

Edgar Filing: FAIRCHILD CORP - Form 10-Q

FAIRCHILD CORP
Form 10-Q
May 12, 2003

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

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15(d) of the
Securities Exchange Act of 1934

For the Quarterly Period Ended March 30, 2003 Commission File Number 1-6560

THE FAIRCHILD CORPORATION
(Exact name of Registrant as specified in its charter)

Delaware 34-0728587
(State of incorporation or organization) (I.R.S. Employer Identification No.)

45025 Aviation Drive, Suite 400, Dulles, VA 20166
(Address of principal executive offices)

(703) 478-5800 (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 ninety (90) days.

YES X NO

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act).

YES X NO

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

Title of Class	Outstanding at March 30, 2003
Class A Common Stock, \$0.10 Par Value	22,560,489
Class B Common Stock, \$0.10 Par Value	2,621,502

THE FAIRCHILD CORPORATION INDEX TO QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED MARCH 30, 2003

Edgar Filing: FAIRCHILD CORP - Form 10-Q

	Page
PART I. FINANCIAL INFORMATION	
Item 1. Independent Accountants' Review Report.....	3
Condensed Consolidated Balance Sheets as of March 30, 2003 (Unaudited) and June 30, 2002.....	4
Condensed Consolidated Statements of Earnings (Unaudited) for the Three and Nine Months Ended March 30, 2003 and March 31, 2002.....	6
Condensed Consolidated Statements of Cash Flows (Unaudited) for the Nine Months Ended March 30, 2003 and March 31, 2002	8
Notes to Condensed Consolidated Financial Statements (Unaudited).....	9
Item 2. Management's Discussion and Analysis of Results of Operations and Financial Condition.....	19
Item 3. Quantitative and Qualitative Disclosure About Market Risk	27
Item 4. Controls and Procedures.....	28
PART II. OTHER INFORMATION	
Item 1. Legal Proceedings.....	29
Item 2. Changes in Securities and Use of Proceeds.....	29
Item 5. Other Information.....	29
Item 6. Exhibits and Reports on Form 8-K.....	29

All references in this Quarterly Report on Form 10-Q to the terms "we," "our," "us," the "Company" and "Fairchild" refer to The Fairchild Corporation and its subsidiaries. All references to "fiscal" in connection with a year shall mean the 12 months ended June 30.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

Independent Accountants' Review Report

The Board of Directors
The Fairchild Corporation

Edgar Filing: FAIRCHILD CORP - Form 10-Q

We have reviewed the accompanying condensed consolidated balance sheet of The Fairchild Corporation and consolidated subsidiaries as of March 30, 2003, and the related condensed consolidated statements of income for the three-month and nine-month periods ended March 30, 2003 and March 31, 2002, and the condensed consolidated statements of cash flows for the nine-month periods ended March 30, 2003 and March 31, 2002. These financial statements are the responsibility of the Company's management.

We conducted our reviews in accordance with standards established by the American Institute of Certified Public Accountants. A review of interim financial information consists principally of applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit conducted in accordance with auditing standards generally accepted in the United States, which will be performed for the full year with the objective of expressing an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our reviews, we are not aware of any material modifications that should be made to the accompanying condensed consolidated financial statements referred to above for them to be in conformity with accounting principles generally accepted in the United States.

We have previously audited, in accordance with auditing standards generally accepted in the United States, the consolidated balance sheet of The Fairchild Corporation as of June 30, 2002, and the related consolidated statements of earnings, stockholders' equity, and cash flows for the year then ended (not presented herein) and in our report dated March 28, 2003, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of June 30, 2002, is fairly stated, in all material respects, in relation to the consolidated balance sheet from which it has been derived.

...../s/ Ernst & Young LLP

May 9, 2003

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
March 30, 2003 (Unaudited) and June 30, 2002
(In thousands)

ASSETS

CURRENT ASSETS:

Cash and cash equivalents

Short-term investments

Accounts receivable, less allowances of \$4,642 and \$2,577

Inventories:

Finished goods

Edgar Filing: FAIRCHILD CORP - Form 10-Q

Work-in-process
Raw materials

Net current assets of discontinued operations
Prepaid expenses and other current assets

Total Current Assets

Property, plant and equipment, net of accumulated
depreciation of \$26,136 and \$22,228
Net noncurrent assets held for sale
Net noncurrent assets of discontinued operations
Goodwill
Investments and advances, affiliated companies
Prepaid pension assets
Deferred loan costs
Long-term investments
Notes receivable
Deferred tax assets
Other assets

TOTAL ASSETS

The accompanying Notes to Condensed Consolidated Financial
Statements are an integral part of these statements.

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
March 30, 2003 (Unaudited) and June 30, 2002
(In thousands)

LIABILITIES AND STOCKHOLDERS' EQUITY

CURRENT LIABILITIES:

Bank notes payable and current maturities of long-term debt
Accounts payable

Accrued liabilities:

Salaries, wages and commissions
Employee benefit plan costs
Insurance
Interest

Edgar Filing: FAIRCHILD CORP - Form 10-Q

Other accrued liabilities
 Current deferred income taxes
 Current liabilities of discontinued operations

Total Current Liabilities

LONG-TERM LIABILITIES:

Long-term debt, less current maturities
 Fair value of interest rate contract
 Other long-term liabilities
 Pension liabilities
 Retiree health care liabilities
 Noncurrent deferred income taxes
 Noncurrent income taxes
 Noncurrent liabilities of discontinued operations

TOTAL LIABILITIES

STOCKHOLDERS' EQUITY:

Class A common stock, \$0.10 par value; 40,000 shares authorized,
 30,374 (30,354 in June) shares issued and 22,560 (22,540 in June)
 shares outstanding; entitled to one vote per share
 Class B common stock, \$0.10 par value; 20,000 shares authorized,
 2,622 shares issued and outstanding; entitled to ten votes per share
 Paid-in capital
 Treasury stock, at cost, 7,814 shares of Class A common stock
 Retained earnings
 Notes due from stockholders
 Cumulative other comprehensive loss

TOTAL STOCKHOLDERS' EQUITY

TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES
 CONDENSED CONSOLIDATED STATEMENTS OF
 EARNINGS (Unaudited) For The Three (3) and Nine (9)
 Months Ended March 30, 2003 and March 31, 2002
 (In thousands, except per share data)

	Three Months Ended	
	03/30/03	03/31/02
REVENUE:		
Net sales	\$ 14,496	\$ 19,6

Edgar Filing: FAIRCHILD CORP - Form 10-Q

Rental revenue	2,277	1,7
	-----	-----
	16,773	21,3
COSTS AND EXPENSES:		
Cost of goods sold	11,489	15,0
Cost of rental revenue	1,470	1,1
Selling, general & administrative	10,248	8,8
Other (income) expense, net	(935)	(50)
	-----	-----
	22,272	24,6
OPERATING LOSS	(5,499)	(3,23
Interest expense	2,982	12,3
Interest income	(785)	(1,04
	-----	-----
Net interest expense	2,197	11,3
Investment income (loss)	118	
Increase (decrease) in fair market value of interest rate contract	999	1,9
	-----	-----
Loss from continuing operations before taxes	(6,579)	(12,59
Income tax benefit (provision)	(117)	5,4
Equity in loss of affiliates, net	(178)	(13
	-----	-----
Loss from continuing operations	(6,874)	(7,31
Earnings (loss) from discontinued operations, net	(763)	7,6
Gain on disposal of discontinued operations, net	80	
Cumulative effect of change in accounting for goodwill	-	
	-----	-----
NET EARNINGS (LOSS)	\$ (7,557)	\$ 3
	-----	-----
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments (a)	(215)	(5,34
Unrecognized actuarial loss on pensions	-	
Unrealized holding changes on derivatives	222	
Unrealized periodic holding changes on securities	420	(40
	-----	-----
Other comprehensive income (loss)	427	(5,73
	-----	-----
COMPREHENSIVE LOSS	\$ (7,130)	\$ (5,39
	-----	-----

