# 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 September 30, 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 1-8174

# DUCOMMUN INCORPORATED

**(Exact name of registrant as specified in its charter)**

| | |
|---|---|
| **Delaware**<br>**(State or other jurisdiction of incorporation or organization)** | **95-0693330**<br>**(I.R.S. Employer Identification No.)** |
| **23301 Wilmington Avenue, Carson, California**<br>**(Address of principal executive offices)** | **90745-6209**<br>**(Zip Code)** |

**(310) 513-7280**

**(Registrant s telephone number, including area code)**

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**(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. 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. (Check one):

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 the latest practicable date. As of October 25, 2006, there were outstanding 10,242,996 shares of common stock.

DUCOMMUN INCORPORATED

FORM 10-Q

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**PART I - FINANCIAL INFORMATION**

**Item 1. Financial Statements**

DUCOMMUN INCORPORATED AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

| | (Unaudited) September 30, 2006 | December 31, 2005 |
|---|---|---|
| **Assets** | | |
| Current Assets: | | |
| Cash and cash equivalents | $ 2,618 | $ 19,221 |
| Accounts receivable (less allowance for doubtful accounts of $288 and $244) | 40,242 | 32,890 |
| Unbilled receivables | 4,611 | |
| Inventories | 65,950 | 53,299 |
| Deferred income taxes | 7,516 | 6,048 |
| Prepaid income taxes | | 56 |
| Other current assets | 5,485 | 4,464 |
| Total Current Assets | 126,422 | 115,978 |
| Property and Equipment, Net | 53,822 | 52,481 |
| Goodwill, Net | 108,066 | 57,201 |
| Other Intangible Assets, Net | 10,741 | |
| Other Assets | 1,757 | 2,309 |
| | $ 300,808 | $ 227,969 |
| **Liabilities and Shareholders Equity** | | |
| Current Liabilities: | | |
| Current portion of long-term debt | $ 1,253 | $ |
| Accounts payable | 26,851 | 17,787 |
| Accrued liabilities | 38,869 | 33,879 |
| Total Current Liabilities | 66,973 | 51,666 |
| Long-Term Debt, Less Current Portion | 43,850 | |
| Deferred Income Taxes | 6,279 | 5,752 |
| Other Long-Term Liabilities | 2,700 | 2,700 |
| Total Liabilities | 119,802 | 60,118 |
| Commitments and Contingencies | | |
| Shareholders Equity: | | |
| Common stock $.01 par value; authorized 35,000,000 shares; issued 10,234,996 shares in 2006 and 10,108,996 shares in 2005 | 102 | 101 |
| Additional paid-in capital | 45,112 | 41,987 |
| Retained earnings | 138,492 | 128,463 |
| Accumulated other comprehensive loss | (2,700) | (2,700) |

| | | | | |
|---|---|---|---|---|
| Total Shareholders Equity | | 181,006 | | 167,851 |
| | $ | 300,808 | $ | 227,969 |

*See accompanying notes to consolidated financial statements.*

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DUCOMMUN INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

(Unaudited)

| | For Three Months Ended September 30, 2006 | For Three Months Ended October 1, 2005 |
|---|---|---|
| Net Sales | $ 81,557 | $ 63,008 |
| Operating Costs and Expenses: | | |
| Cost of goods sold | 64,612 | 49,958 |
| Selling, general and administrative expenses | 10,374 | 7,555 |
| Total Operating Costs and Expenses | 74,986 | 57,513 |
| Operating Income | 6,571 | 5,495 |
| Interest (Expense)/Income, Net | (704) | 407 |
| Income Before Taxes | 5,867 | 5,902 |
| Income Tax Expense, Net | (1,768) | (1,587) |
| Net Income | $ 4,099 | $ 4,315 |
| Earnings Per Share: | | |
| Basic earnings per share | $ .40 | $ .43 |
| Diluted earnings per share | $ .40 | $ .42 |
| Weighted Average Number of Common Shares Outstanding: | | |
| Basic | 10,231 | 10,069 |
| Diluted | 10,292 | 10,222 |

*See accompanying notes to consolidated financial statements.*

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DUCOMMUN INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(In thousands, except per share amounts)

(Unaudited)

| | For Nine Months Ended September 30, 2006 | October 1, 2005 |
|---|---|---|
| Net Sales | $ 231,195 | $ 188,818 |
| Operating Costs and Expenses: | | |
| Cost of goods sold | 184,508 | 150,041 |
| Selling, general and administrative expenses | 29,609 | 22,195 |
| Total Operating Costs and Expenses | 214,117 | 172,236 |
| Operating Income | 17,078 | 16,582 |
| Interest (Expense)/Income, Net | (1,868) | 322 |
| Income Before Taxes | 15,210 | 16,904 |
| Income Tax Expense, Net | (5,181) | (4,433) |
| Net Income | $ 10,029 | $ 12,471 |
| Earnings Per Share: | | |
| Basic earnings per share | $ .98 | $ 1.24 |
| Diluted earnings per share | $ .97 | $ 1.22 |
| Weighted Average Number of Common Shares Outstanding: | | |
| Basic | 10,195 | 10,058 |
| Diluted | 10,287 | 10,190 |

