<u>88.1%</u>	<u>4.8%</u>	<u>0.7%</u>	<u>43.9%</u>
	80.5%	27.4%	7.8%	50.3%
Cost of products sold	\$ 12,173	\$ 6,174	\$ 1,403	\$ 19,750
	57.7%	36.2%	21.9%	44.3%
Gross margin	\$ 9,831	\$ 268	\$ (886)	\$ 9,213
	157.5%	4.1%	-333.5%	71.1%
Selling and administrative expenses	\$ 896	\$ 297	\$ (4)	\$ 1,189
	22.2%	7.4%	-0.6%	13.6%
Operating profit	\$ 8,935	\$ (29)	\$ (882)	\$ 8,024
	406.4%	-1.2%	-229.4%	189.4%

Industrial Hardware Segment

Net sales in the Industrial Hardware segment were up 1% in the second quarter of 2007 and 80% in the first half compared to the prior year periods. New product introductions, mainly the door latching components for a military project to up-armor existing Humvees, which was completed during the first quarter, were responsible for the majority of the increase in sales for this segment. This segment continues to provide quotations and prototypes for additional military business including the MRAP (Mine Resistant Ambush Protected) program. New products included a retro-fit kit for the military Humvee, a 2 point pad lock assembly and a star wheel rotary assembly for the truck accessory market, a compartment wire harness, a paddle rotary and a door jamb latch for the service body market, wardrobe lock hardware for Class 8 trucks and an assortment of handles and latches used in many of the markets we sell to. As we anticipated, sales volume of existing products declined in the Industrial Hardware segment primarily due to decreased sales of sleeper cabs for the Class 8 truck market, as truck dealers built up their inventories ahead of new greenhouse gas emission regulations that went into effect for Class 8 trucks produced after March 31, 2007. Sales of sleeper cabs are expected to increase as the year progresses as Class 8 truck dealers sell down their inventories.

Cost of products sold for the Industrial Hardware segment increased 1% in the second quarter and 58% in the first half of 2007 compared to the prior year periods. In addition to manufacturing costs associated with the higher volume of sales, the major factor causing the increase was higher raw material costs in 2007.

Gross margin as a percent of net sales decreased from 22% to 21% in the second quarter compared to the prior year quarter, due to higher manufacturing costs and changes in the mix of products sold. Gross margin increased from 23% to 33% in the first half of 2007 compared to the prior year period as a direct result of the significant increase in sales volume, primarily the door latching components for a military project to up-armor existing Humvees which was completed during the first quarter of 2007, resulting in more efficient utilization of our existing facilities.

Selling and administrative expenses increased 12% for the second quarter and 22% for the first half of 2007 compared to the prior year periods primarily due to increases in payroll and payroll related charges.

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Security Products Segment

Net sales in the Security Products segment increased 33% in the second quarter and 27% in the first half of 2007 compared to the 2006 periods. The increase in sales volume was primarily the result of the integration of the Royal Lock and Summit Manufacturing acquisitions. Sales volume improved considerably in commercial laundry products during the second quarter of 2007, after experiencing softness during the first quarter. Sales of new products focused on oven latches from the Summit Manufacturing acquisition and lock products such as a L-handle for a sportrack and hinge used on truck tonneau covers as well as various other items for the many markets we service.

Cost of products sold for the Security Products segment was up 43% in the second quarter and 36% in the first half of 2007 compared to the same periods in 2006. The increase in cost of products sold was due to the increase in sales volume and increases in raw material costs.

Gross margin as a percentage of sales in both the second quarter and first half decreased from 27% in the 2006 periods to 22% in 2007. The decreases were due to higher raw material costs in all operating units in the Security Products segment in 2007 compared to the same periods in 2006. Gross margin in the Security Products segment was also impacted by customers phasing out certain higher margin products in favor of other products with lower margins.

Selling and administrative expenses increased 11% in the second quarter and 7% in the first half of 2007 from 2006 levels. The increase was due to increased payroll and payroll related charges, increased travel expense and amortization of intangibles resulting from the acquisitions of Royal Lock and Summit Manufacturing.

Metal Products Segment

Net sales in the Metal Products segment were up 15% in the second quarter and 8% in the first half of 2007 as compared to the prior year periods. Sales of mining products were up 14% in the second quarter and 13% in the first half of 2007 compared to the prior year periods. Sales of contract castings increased 42% in the second quarter and 7% in the first half of 2007 from the prior year levels. The increase in sales of contract castings is the result of increased demand for ductile iron castings with a higher average selling price compared to the prior year quarter. New product sales included a spherical nut used in underground mining. The Company is continuing its marketing efforts to introduce our mine roof anchors in the China mining industry. While that effort has not yet yielded great success, we remain optimistic that the course of action we are taking will produce positive results.

Cost of products sold increased 32% in the second quarter and 22% in the first half of 2007 compared to the same periods in 2006. The increase is attributable to the mix of products produced and increased costs for raw materials, utilities, supplies and tools, equipment maintenance and payroll and payroll related charges.

Gross margin as a percentage of net sales decreased from 2% to -12% in the second quarter of 2007 and from 4% to -9% for the first half of 2007 compared to the 2006 periods. The decrease is primarily due to the mix of products produced and higher production costs. The higher production costs primarily related to problems in casting two new products related to military orders which reduced our margins. The Company believes the problems associated with these two products are now behind us.

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Selling and administrative expenses were up 7% in the second quarter and down 1% in the first half of 2007 compared to the same periods in 2006. The increase in the second quarter was the result of costs associated with higher levels of employment in 2007, including safety equipment and training. The decrease in the first half was due to lower expenses for advertising and commissions.