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF
EARNINGS (Unaudited) For The Three (3) and Nine (9)
Months Ended March 30, 2003 and March 31, 2002
(In thousands, except per share data)

Edgar Filing: FAIRCHILD CORP - Form 10-Q

	Three Months Ended	
	03/30/03	03/31/02
BASIC AND DILUTED EARNINGS (LOSS) PER SHARE:		
Loss from continuing operations	\$ (0.27)	\$ (0.27)
Earnings (loss) from discontinued operations, net	(0.03)	0.00
Gain on disposal of discontinued operations, net	-	-
Cumulative effect of change in accounting for goodwill	-	-
NET EARNINGS (LOSS)	\$ (0.30)	\$ (0.27)
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments (a)	\$ (0.01)	\$ (0.01)
Unrecognized actuarial loss on pensions	-	-
Unrealized holding changes on derivatives	0.01	0.01
Unrealized periodic holding changes on securities	0.02	(0.01)
Other comprehensive income (loss)	0.02	(0.01)
COMPREHENSIVE LOSS	\$ (0.28)	\$ (0.28)
Weighted average shares outstanding:		
Basic	25,169	25,169
Diluted	25,169	25,169

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

Edgar Filing: FAIRCHILD CORP - Form 10-Q

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)
For The Nine (9) Months Ended March 30, 2003 and March 31, 2002
(In thousands)

3/3

Cash flows from operating activities:

Net loss
Depreciation and amortization
Amortization of deferred loan fees
Unrealized holding loss on interest rate contract
Gain on disposal of discontinued operations, net
Undistributed equity in loss of affiliates, net
Net (gain) loss on sale of property, plant, and equipment
Paid-in kind interest income
Cumulative effect of change in accounting for goodwill
Loss (gain) on sale of investments
Change in trading securities
Change in operating assets and liabilities
Non-cash charges and working capital changes of discontinued operations

Net cash provided by (used for) operating activities

Cash flows from investing activities:

Purchase of property, plant and equipment
Net proceeds received from the sale of property, plant, and equipment
Net cash used for investment securities, net
Net proceeds received from the sale of discontinued operations
Equity investment in affiliates
Changes in net assets held for sale
Changes in notes receivable
Investing activities of discontinued operations

Net cash provided by (used for) investing activities

Cash flows from financing activities:

Proceeds from issuance of debt
Debt repayments
Issuance of Class A common stock
Loan repayments from stockholders

Net cash used for financing activities

Effect of exchange rate changes on cash

Net change in cash and cash equivalents

Cash and cash equivalents, beginning of the year

Cash and cash equivalents, end of the period

The accompanying Notes to Condensed Consolidated Financial Statements are an integral part of these statements.

Edgar Filing: FAIRCHILD CORP - Form 10-Q

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Unaudited)
(In thousands, except share data)

1. FINANCIAL STATEMENTS

The condensed consolidated balance sheet as of March 30, 2003, and the condensed consolidated statements of earnings and cash flows for the periods ended March 30, 2003 and March 31, 2002 have been prepared by us, without audit. In the opinion of management, all adjustments, necessary to present fairly the financial position, results of operations and cash flows at March 30, 2003, and for all periods presented, have been made. These adjustments include reclassification adjustments to reflect the sale of the fastener business and APS as discontinued operations. The balance sheet at June 30, 2002 was condensed from the audited financial statements as of that date.

The condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial statements and the Securities and Exchange Commission's instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in complete financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in our 2002 Annual Report on Form 10-K, as amended, and restated on Form 8-K. The results of operations for the period ended March 30, 2003 are not necessarily indicative of the operating results for the full year. Certain amounts in the prior year's quarterly financial statements have been reclassified to conform to the current presentation.

2. DISCONTINUED OPERATIONS

Fastener Business

On December 3, 2002, we completed the sale of our fastener business to Alcoa Inc. for approximately \$657 million in cash and the assumption of certain liabilities. The cash received from Alcoa is subject to a post-closing adjustment based upon the net working capital of the fastener business on December 3, 2002, compared with its net working capital as of March 31, 2002. We may also receive additional cash proceeds up to \$12.5 million per year over the four-year period from 2003 to 2006, if the number of commercial aircraft delivered by Boeing and Airbus exceeds specified annual levels.

In May 2003, we tentatively agreed upon the post-closing adjustment with Alcoa, based upon the net working capital of our fastener business on December 3, 2002, compared with its net working capital at March 31, 2002. As a result, we expect to receive \$0.1 million from Alcoa.

In connection with the sale, we have deposited with an escrow agent \$25 million to secure indemnification obligations we may have to Alcoa. The escrow period is five years, but funds may be held longer if claims are asserted and unresolved. The escrow is classified as long-term investments on our balance sheet. In addition, for a period of five years after the closing, we are required to maintain our corporate existence, take no action to cause our own liquidation or dissolution, and take no action to declare or pay any dividends on our common stock.

The sale of the fastener business has reduced our dependence upon the aerospace industry. Additionally, the sale has allowed us to eliminate substantially all of our debt. We used a portion of the proceeds from the sale to repay our bank debt and to acquire by tender all of our outstanding \$225

Edgar Filing: FAIRCHILD CORP - Form 10-Q

million 10.75% senior subordinated notes due in April 2009, leaving us with only \$3.5 million of debt outstanding on March 30, 2003. We plan to use the remaining proceeds from the sale to fund acquisitions.

In the nine months ended March 30, 2003, we recorded a \$40.1 million gain on the disposal of discontinued operations, net of \$10.5 million of taxes, as a result of the sale of the fastener business.

APS

In February 2003, our Board of Directors adopted a formal plan for the sale of APS, a small operation in our aerospace manufacturing segment, which has been unprofitable. Based on our formal plan, APS is available for sale immediately, and we believe that it is probable that we can consummate a sale of APS by December 2003. Accordingly, the results of APS are being reported as a discontinued operation.

The results of the fastener business and APS are recorded as earnings from discontinued operations, the components of which are as follows:

	Three Months Ended	
	03/30/03	03/31/02
Net sales	\$ 95	\$ 133,592
Cost of goods sold	314	100,515
Gross margin	(219)	33,077
Selling, general & administrative expense	524	23,237
Other (income) expense, net	-	(733)
Operating income (loss)	(743)	10,573
Net interest expense (income)	(5)	425
Earnings (loss) from discontinued operations before taxes	(738)	10,148
Income tax benefit (provision)	(25)	(2,490)
Net earnings (loss) from discontinued operations	\$ (763)	\$ 7,658

The assets and liabilities of the fastener business sold to Alcoa and APS were reported as assets and liabilities of discontinued operations at March 30, 2003 and June 30, 2002, and were as follows:

	March 30, 2003
Current assets of discontinued operations:	
Short-term investments	\$ -

Edgar Filing: FAIRCHILD CORP - Form 10-Q

Accounts receivable	592
Inventories	225
Deferred taxes	-
Prepaid expenses and other current assets	-

	\$ 817

Noncurrent assets of discontinued operations:	
Property, plant and equipment	\$ 71
Accumulated depreciation	(71)
Goodwill	-
Notes receivable	-
Other assets	125

	\$ 125

Current liabilities of discontinued operations:	
Accounts payable	(85)
Accrued liabilities	(948)

\$ (1,033) \$ (69,059)	

Noncurrent liabilities of discontinued operations:	
Retiree health care liabilities	\$ -
Noncurrent deferred income taxes	-
Other long-term liabilities	-

	\$ -

Total net assets (liabilities) of discontinued operations	\$ (91)