*See accompanying notes to consolidated financial statements.*

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DUCOMMUN INCORPORATED AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

| | For Nine Months Ended September 30, 2006 | For Nine Months Ended October 1, 2005 |
|---|---|---|
| Cash Flows from Operating Activities: | | |
| Net Income | $ 10,029 | $ 12,471 |
| Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities: | | |
| Depreciation | 6,131 | 5,652 |
| Amortization of other intangible assets | 999 | |
| Deferred income tax (benefit)/provision | (941) | 2,454 |
| Excess tax benefit from stock-based compensation | (182) | |
| Income tax benefit from stock-based compensation | 501 | 177 |
| Stock-based compensation expense | 1,067 | |
| Recovery of doubtful accounts | (15) | (110) |
| Gain on sale of assets | (36) | (13) |
| Net (recovery of)/provision for warranty reserves | (23) | 108 |
| Net reduction of contract cost overruns | (257) | (574) |
| Changes in Assets and Liabilities Net of Effects from Acquisitions: | | |
| Accounts receivable - (increase) | (856) | (6,882) |
| Unbilled receivables - (increase) | (2,052) | |
| Inventories - (increase) | (10,784) | (588) |
| Prepaid income taxes - decrease | 56 | 272 |
| Other assets - (increase) | (186) | (570) |
| Accounts payable - increase | 7,781 | 2,092 |
| Accrued and other liabilities - (decrease)/increase | (408) | 3,375 |
| Net Cash Provided by Operating Activities | 10,824 | 17,864 |
| Cash Flows from Investing Activities: | | |
| Purchase of Property and Equipment | (6,851) | (3,229) |
| Proceeds from Sale of Assets | 179 | 18 |
| Acquisition of Businesses, Net of Cash Acquired | (60,495) | |
| Net Cash Used in Investing Activities | (67,167) | (3,211) |
| Cash Flows from Financing Activities: | | |
| Net Borrowings/(Repayment) of Long-Term Debt | 38,000 | (1,200) |
| Net Cash Effect of Exercise Related to Stock Options | 1,558 | 247 |
| Excess Tax Benefit from Stock-Based Compensation | 182 | |
| Net Cash Provided by/(Used in) Financing Activities | 39,740 | (953) |
| Net (Decrease)/Increase in Cash and Cash Equivalents | (16,603) | 13,700 |
| Cash and Cash Equivalents at Beginning of Period | 19,221 | 158 |
| Cash and Cash Equivalents at End of Period | $ 2,618 | $ 13,858 |

| | | |
|---|---|---|
| Supplemental Disclosures of Cash Flow Information: | | |
| Interest Paid | $ 1,654 | $ 32 |
| Taxes Paid | $ 4,930 | $ 2,237 |

*See accompanying notes to consolidated financial statements.*

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DUCOMMUN INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

**Note 1. Basis of Presentation**

The consolidated balance sheet is unaudited as of September 30, 2006 and the consolidated statements of income and the consolidated statements of cash flows are unaudited for the three months and nine months ended September 30, 2006 and October 1, 2005. The consolidated financial statements include the accounts of Ducommun Incorporated and its subsidiaries ( Ducommun or the Company ), after eliminating inter-company balances and transactions. The interim financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are, in the opinion of the Company, necessary for a fair presentation of the results for the interim periods presented. The financial information included in this Form 10-Q should be read in conjunction with the Company s consolidated financial statements and related notes thereto included in the Form 10-K for the year ended December 31, 2005. The results of operations for the three months and nine months ended September 30, 2006 are not necessarily indicative of the results to be expected for the full year ending December 31, 2006.

**Note 2. Changes in Significant Accounting Policies**

Ducommun operates in two business segments. Ducommun AeroStructures, Inc. ( DAS ), engineers and manufactures aerospace structural components and subassemblies. Ducommun Technologies, Inc. ( DTI ), designs, engineers and manufactures electromechanical components and subsystems, and through its Miltec Corporation ( Miltec ) subsidiary, provides engineering, technical and program management services (including design, development, integration and test of prototype products) principally for the aerospace and military markets. The significant accounting policies of the Company and its two business segments are the same except as described below.

Revenue Recognition

Except for the Company s Miltec subsidiary, the Company recognizes revenue when persuasive evidence of an arrangement exists, the price is fixed or determinable, collection is reasonably assured and delivery of products has occurred or services have been rendered. Revenue from products sold under long-term contracts is recognized by the Company on the same basis as other sale transactions. The Company recognizes revenue on the sale of services (including prototype products) by its Miltec

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subsidiary based on the type of contract: time and materials, cost-plus reimbursement and firm-fixed price. Revenue is recognized by Miltec (i) on time and materials contracts as time is spent at hourly rates, which are negotiated with customers, plus the cost of any allowable materials and out-of-pocket expenses, (ii) on cost-plus reimbursement contracts based on direct and indirect costs incurred plus a negotiated profit calculated as a percentage of cost, a fixed amount or a performance-based award fee, and (iii) on fixed-price contracts on the percentage-of-completion method measured by the percentage of costs incurred to estimated total costs.