Other Items

Interest expense increased 37% in the first quarter and 47% in the first half of 2007 compared to the prior year periods due to the higher debt balances, higher interest rates and borrowings under the revolving loan to fund interim working capital needs in the first quarter of 2007.

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Other income increased 335% in the quarter and 89% from the first six months of 2006 to 2007 due to higher cash balances in the Company's cash management program, which resulted in higher interest income.

Income taxes increased in line with the higher earnings level. The effective tax rate in the second quarter of 2007 was 35% compared to 39% in the second quarter of 2006. The effective tax rate for the first six months of 2007 was 35% compared to 38% in the first six months of 2006. The decrease in the effective tax rate is the result of the Company deriving a higher percentage of its earnings from countries with lower effective tax rates.

Liquidity and Sources of Capital

The Company generated \$6.9 million from operations for the first six months of 2007 compared to \$1.1 million for the same period in 2006. The change in cash flows was the result of changes in the level of sales related to the Company's military contract, which was completed in the first quarter of 2007, and the associated timing differences for collections of accounts receivable and payments of liabilities and changes in inventories. Cash flow from operations coupled with cash on hand at the beginning of the year were sufficient to fund capital expenditures, debt service, incentive payments, contributions to the Company's pension plans, and dividend payments. The Company did not utilize the line of credit during the second quarter of 2007. The maximum balance outstanding during the first half of 2007 was approximately \$5.3 million; however, the line was completely re-paid at the end of the first quarter. The line of credit was not used during the first half of 2006.

Additions to property, plant and equipment were \$1.4 million during the first six months of 2007 versus \$2.4 million for the comparable period in the prior year. Total capital expenditures for 2007 are expected to be in the range of \$3 million to \$5 million.

Total inventories as of June 30, 2007 were \$27.1 million, compared to \$28.0 million at year-end 2006. The inventory turnover ratio of 4.7 turns at the end of the second quarter was higher than both the prior year second quarter and year-end 2006 ratio of 3.8 and 3.7 turns, respectively. The improvement is related to the military contract which was completed during the first quarter of 2007. Accounts receivable decreased by \$4.6 million from year end, due to completion of the military contract, and increased \$4.1 million from the second quarter of Fiscal 2006, primarily due to increased sales volume. The average days sales in accounts receivable for the second quarter of 2007 at 54 days increased in comparison to the second quarter of 2006 at 49 days and year end 2006 at 46 days, due to a slowdown of collections in the Industrial Hardware and Security Products segment. The Company is confident that these receivables will ultimately be collected.

Cash flow from operating activities and funds available under the revolving credit portion of the Company's loan agreement are expected to be sufficient to cover future foreseeable working capital requirements.

ITEM 3 QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk from what was reported in the 2006 Annual Report on Form 10-K.

ITEM 4 CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of the Company's management, including the Chief Executive Officer (CEO) and Chief Financial Officer (CFO), of the effectiveness of the design and operation of the Company's disclosure controls and procedures as of the end of the period covered by this report. Based on that evaluation, the Company's management, including the CEO and CFO, concluded that the Company's disclosure controls and procedures were effective as of the end of the period covered by this report.

The Company believes that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide

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absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. The Company's disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives, and the CEO and CFO have concluded that these controls and procedures are effective at the reasonable assurance level.

Changes in Internal Controls

During the period covered by this report, there have been no significant changes in the Company's internal control over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1 LEGAL PROCEEDINGS

There are no legal proceedings, other than ordinary routine litigation incidental to the Company's business, to which either the Company or any of its subsidiaries is a party or to which any of their property is the subject.

ITEM 1A RISK FACTORS

There have been no material changes in risk factors from what was reported in the 2006 Annual Report on Form 10-K.

ITEM 2 UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There have been no sales of unregistered securities by the Company during the period covered by this report.

Issuer Purchases of Equity Securities

		(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number that May Yet Be Purchased Under the Plans or Programs
Period					
April 1	April 28, 2007	-	-	-	-
April 29	May 26, 2007	7,773	\$28.70	-	-
May 27	June 30, 2007	-	-	-	-
Total		7,773	\$28.70	-	-

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The Company does not have any share repurchase plans or programs. The figures shown in the table above are for shares delivered to the Company to exercise stock options.

ITEM 3 DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4 SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS

See the information set forth in Part II, Item 4 of the Form 10-Q of the Company for the quarterly period ended March 31, 2007.

ITEM 5 OTHER INFORMATION

None

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ITEM 6 EXHIBITS

31) Certifications required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32) Certifications pursuant to Rule 13a-14(b) and 18 USC 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99(1)) The Registrant's Annual Report on Form 10-K as amended for the fiscal year ended December 30, 2006 is incorporated herein by reference.

99(2)) Form 8-K filed on April 25, 2007 setting forth the press release reporting the Company's earnings for the quarter ended March 31, 2007 is incorporated herein by reference.

99(3)) Form 8-K filed on April 25, 2007 setting forth the Company's projected revenue for 2007 is incorporated herein by reference.

99(4)) Form 8-K filed on July 26, 2007 setting forth the press release reporting the Company's earnings for the quarter ended June 30, 2007 is incorporated herein by reference.

SIGNATURES

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

THE EASTERN COMPANY
(Registrant)

DATE: July 30, 2007

/s/Leonard F. Leganza
Leonard F. Leganza

Chairman, President and Chief Executive Officer

DATE: July 30, 2007

/s/John L. Sullivan III
John L. Sullivan III