3. CASH EQUIVALENTS AND INVESTMENTS

Cash equivalents and investments at March 30, 2003 consist primarily of investments in United States government securities and investment grade corporate bonds, which are recorded at market value. Restricted cash equivalent investments are classified as short-term or long-term investments depending upon the length of the restriction period. Investments in common stock of public corporations are recorded at fair market value and classified as trading securities or available-for-sale securities. Other short-term investments and long-term investments do not have readily determinable fair values and consist primarily of investments in preferred and common shares of private companies and limited partnerships. A summary of the cash equivalents and investments held by us follows:

March 30, 2003	Jun
-----	-----
Aggregate	
-----	-----

Edgar Filing: FAIRCHILD CORP - Form 10-Q

	Fair Value	Cost Basis	Fair Value
Cash and cash equivalents:			
U.S. government securities	\$ 34,699	\$ 34,699	\$
Money market and other cash funds	973	973	14,
Total cash and cash equivalents	\$ 35,672	\$ 35,672	\$ 14,
Short-term investments:			
U.S. government securities - restricted	\$ 7,605	\$ 7,605	\$
Money market funds - restricted	6	6	
Trading securities - corporate bonds	34,048	34,078	
Trading securities - equity securities	331	601	
Available-for-sale equity securities	58	200	
Other investments	55	55	
Total short-term investments	\$ 42,103	\$ 42,545	\$
Long-term investments:			
U.S. government securities - restricted	\$ 21,015	\$ 21,015	\$
Money market funds - restricted	220	220	
Corporate bonds - restricted	22,812	23,095	
Available-for-sale equity securities	7,606	10,110	1,
Other investments	4,286	4,286	4,
Total long-term investments	\$ 55,939	\$ 58,726	\$ 5,
Total cash equivalents and investments	\$ 133,714	\$ 136,943	\$ 21,

On March 30, 2003 and June 30, 2002, we had restricted investments of \$51,658 and \$472, respectively, all of which are maintained as collateral for certain debt facilities, our interest rate contract and escrow arrangements. The restricted funds are invested in money market funds, U.S. government securities, or grade AAA or higher corporate bonds.

4. PENSIONS

The sale of our fastener business on December 3, 2002 was considered a "significant event" under US generally accepted accounting principles. As such, we were required to re-measure our pension obligations at that date, in addition to measuring any gain or loss resulting from certain actions taken as a result of the sale of the fastener business.

Several plan assumptions were changed during the remeasurement of our pension plan on December 3, 2002. The discount rate was decreased from 7.125% to 6.75% reflecting the drop in bond yields since June 30, 2002. The return on plan assets was reduced from 9.0% to 8.5% to reflect lower long-term expected return on plan assets. To recognize mortality improvements, the mortality assumption was changed from the 1983 Group Annuity Mortality table to the 1994 Group Annuity Mortality table. The assumed form of payment for our remaining employees was changed from life annuity to lump sum, to reflect actual experience.

In connection with the agreement under which we sold our fastener business, we extended vesting of pension benefits to United States fastener employees who

Edgar Filing: FAIRCHILD CORP - Form 10-Q

were not already vested. Generally accepted accounting principles in the United States require us to recognize immediately the costs for the enhanced termination benefits related to this curtailment event. The pre-tax expense of this one-time curtailment accounting loss was \$8.3 million, which was included as a partial offset to the net gain on the disposal of discontinued operations.

All United States fastener employees transferring to Alcoa are being treated by us as having been terminated from our employment, and as such, were eligible to request immediate distribution of pension benefits in the form of lump sums. Almost all have done so. In accordance with generally accepted accounting principles, this caused us to record a one-time, pre-tax settlement accounting loss of \$17.5 million, which was included as a partial offset to the net gain on disposal of discontinued operations.

We have reviewed our pension plan's funded position to determine if it is necessary to reflect a pension liability and recognize a reduction in equity. On December 3, 2002, the accumulated benefit obligation of the pension plan exceeded the fair value of the plan assets by \$17.5 million. Under generally accepted accounting principles, this caused us to record an additional minimum pension liability of \$50.5 million, and required the recognition of a \$47.5 million non-cash reduction to our stockholders' equity. These amounts may change in the future as the pension plan assets change in value and assumptions change. Should, in the future, our pension plan's accumulated benefit obligations be less than the fair value of plan assets, the additional minimum pension liability and corresponding equity reduction will be reversed.

During the nine months ended March 30, 2003, we contributed \$7.4 million of cash to fund our pension plan in advance of required contributions. Based upon our actuary's current assumptions and projections, we do not expect additional cash contributions to the pension plan to be required until 2008.

5. NOTES PAYABLE AND LONG-TERM DEBT

In connection with the sale of the fastener business, we repaid our bank credit agreement in the United States, all of the outstanding \$225 million senior subordinated notes and our \$30,750 term loan agreement. The remaining \$9.9 million of deferred loan fees associated with the bank credit agreement and senior subordinated notes were expensed as interest expense during the nine months ended March 30, 2003. At March 30, 2003 and June 30, 2002, notes payable and long-term debt consisted of the following:

	3/30/03
Short-term notes payable	\$
Bank credit agreement	\$
103/4% Senior subordinated notes due 2009	
\$30,750 term loan agreement	
Capital lease obligations	10
Other notes payable, collateralized by property, plant and equipment	3,43
	3,53
Less: current maturities of long-term debt	(641
Net long-term debt	\$ 2,89
Total debt	\$ 3,53

Edgar Filing: FAIRCHILD CORP - Form 10-Q

6. EQUITY SECURITIES

We had 22,560,489 shares of Class A common stock and 2,621,502 shares of Class B common stock outstanding at March 30, 2003. Class A common stock is traded on both the New York and Pacific Stock Exchanges. There is no public market for the Class B common stock. The shares of Class A common stock are entitled to one vote per share and cannot be exchanged for shares of Class B common stock. The shares of Class B common stock are entitled to ten votes per share and can be exchanged, at any time, for shares of Class A common stock on a share-for-share basis. During the nine months ended March 30, 2003, we issued 4,586 shares of Class A common stock as a result of the exercise of stock options and issued 15,882 shares of Class A common stock as a result of the pay out of 15,882 deferred compensation units pursuant to our stock option deferral plan.

7. EARNINGS PER SHARE

The following table illustrates the computation of basic and diluted earnings per share:

	Three Months Ended	
	3/30/03	3/31/02
Basic earnings per share:		
Loss from continuing operations	\$ (6,874)	\$ (7,311)
Weighted average common shares outstanding	25,169	25,158
Basic loss from continuing operations per share	\$ (0.27)	\$ (0.29)
Diluted earnings per share:		
Loss from continuing operations	\$ (6,874)	\$ (7,311)
Weighted average common shares outstanding	25,169	25,158
Options	antidilutive	antidilutive
Warrants	N/A	antidilutive
Total shares outstanding	25,169	25,158
Diluted loss from continuing operations per share	\$ (0.27)	\$ (0.29)

Stock options entitled to purchase 1,990,521 and 1,952,543 shares of Class A common stock were antidilutive and not included in the earnings per share calculation for the three and nine months ended March 30, 2003, respectively. Stock options entitled to purchase 1,985,377 and 2,092,616 shares of Class A common stock were antidilutive and not included in the earnings per share calculation for the three and nine months ended March 31, 2002, respectively. Stock warrants entitled to purchase 400,000 shares of Class A common stock were antidilutive and not included in the earnings per share calculation for the three and nine months ended March 31, 2002. The stock warrants expired during fiscal 2002. The stock options could be dilutive in future periods.