Goodwill

The Company s business acquisitions have resulted in goodwill. Goodwill is not amortized but is subject to impairment tests on an annual basis in the fourth quarter and between annual tests, in certain circumstances, when events indicate an impairment may have occurred. Goodwill is tested for impairment utilizing a two-step method. In the first step, the Company determines the fair value of the reporting unit using expected future discounted cash flows and other market valuation approaches, requiring management to make estimates and assumptions about the reporting unit s future prospects. If the net book value of the reporting unit exceeds the fair value, the Company would then perform the second step of the impairment test which requires fair valuation of all the reporting unit s assets and liabilities in a manner similar to a purchase price allocation, with any residual fair value being allocated to goodwill. This residual fair value of goodwill is then compared to the carrying amount to determine impairment. An impairment charge will be recognized only when the implied fair value of a reporting unit, including goodwill, is less than its carrying amount.

Other Intangible Assets

The Company amortizes purchased other intangible assets with finite lives using the straight-line method over the estimated economic lives of the assets, ranging from one to fourteen years. The value of other intangibles acquired through business combinations has been estimated using present value techniques which involve estimates of future cash flows. Actual results could vary, potentially resulting in impairment charges.

Accounting for Stock-Based Compensation

Effective January 1, 2006, the Company began recognizing compensation expense for share-based payment transactions in the financial statements at their fair value. The expense is measured at the grant date, based on the calculated fair value of the share-based award, and is recognized over the

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requisite service period (generally the vesting period of the equity award). Prior to January 1, 2006, the Company accounted for share-based compensation based upon the intrinsic value of options at the grant date. The transition to fair value was accounted for using the modified prospective method. Therefore, financial statement amounts for prior periods presented in this Form 10-Q have not been restated to reflect the fair value method of recognizing compensation cost relating to stock options.

Prior to January 1, 2006, the Company presented all benefits of tax deductions resulting from the exercise of share-based compensation as operating cash flows in the statements of cash flows. Prospectively, the benefits of tax deductions in excess of the compensation cost recognized for stock options ( excess tax benefits ) are classified as financing cash flows. Excess tax benefits reflected as a financing cash inflow totaled $182,000 during the first nine months ended September 30, 2006. Income tax benefits reflected as an operating cash inflow totaled $319,000 during the first nine months ended September 30, 2006.

Earnings Per Share

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding in each period. Diluted earnings per share is computed by dividing income available to common shareholders plus income associated with dilutive securities by the weighted average number of common shares outstanding plus any potential dilutive shares that could be issued if exercised or converted into common stock in each period. For the three months ended September 30, 2006 and October 1, 2005, income available to common shareholders was $4,099,000 and $4,315,000, respectively. The weighted average number of common shares outstanding for the three months ended September 30, 2006 and October 1, 2005 were 10,231,000 and 10,069,000, respectively; the dilutive shares associated with stock options were 61,000 and 153,000, respectively. For the nine months ended September 30, 2006 and October 1, 2005, income available to common shareholders was $10,029,000 and $12,471,000, respectively. The weighted average number of common shares outstanding for the nine months ended September 30, 2006 and October 1, 2005 were 10,195,000 and 10,058,000; and the dilutive shares associated with stock options were 92,000 and 133,000, respectively. For the three months ended September 30, 2006 and October 1, 2005 the number of shares not included in the calculations because the impact would have been antidilutive was 632,000 and 48,000, respectively; and for the nine months ended September 30, 2006 and October 1, 2005 the number of shares not included in the calculation because the impact would have been antidilutive was 523,000 and 246,000, respectively.

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Comprehensive Income

Certain items such as foreign currency translation adjustments, unrealized gains and losses on certain investments in debt and equity securities and minimum pension liability adjustments are presented as separate components of shareholders equity. The current period change in these items is defined as other comprehensive income and separately reported in the financial statements. Accumulated other comprehensive loss, as reflected in the Consolidated Balance Sheets under the equity section, is comprised of a minimum pension liability adjustment of $2,700,000, net of tax, at September 30, 2006 and December 31, 2005.

Recent Accounting Pronouncements

On September 15, 2006, the Financial Accounting Standards Board (FASB or the Board ) issued FASB Statement No. 157, *Fair Value Measurements ( SFAS No. 157 )*, which addresses how companies should measure fair value when they are required to use a fair value measure for recognition or disclosure purposes under generally accepted accounting principles (GAAP). As a result of SFAS No. 157 there is now a common definition of fair value to be used throughout GAAP. The FASB believes that the new standard will make the measurement of fair value more consistent and compar