Edgar Filing: FAIRCHILD CORP - Form 10-Q

8. STOCK OPTIONS

On December 31, 2002, the FASB issued Statement of Financial Accounting Standards No. 148, "Accounting for Stock-Based Compensation - Transition and Disclosure". Statement 148 amends FASB Statement No. 123, "Accounting for Stock-Based Compensation," to provide alternative methods of transition to Statement 123's fair value method of accounting for stock-based employee compensation. Statement 148 also amends the disclosure provisions of Statement 123 and APB Opinion No. 28, Interim Financial Reporting, to require disclosure in the summary of significant accounting policies of the effects of an entity's accounting policy with respect to stock-based employee compensation on reported net income and earnings per share in annual and interim financial statements. While the Statement does not amend Statement 123 to require companies to account for employee stock options using the fair value method, the disclosure provisions of Statement 148 are applicable to all companies with stock-based employee compensation, regardless of whether they account for that compensation using the fair value method of Statement 123 or the intrinsic value method of Opinion 25. Previous to Statement 148, the disclosure was required only in annual financial statements. We adopted this standard for our quarter ended March 30, 2003.

We are currently accounting for stock options using the intrinsic value method and are applying APB Opinion No. 25. Accordingly, no compensation cost has been recognized for the granting of stock options to our employees in the periods ended March 30, 2003 and March 31, 2002, but the effects are disclosed below. If stock options granted in the periods ended March 30, 2003 and March 31, 2002, were accounted for based on their fair value as determined under SFAS 123, the pro forma earnings would be as follows:

	Three Months Ended	
	03/30/03	03/31/02
Net earnings (loss), as reported	\$ (7,557)	\$ 3
Stock-based employee compensation cost included in the determination of net earnings (loss), as reported	-	
Stock-based employee compensation cost that would have been included in the determination of net earnings (loss), as reported, if the fair value method was applied to all awards	(137)	(22)
Pro forma net earnings (loss)	\$ (7,694)	\$ 1
Basic and diluted earnings (loss) per share:		
As reported	\$ (0.30)	\$ 0.
Pro forma	\$ (0.31)	\$ 0.

The weighted average grant date fair value of options granted during the periods ended March 30, 2003 and March 31, 2002 was \$3.07 and \$1.62 respectively. The fair value of each option granted is estimated on the grant date using the Black-Scholes option pricing model. The following significant assumptions were made in estimating fair value:

For the three and nine months ended March 2003 2002

Edgar Filing: FAIRCHILD CORP - Form 10-Q

Risk-free interest rate	3.0% - 3.3%	3.6% - 4.7%
Expected life in years	4.95	4.75
Expected volatility	72%	53% - 65%
Expected dividends	None	None

9. CONTINGENCIES

Environmental Matters

Our operations are subject to stringent government imposed environmental laws and regulations concerning, among other things, the discharge of materials into the environment and the generation, handling, storage, transportation and disposal of waste and hazardous materials. To date, such laws and regulations have not had a material effect on our financial condition, results of operations, or net cash flows, although we have expended, and can be expected to expend in the future, significant amounts for the investigation of environmental conditions and installation of environmental control facilities, remediation of environmental conditions and other similar matters.

In connection with our plans to dispose of certain real estate, we must investigate environmental conditions and we may be required to take certain corrective action prior or pursuant to any such disposition. In addition, we have identified several areas of potential contamination related to other facilities owned, or previously owned, by us, that may require us either to take corrective action or to contribute to a clean-up. We are also a defendant in certain lawsuits and proceedings seeking to require us to pay for investigation or remediation of environmental matters, and we have been alleged to be a potentially responsible party at various "superfund" sites. We believe that we have recorded adequate reserves in our financial statements to complete such investigation and take any necessary corrective actions or make any necessary contributions. No amounts have been recorded as due from third parties, including insurers, or set off against, any environmental liability, unless such parties are contractually obligated to contribute and are not disputing such liability.

As of March 30, 2003, the consolidated total of our recorded liabilities for environmental matters was approximately \$10.0 million, which represented the estimated probable exposure for these matters. On March 30, 2003, \$4.8 million of these liabilities were classified as other accrued liabilities and \$5.2 million was classified as other long-term liabilities. It is reasonably possible that our total exposure for these matters could be approximately \$13.4 million.

The sales agreement with Alcoa includes an indemnification, subject to reserves of \$8.4 million which were carried on the books of our fastener business. To date, Alcoa has contacted us concerning potential environmental claims which, while disputed, could consume approximately \$6.0 million of the indemnification reserve. These environmental claims are not covered by the environmental accrual on our books as of March 30, 2003.

Other Matters

On January 21, 2003, we and one of our subsidiaries were served with a third-party complaint in an action brought in New York by a non-employee worker and his spouse alleging personal injury as a result of exposure to asbestos-containing products. The defendant, which is one of many defendants in

Edgar Filing: FAIRCHILD CORP - Form 10-Q

the action, had purchased a pump business from us, and asserts the right to be indemnified by us under its purchase agreement. While the purchaser has notified us of, and claimed a right to indemnity from us against other asbestos-related claims against it, this is the only instance in which a suit has been instituted against us. We have not received enough information to assess the impact, if any, of the other claims.

We are involved in various other claims and lawsuits incidental to our business. We, either on our own or through our insurance carriers, are contesting these matters. In the opinion of management, the ultimate resolution of litigation against us, including that mentioned above, will not have a material adverse effect on our financial condition, future results of operations or net cash flows.

10.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets", which supersedes SFAS No. 121. Though it retains the basic requirements of SFAS 121 regarding when and how to measure an impairment loss, SFAS 144 provides additional implementation guidance. SFAS 144 applies to long-lived assets to be held and used or to be disposed of, including assets under capital leases of lessees; assets subject to operating leases of lessors; and prepaid assets. SFAS 144 also expands the scope of a discontinued operation to include a component of an entity, and eliminates the current exemption to consolidation when control over a subsidiary is likely to be temporary. This statement is effective for our fiscal year beginning on July 1, 2002. Accordingly, we have accounted for the sale of the fastener business and APS as discontinued operations.

In April 2002, the FASB issued Statement of Financial Accounting Standards No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections as of April 2002". SFAS No. 145 eliminates the requirement to report material gains or losses from debt extinguishments as an extraordinary item, net of tax, in an entity's statement of earnings. SFAS No. 145 instead requires that a gain or loss recognized from a debt extinguishment be classified as an extraordinary item only when the extinguishment meets the criteria of both "unusual in nature" and "infrequent in occurrence" as prescribed under Accounting Principles Bulletin No. 30, "Reporting the Result of Operations - Reporting the Effects of Disposal of a Segment of Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions". This statement is effective for our fiscal year beginning on July 1, 2002.

In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". This standard requires costs associated with exit or disposal activities to be recognized when they are incurred and applies prospectively to such activities initiated after December 31, 2002. Included in selling, general and administrative expense for the three and nine months ended March 30, 2003, was \$1.1 million of severance expense associated with the downsizing of our corporate staff. This plan was initiated prior to December 31, 2002.

11.

Edgar Filing: FAIRCHILD CORP - Form 10-Q

BUSINESS SEGMENT INFORMATION

We currently report in three principal business segments: aerospace distribution, aerospace manufacturing and real estate operations. The following table provides the historical results of our operations for the three and nine months ended March 30, 2003 and March 31, 2002, respectively.

	Three Months Ended		N
	3/30/03	3/31/02	3/30
Revenues			
Aerospace Distribution Segment	\$ 12,231	\$ 16,272	\$
Aerospace Manufacturing Segment	2,265	3,368	
Real Estate Operations Segment	2,277	1,745	
Total	\$ 16,773	\$ 21,385	\$
Operating Income (Loss)			
Aerospace Distribution Segment	\$ 214	\$ 1,202	\$
Aerospace Manufacturing Segment	(712)	(417)	
Real Estate Operations Segment	733	345	
Corporate and Other	(5,734)	(4,363)	(
Total	\$ (5,499)	\$ (3,233)	\$ (
Earnings (Loss) From Continuing Operations Before Taxes			
Aerospace Distribution Segment	\$ 193	\$ 1,188	\$
Aerospace Manufacturing Segment	(779)	(537)	
Real Estate Operations Segment	324	(150)	
Corporate and Other	(6,317)	(13,091)	(
Total	\$ (6,579)	\$ (12,590)	\$ (
Assets			
	3/30/03	6/30/02	
Aerospace Distribution Segment	\$ 48,530	\$ 49,358	
Aerospace Manufacturing Segment	10,623	677,164	
Real Estate Operations Segment	120,048	120,320	
Corporate and Other	225,965	145,276	
Total	\$ 405,166	\$ 992,118	

Edgar Filing: FAIRCHILD CORP - Form 10-Q

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

The Fairchild Corporation was incorporated in October 1969, under the laws of the State of Delaware. Banner Aerospace, Inc. is a 100% owned subsidiary. Fairchild Holding Corp. is our indirect 100% owned subsidiary. Fairchild Holding Corp. is the owner of Fairchild Aerostructures, Inc., and the indirect owner of 100% of Warthog Inc. Our principal operations are conducted through Banner Aerospace, Fairchild Aerostructures, and Warthog. Our financial statements present the results of our former fastener business, and APS, a small subsidiary being sold, as discontinued operations.

The following discussion and analysis provide information which management believes is relevant to the assessment and understanding of our consolidated results of operations and financial condition. The discussion should be read in conjunction with the consolidated financial statements and notes thereto.

GENERAL

Our business consists of three segments: aerospace distribution, aerospace manufacturing and real estate operations. Our aerospace distribution segment stocks and distributes a wide variety of aircraft parts to commercial airlines and air cargo carriers, fixed-base operators, corporate aircraft operators and other aerospace companies worldwide. Our aerospace manufacturing segment primarily manufactures airframe components. Our real estate operations segment owns and leases a shopping center located in Farmingdale, New York, and owns and rents two improved parcels located in Southern California.

On December 3, 2002, we completed the sale of our fastener business to Alcoa Inc. for approximately \$657 million in cash and the assumption of certain liabilities. The cash received from Alcoa is subject to a post-closing adjustment based upon the net working capital of the fastener business on December 3, 2002, compared with its net working capital as of March 31, 2002. We may also receive additional cash proceeds up to \$12.5 million per year over the four-year period from 2003 to 2006, if the number of commercial aircraft delivered by Boeing and Airbus exceeds specified annual levels.

We are continuing to investigate how best to redeploy our cash in opportunities which will enable it to build a strong industrial company for the long term.

CAUTIONARY STATEMENT

Certain statements in this financial discussion and analysis by management contain "forward-looking statements" within the meaning of the Private Securities Litigation Reform Act of 1995 with respect to our financial condition, results of operation and business. These statements relate to analyses and other information, which are based on forecasts of future results and estimates of amounts not yet determinable. These statements also relate to our future prospects, developments and business strategies. These forward-looking statements are identified by their use of terms and phrases such as "anticipate," "believe," "could," "estimate," "expect," "intend," "may," "plan," "predict," "project," "will" and similar terms and phrases, including references to assumptions. These forward-looking statements involve risks and uncertainties, including current trend information, projections for deliveries, backlog and other trend estimates, that may cause our actual future activities and results of operations to be materially different from those suggested or described in this financial discussion and analysis by management. These risks include: our ability to find, acquire and successfully operate one or more new businesses; product demand; our dependence on the aerospace industry; customer satisfaction and quality issues; labor disputes; competition; our ability to

Edgar Filing: FAIRCHILD CORP - Form 10-Q

achieve and execute internal business plans; worldwide political instability and economic growth; military conflicts; reduced airline revenues as a result of the September 11, 2001 terrorist attacks on the United States, and their aftermath; the affect on the aerospace industry due to SARS; and the impact of any economic downturns and inflation.

If one or more of these risks or uncertainties materializes, or if underlying assumptions prove incorrect, our actual results may vary materially from those expected, estimated or projected. Given these uncertainties, users of the information included in this financial discussion and analysis by management, including investors and prospective investors are cautioned not to place undue reliance on such forward-looking statements. We do not intend to update the forward-looking statements included in this Quarterly Report, even if new information, future events or other circumstances have made them incorrect or misleading.

RESULTS OF OPERATIONS

Business Transactions

On December 3, 2002, we completed the sale of our fastener business to Alcoa Inc. for approximately \$657 million in cash and the assumption of certain liabilities. The cash received from Alcoa is subject to a post-closing adjustment based upon the net working capital of the fastener business on December 3, 2002, compared with its net working capital as of March 31, 2002. We may also receive additional cash proceeds up to \$12.5 million per year over the four-year period from 2003 to 2006, if the number of commercial aircraft delivered by Boeing and Airbus exceeds specified annual levels.

In connection with the sale, we have deposited with an escrow agent \$25 million to secure indemnification obligations we may have to Alcoa. The escrow period is five years, but funds may be held longer if claims are asserted and unresolved. In addition, for a period of five years after the closing, we are required to maintain our corporate existence, take no action to cause our own liquidation or dissolution, and take no action to declare or pay any dividends on our common stock.

The sale of the fastener business has reduced our dependence upon the aerospace industry. Additionally, the sale has allowed us to eliminate substantially all of our debt. We used a portion of the proceeds from the sale to repay our bank debt and to acquire by tender all of our outstanding \$225 million 10.75% senior subordinated notes due in April 2009, leaving us with only \$3.5 million of debt outstanding on March 30, 2003. We plan to use the remaining proceeds from the sale to fund acquisitions.

Recent Developments

In February 2003, our Board of Directors adopted a formal plan for the sale of APS, a small operation in our aerospace manufacturing segment, which has been unprofitable. Based on our formal plan, APS is available for sale immediately, and we believe that it is probable that we can consummate a sale of APS by December 2003. Accordingly, the results of APS are being reported as a discontinued operation.

The results of the fastener business and APS are recorded as earnings from discontinued operations, the components of which are as follows:

(In thousands)

Three Months Ended

03/30/03 03/31/02

Edgar Filing: FAIRCHILD CORP - Form 10-Q

Earnings (loss) from discontinued operations before taxes	(738)	10,148
Income tax benefit (provision)	(25)	(2,490)
Net earnings from discontinued operations	\$ (763)	\$ 7,658

Consolidated Results

On December 3, 2002, we completed the sale of our fasteners business to Alcoa for \$657 million. As a result of this transaction, we recognized a \$40.1 million net gain on the disposal of discontinued operations in the nine months ended March 30, 2003. The results of the fasteners business, during the time we owned it, have been reclassified to earnings (loss) from discontinued operations. Selling, general and administrative expense for the nine months ended March 30, 2003, includes \$13.7 million of one-time change of control payments required under contracts with our top four executives as a result of the sale of the fastener business, and \$10.4 million of bonuses awarded to our top four executives as a result of the sale of the fasteners business. The top four executives have relinquished their right to any other future change of control payments. The proceeds received from the sale have significantly reduced our debt. Accordingly, we are currently seeking acquisition opportunities. Because of these events, the discussion below can not be relied upon as a trend of our future results.

We currently report in three principal business segments: aerospace distribution, aerospace manufacturing, and real estate operations. The following table provides the historical sales and operating income of our segments for the three and nine months ended March 30, 2003 and March 31, 2002, respectively.

(In thousands)	Three Months Ended		N
	3/30/03	3/31/02	
Revenues			
Aerospace Distribution Segment	\$ 12,231	\$ 16,272	\$
Aerospace Manufacturing Segment	2,265	3,368	
Real Estate Operations Segment	2,277	1,745	
Total	\$ 16,773	\$ 21,385	\$
Operating Income (Loss)			
Aerospace Distribution Segment	\$ 214	\$ 1,202	\$
Aerospace Manufacturing Segment	(712)	(417)	
Real Estate Operations Segment	733	345	
Corporate and Other	(5,734)	(4,363)	(
Total	\$ (5,499)	\$ (3,233)	\$ (

Edgar Filing: FAIRCHILD CORP - Form 10-Q

Revenues of \$16.8 million in the third quarter of fiscal 2003 decreased by \$4.6 million, or 21.6%, compared to revenues of \$21.4 million in the third quarter of fiscal 2002. Revenues of \$56.8 million in the first nine months of fiscal 2003 decreased by \$7.2 million, or 11.3%, compared to revenues of \$64.0 million in the first nine months of fiscal 2002. Revenues in the first nine months of fiscal 2003 were adversely affected by the overall conditions in the aerospace industry. The aerospace industry is still sluggish following the events of September 11, 2001 and weakness in the overall economy. The recent, well publicized, financial difficulties of major commercial airlines and reduction in travel have affected the demand for products we sell at our remaining aerospace businesses.

Gross margin as a percentage of sales remained stable in our aerospace distribution segment and was 26.0% and 25.9% in the first nine months of fiscal 2003 and fiscal 2002, respectively, and 27.9% and 28.2% in the third quarter of fiscal 2003 and fiscal 2002, respectively. Cost of goods sold, including inventory adjustments, have exceeded revenues at our remaining aerospace manufacturing location, reflecting highly competitive pricing pressures.

Gross margin as a percentage of rental revenue at our real estate segment increased to 35.4 % and 35.7% in the third quarter and first nine months of fiscal 2003, respectively, as compared to 32.8% and 31.1% in the third quarter and first nine months of fiscal 2002, respectively. The improved margins reflected an increase in rental revenue of 30.5% and 16.4% in the third quarter and first nine months of fiscal 2003, respectively, as compared to the prior periods.

Selling, general and administrative expense for the nine months ended March 30, 2003, includes \$13.7 million of one-time change of control payments required under contracts with our top four executives as a result of the sale of the fastener business, and \$10.4 million of bonuses awarded to our top four executives as a result of the sale of the fasteners business. The top four executives have relinquished their right to any other future change of control payments. In addition, selling, general and administrative expense for the three and nine months ended March 30, 2003, includes \$1.1 million of severance expense. Excluding these items, selling, general & administrative expense as a percentage of revenues was 50.3% for the first nine months of fiscal 2003 as compared to 47.7% for the first nine months of 2002.

Other income decreased \$3.9 million in the first nine months of fiscal 2003, as compared to the first nine months of fiscal 2002. This change primarily reflects income recognized in the first nine months of fiscal 2002 from the disposition of future royalty revenues to an unaffiliated third party in exchange for \$4.7 million of promissory notes, offset partially by \$0.8 million of income recognized in the first nine months of fiscal 2003 from the sale of non-core property.

Operating loss for the nine months ended March 30, 2003, includes the \$13.7 million of one-time change of control payments required under contracts with our top four executives as a result of the sale of the fastener business, and \$10.4 million of bonuses awarded to our top four executives as a result of the sale of the fasteners business. The top four executives have relinquished their right to any other future change of control payments. In addition, the operating loss for the three and nine months ended March 30, 2003, includes \$1.1 million of severance expense. With the sale of the fasteners business, we have become a much smaller company and are currently seeking acquisition opportunities. Costs at all locations are being strictly monitored, and reduced wherever possible. In January 2003, we announced a staff reduction of 24% at our corporate headquarters.

Net interest expense was \$25.0 million and \$33.6 million for the nine

Edgar Filing: FAIRCHILD CORP - Form 10-Q

months ended March 30, 2003 and March 31, 2002, respectively. The results for the first nine months of fiscal 2003 included an expense of \$9.9 million to write-off deferred loan fees due to the repayment of all our outstanding senior subordinated notes and our term loan and revolving credit facilities, offset partially by \$6.9 million of interest income recognized from the acceleration of principal on the repayment of notes due to us from an unaffiliated third party. As a result of the sale of the fastener business, our debt has been reduced by \$488.3 million since June 30, 2002, to \$3.5 million at March 30, 2003. As a result of our debt reduction, cash interest expense is expected to be significantly lower in the future.

We recognized investment income of \$0.6 million in the nine months ended March 30, 2003 due to realized gains on investments sold. The results of the nine months ended March 31, 2002, respectively, reflect \$0.3 million of losses realized on investments sold.

We recognized an expense of \$5.7 million and \$1.0 million in the first nine months of 2003 and 2002, respectively, from the fair market value adjustment of a ten-year \$100 million interest rate contract. The fair market value adjustment of this agreement will generally fluctuate, based on the implied forward interest rate curve for 3-month LIBOR. If the implied forward interest rate curve decreases, the fair market value of the interest rate contract will increase and we will record an additional charge. If the implied forward interest rate curve increases, the fair market value of the interest rate contract will decrease, and we will record income. Declining interest rates have caused the change in fair market value of the contract.

An income tax benefit of \$1.3 million in the first nine months of fiscal 2003 on continuing operations, was lower than the statutory rate, due primarily to the loss from continuing operations recognized during these periods not being available to be utilized immediately. An income tax benefit of \$16.0 million in the first nine months of fiscal 2002 represented a 34.4% effective tax rate on the pre-tax losses from continuing operations.

Earnings (loss) from discontinued operations includes the results of the fasteners business prior to its sale, and APS. The current period reductions in earnings reflect us owning the fastener business for only five months in 2003 as compared to the full nine months in 2002.

In the nine months ended March 30, 2003, we recorded a \$40.1 million gain on the disposal of discontinued operations, net of \$10.5 million of taxes, as a result of the sale of the fastener business.

In the first nine months of fiscal 2002, we recorded a goodwill impairment charge of \$144.6 million from the implementation of SFAS No. 142, presented as a cumulative effect of change in accounting, as of the beginning of our fiscal year. Of this amount, \$19.3 million relates to our Fairchild Aerostructures operating unit in our aerospace manufacturing segment and \$125.3 million relates to our fastener business sold to Alcoa on December 3, 2002. No tax effect was recognized on the change in accounting for goodwill. Instead of amortizing goodwill and intangible assets deemed to have an indefinite life, goodwill will be tested for impairment annually, or immediately if conditions indicate that such an impairment could exist. All of our goodwill has been deemed to have an indefinite life; and as a result of adopting SFAS No. 142, we ceased amortizing goodwill.

Other comprehensive income includes foreign currency translation adjustments, unrecognized actuarial loss on pensions, and unrealized periodic holding changes in the fair market value of available-for-sale investment securities. For the nine months ended March 30, 2003, other comprehensive income included a decrease of \$47.5 million due to the recognition of an additional minimum pension liability, offset partially by an increase of \$17.3 million

Edgar Filing: FAIRCHILD CORP - Form 10-Q

foreign currency translation adjustments which were realized as part of the sale of our fasteners business. For the nine months ended March 31, 2002, the foreign currency translation adjustment resulted in a \$4.0 million increase to other comprehensive income, and was offset partially by a \$0.8 million decrease in the fair market value of unrealized holding gains on investment securities.

Segment Results

Aerospace Distribution Segment

Our aerospace distribution business is an international supplier to the airlines, corporate aviation, and the military. The business operates from five locations in the United States and specializes in the distribution of avionics, airframe accessories, and other components. Products include: navigation and radar systems, instruments, and communication systems, flat panel technologies and rotables. The company also overhauls and repairs, landing gear, pressurization components, instruments, and avionics. Customers include commuter and regional airlines, corporate aircraft and fixed-base operators, air cargo carriers, general aviation suppliers and the military. Sales in our aerospace distribution segment decreased by \$4.0 million, or 24.8%, and \$4.9 million, or 10.2%, in the third quarter and first nine months of fiscal 2003, respectively, as compared to the same periods of fiscal 2002. Sales in the nine months ended March 30, 2003 and March 31, 2002, were adversely affected by the overall conditions in the aerospace industry, resulting primarily from the events of September 11, 2001, and the general weakness in the overall economy.

Operating income decreased by \$1.0 million in the third quarter and \$0.7 million in the first nine months of fiscal 2003, as compared to the same periods in fiscal 2002. The results for the three and nine months ended March 30, 2003, reflect the decrease in sales.

Aerospace Manufacturing Segment

Sales in our aerospace manufacturing segment decreased by \$1.1 million in the third quarter, and by \$3.2 million in the first nine months of fiscal 2003, as compared to the same periods of fiscal 2002. The change reflected a reduction in shipments in the current period due to an overall lower level of demand in the aerospace industry resulting from the September 11, 2001 terrorist attacks and the recent financial difficulties of major commercial airlines.

Operating loss increased by \$0.3 million in the third quarter and remained flat in the first nine months of fiscal 2003, as compared to the same periods of fiscal 2002. The change for the third quarter reflects primarily the decrease in sales as a result of the downturn in the aerospace industry and \$0.3 million of inventory adjustments recognized in the third quarter.

On December 3, 2002, we sold our fastener business for approximately \$657 million in cash to Alcoa Inc. Additionally, in February 2003, we adopted a formal plan to sell APS. We expect to sell APS by December 2003. Accordingly, the results of our fastener business and APS have been restated to report them as discontinued operations.

Real Estate Operations Segment

Our real estate operations segment owns and operates a 451,000 square foot shopping center located in Farmingdale, New York. We have two tenants that each occupy more than 10% of the rentable space of the shopping center. Rental revenue increased slightly in the three months ended March 30, 2003, due to a slight increase in the amount of space leased to tenants, as compared to the three months ended March 31, 2002. The weighted average occupancy rate of the shopping center was 89.5% and 76.9% in the first nine months of 2003 and 2002, respectively. The average effective annual rental rate per square foot was

Edgar Filing: FAIRCHILD CORP - Form 10-Q

\$19.05 and \$19.48 during the first nine months of 2003 and 2002, respectively. As of March 30, 2003, approximately 91% of the shopping center was leased. During the third quarter of fiscal 2002, our real estate segment purchased, for \$5.3 million, a 208,000 square foot manufacturing facility located in Fullerton, California. The Fullerton property is leased to Alcoa through October 2007, and is expected to generate revenues and operating income in excess of \$0.5 million per year. Our real estate segment also owns and leases a 102,000 square foot building in Chatsworth, California. The Chatsworth property is leased through July 2008, and is expected to generate revenues and operating income approximating \$0.5 million per year.

Rental revenue increased by 30.5% in the third quarter and 16.4% in the first nine months of fiscal 2003, as compared to the same periods of fiscal 2002. The increase reflects the lease of the Fullerton property and tenants occupying an additional 66,000 square feet of the shopping center during the current periods.

Operating income increased by \$0.4 million in the third quarter and \$1.0 million in the first nine months of fiscal 2003, as compared to the same periods of fiscal 2002. The improvement in the first nine months of fiscal 2003 reflects an increase in the weighted-average portion of the shopping center occupied during fiscal 2003, and the write-off of \$0.4 million of tenant improvements in the first nine months of fiscal 2002.

Corporate

The operating results at corporate for the first nine months of fiscal 2003 includes \$13.7 million of one-time change of control payments required under contracts with our top four executives as a result of the sale of the fastener business, and \$10.4 million of bonuses awarded to our top four executives as a result of the sale of the fasteners business. The top four executives have relinquished their right to any other future change of control payments. Other income at corporate decreased by \$4.3 million due primarily to income recognized in the first nine months of fiscal 2002 from the disposition of future royalty revenues to an unaffiliated third party in exchange for promissory notes. In January 2003, we reduced our corporate staff by approximately 24%. Severance expense associated with the reduction was \$1.1 million in our third quarter ended March 30, 2003.

FINANCIAL CONDITION, LIQUIDITY AND CAPITAL RESOURCES

Our combined cash and investment balances increased by \$112.6 million to \$133.7 million on March 30, 2003, as compared to \$21.1 million on June 30, 2002. Our debt was reduced by \$488.3 million, to \$3.5 million on March 30, 2003, as compared to \$491.8 million on June 30, 2002. Total capitalization was \$183.5 million and \$722.0 million as of March 30, 2003 and June 30, 2002, respectively. The change in capitalization included the \$488.3 million decrease in debt reflecting the repayment with the proceeds received from the sale of the fasteners business, and a decrease in equity of \$50.3 million. The change in equity was due primarily to our reported net loss and changes in other comprehensive income, which included a decrease of \$47.5 million, due to the recognition of the additional minimum pension liability, offset partially by a \$17.3 million increase in foreign currency translation adjustments which were realized as part of the sale of our fasteners business.

Net cash used for operating activities for the nine months ended March 30, 2003, was \$104.3 million. The working capital uses of cash in the first nine months of fiscal 2003 included \$41.2 million of cash used for investments in trading securities, \$7.4 million contributed to fund our pension plan, \$13.7 million of one-time change of control payments required under contracts with our top four executives as a result of the sale of the fastener business, and \$10.4 million of bonuses awarded to our top four executives as a result of the sale of

Edgar Filing: FAIRCHILD CORP - Form 10-Q

the fasteners business. Net cash provided by operating activities was \$11.8 million for the nine months ended March 31, 2002. The primary source of cash from operating activities in the first nine months of fiscal 2002 included \$10.0 million of non-cash charges and net working capital changes of discontinued operations. Other sources of cash from operating activities included \$3.7 million of earnings after deducting non-cash items, including \$144.6 million for the cumulative effect of change in accounting for goodwill, offset partially by \$1.9 million of working capital changes from our continuing operations.

Net cash provided by investing activities for the nine months ended March 30, 2003, was \$613.1 million. In the first nine months of fiscal 2003, the primary source of cash was \$657.1 million of proceeds from the sale of our fastener business and \$14.3 million of net cash proceeds from the collection of notes receivable. Net cash provided by investing activities was offset partially by \$49.2 million of new investments and \$7.8 million of capital expenditures, including the purchase of a manufacturing facility located in Fullerton, California. Net cash used for investing activities was \$7.7 million for the nine months ended March 31, 2002. In the first nine months of fiscal 2002, the primary source of cash was \$4.0 million provided from the dispositions of non-core real estate and net assets held for sale, offset by a \$5.0 million increase in notes receivable and \$6.1 million of capital expenditures, including \$4.8 million at discontinued operations.

Net cash used by financing activities was \$488.0 million for the nine months ended March 30, 2003, which reflected the repayment of essentially all of our debt, except for \$3.5 million of debt at Fairchild Aerostructures. Net cash used for financing activities was \$5.4 million for the nine months ended March 31, 2002, and included the net proceeds we received from the issuance of additional debt used to fund operations.

Our principal cash requirements include acquisitions, capital expenditures, and the payment of other liabilities including postretirement benefits, environmental investigation and remediation obligations, and litigation settlements and related costs. We expect that cash on hand, cash generated from operations, cash available from borrowings, and proceeds received from dispositions of assets will be adequate to satisfy our cash requirements during the next twelve months.

We have entered into discussions with a lender to receive a 10-year, non-recourse, fixed rate, term-loan financing on our shopping center at interest rates currently approximating 5.8%. We estimate that we will receive approximately \$50.0 million of cash, which we plan to use to fund acquisition opportunities.

Prior to the sale of our fastener business, the Pension Benefit Guaranty Corporation had contacted us to understand the impact of the sale of our aerospace fasteners business on our ability to fund our long-term pension obligations. The PBGC has expressed concern that our retirement plan will be underfunded by \$86 million after the sale of our aerospace fasteners business. We have provided the PBGC with information, which represented the underfunding to be \$42 million, using the PBGC plan termination assumptions. During the nine months ended March 30, 2003, we contributed \$7.4 million of cash to fund our pension plan. Based upon our actuary's assumptions and projections, we do not expect additional cash contributions to the pension plan to be required until 2008.

RECENTLY ISSUED ACCOUNTING PRONOUNCEMENTS

Edgar Filing: FAIRCHILD CORP - Form 10-Q

In October 2001, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 144, "Accounting for the Impairment or Disposal of Long-lived Assets", which supersedes SFAS No. 121. Though it retains the basic requirements of SFAS 121 regarding when and how to measure an impairment loss, SFAS 144 provides additional implementation guidance. SFAS 144 applies to long-lived assets to be held and used or to be disposed of, including assets under capital leases of lessees; assets subject to operating leases of lessors; and prepaid assets. SFAS 144 also expands the scope of a discontinued operation to include a component of an entity, and eliminates the current exemption to consolidation when control over a subsidiary is likely to be temporary. This statement is effective for our fiscal year beginning on July 1, 2002. Accordingly, we have accounted for the sale of the fastener business and APS as discontinued operations.

In April 2002, the FASB issued Statement of Financial Accounting Standards No. 145, "Rescission of FASB Statements No. 4, 44, and 64, Amendment of FASB Statement No. 13, and Technical Corrections as of April 2002". SFAS No. 145 eliminates the requirement to report material gains or losses from debt extinguishments as an extraordinary item, net of tax, in an entity's statement of earnings. SFAS No. 145 instead requires that a gain or loss recognized from a debt extinguishment be classified as an extraordinary item only when the extinguishment meets the criteria of both "unusual in nature" and "infrequent in occurrence" as prescribed under Accounting Principles Bulletin No. 30, "Reporting the Result of Operations - Reporting the Effects of Disposal of a Segment of Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions". This statement is effective for our fiscal year beginning on July 1, 2002.

In July 2002, the FASB issued Statement of Financial Accounting Standards No. 146, "Accounting for Costs Associated with Exit or Disposal Activities". This standard requires costs associated with exit or disposal activities to be recognized when they are incurred and applies prospectively to such activities initiated after December 31, 2002.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURE ABOUT MARKET RISK

In fiscal 1998, we entered into a ten-year interest rate swap agreement to reduce our cash flow exposure to increases in interest rates on variable rate debt. The ten-year interest rate swap agreement provides us with interest rate protection on \$100 million of variable rate debt, with interest being calculated based on a fixed LIBOR rate of 6.24% to February 17, 2003. On February 17, 2003, the bank, with which we entered into the interest rate swap agreement, did not exercise a one-time option to cancel the agreement, and accordingly the transaction will proceed, based on a fixed LIBOR rate of 6.745% from February 17, 2003 to February 19, 2008.

We did not elect to pursue hedge accounting for the interest rate swap agreement, which was executed to provide an economic hedge against cash flow variability on the floating rate note. When evaluating the impact of SFAS No. 133 on this hedge relationship, we assessed the key characteristics of the interest rate swap agreement and the note. Based on this assessment, we determined that the hedging relationship would not be highly effective. The ineffectiveness is caused by the existence of the embedded written call option in the interest rate swap agreement, and the absence of a mirror option in the hedged item. As such, pursuant to SFAS No. 133, we designated the interest rate swap agreement in the no hedging designation category. Accordingly, we have

Edgar Filing: FAIRCHILD CORP - Form 10-Q

recognized a non-cash decrease in the fair market value of interest rate derivatives, of \$5.7 million and \$1.0 million, in the nine months ended March 30, 2003 and March 31, 2002, respectively, as a result of the fair market value adjustment for our interest rate swap agreement.

The fair market value adjustment of these agreements will generally fluctuate based on the implied forward interest rate curve for 3-month LIBOR. If the implied forward interest rate curve decreases, the fair market value of the interest hedge contract will increase and we will record an additional charge. If the implied forward interest rate curve increases, the fair market value of the interest hedge contract will decrease, and we will record income.

The table below provides information about our derivative financial instruments and other financial instruments that are sensitive to changes in interest rates, which include interest rate swaps. For interest rate swaps, the table presents notional amounts and weighted average interest rates by expected (contractual) maturity dates. Notional amounts are used to calculate the contractual payments to be exchanged under the contract. Weighted average variable rates are based on implied forward rates in the yield curve at the reporting date.

(In thousands)	February 19, 2008
Expected maturity date	-----
Type of interest rate contract	Variable to Fixed
Variable to fixed contract amount	\$100,000
Fixed LIBOR rate	6.745%
LIBOR cap rate	N/A
Average floor rate	N/A
Weighted average forward LIBOR rate	3.11%
Fair market value at March 30, 2003	\$(16,737)

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The term "disclosure controls and procedures" is defined in Rules 13a-14(c) and 15d-14(c) of the Securities Exchange Act of 1934. These rules refer to the controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Exchange Act is recorded, processed, summarized and reported within required time periods. Our Chief Executive Officer and our Chief Financial Officer have evaluated the effectiveness of our disclosure controls and procedures as of a date within 90 days before the filing of this quarterly report, which we refer to as the Evaluation Date. They have concluded that, as of the Evaluation Date, such controls and procedures were effective at ensuring that the required information was disclosed on a timely basis in our reports filed under the Exchange Act.

Changes in Internal Controls

We maintain a system of internal accounting controls that are designed to provide reasonable assurance that our books and records accurately reflect our

Edgar Filing: FAIRCHILD CORP - Form 10-Q

transactions and that our established policies and procedures are followed. For the quarter ended March 30, 2003, there were no significant changes to our internal controls or in other factors that could significantly affect our internal controls.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information required to be disclosed under this Item is set forth in Footnote 9 (Contingencies) of the Consolidated Financial Statements (Unaudited) included in this Report.

Item 2. Changes in Securities and Use of Proceeds.

Pursuant to the sale of our fastener business to Alcoa, we have agreed that the Company may not declare dividends on its common stock for a period of five years (ending December 3, 2007).

Item 5. Other Information

The Company has been informed by counsel to Mr. Jeffrey Steiner that on March 17, 2003, a trial commenced in France with respect to charges by French authorities against thirty-seven defendants, including Mr. Steiner, in the Elf Bidermann case. Mr. Steiner's counsel has informed the Company that the charges against Mr. Steiner are that in 1989 and 1990 he allegedly facilitated and benefited from the misuse of funds at Elf Aquitaine, a French petroleum company, allegedly committed by a former official of Elf Aquitaine, and/or Maurice Bidermann, against whom the Company had prevailed in litigation. Mr. Steiner has informed the Company that these charges are without merit, and that he will vigorously defend himself against them. The Company had previously disclosed that an investigation was pending, that the Company had provided a surety for Mr. Steiner and, since June 1996, has paid his legal expenses totaling approximately \$5 million in connection with these charges, and will continue to do so, in accordance with Delaware law. Mr. Steiner has undertaken to repay us the surety and expenses paid by us on his behalf if it is ultimately determined that Mr. Steiner was not entitled to indemnification under Delaware law. Delaware law provides that Mr. Steiner would be entitled to indemnification if it is determined that he acted in good faith and in a manner he reasonably believed to be in or not opposed to the best interests of the Company, and had no reasonable cause to believe his conduct was unlawful.

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits:

*12.1 Certifications required by Section 302 of the Sarbanes-Oxley Act.

*12.2 Certifications required by Section 906 of the Sarbanes-Oxley Act.

* Filed herewith.

(b) Reports on Form 8-K:

Edgar Filing: FAIRCHILD CORP - Form 10-Q

We filed a report on Form 8-K on January 10, 2003, reporting the same information that is reported in this Report under Part II, Item 5.

SIGNATURES

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

For THE FAIRCHILD CORPORATION
(Registrant) and as its Chief
Financial Officer:

By: /s/ JOHN L. FLYNN
John L. Flynn
Chief Financial Officer, Treasurer
and Senior Vice President, Tax

Date: May 9, 2003