

KEITHLEY INSTRUMENTS INC
Form 10-K
December 13, 2004
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-K

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For fiscal year ended, SEPTEMBER 30, 2004

Commission file number 1-9965

KEITHLEY INSTRUMENTS, INC.

(Exact name of registrant as specified in its charter)

Ohio
(State or other jurisdiction of incorporation or organization)

34-0794417
(I.R.S. Employer Identification No.)

28775 Aurora Road, Solon, Ohio
(Address of principal executive offices)

44139
(Zip Code)

Registrant's telephone number, including area code (440) 248-0400

Securities registered pursuant to Section 12(b) of the Act:

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Common Shares, Without Par Value
(Title of each class)

New York Stock Exchange
(Name of exchange on which registered)

Securities registered pursuant to Section 12(g) of the Act: None

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

Yes No

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of the registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K.

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

Yes No

The aggregate market value of the Common Shares of the Registrant held by non-affiliates was \$280.6 million and the aggregate market value of the Class B Common Shares of the Registrant held by non-affiliates was \$.4 million for a total aggregate market value of all classes of Common Shares held by non-affiliates of \$281.0 million at March 31, 2004, the registrant's most recently completed second fiscal quarter. While the Class B Common Shares are not listed for public trading on any exchange or market system, shares of that class are convertible into Common Shares at any time on a share-for-share basis. The market values indicated were calculated based upon the last sale price of the Common Shares as reported by the New York Stock Exchange on March 31, 2004, which was \$20.71.

As of December 1, 2004 there were outstanding 14,072,607 Common Shares, without par value, and 2,150,502 Class B Common Shares, without par value.

DOCUMENTS INCORPORATED BY REFERENCE

Portions of the registrant's Proxy Statement for the registrant's Annual Meeting of Shareholders to be held on February 12, 2005 (the 2005 Annual Meeting) are incorporated by reference in Part III in this Annual Report on Form 10-K (this Annual Report) and are identified under the appropriate items in this Annual Report.

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Keithley Instruments, Inc.

10-K Annual Report

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PART I.

ITEM 1 - BUSINESS.

General

Keithley Instruments, Inc. is a corporation that was founded in 1946 and organized under the laws of the State of Ohio on October 1, 1955. Its principal executive offices are located at 28775 Aurora Road, Solon, Ohio 44139; telephone (440) 248-0400. References herein to the Company, Keithley, we or our are to Keithley Instruments, Inc. and its subsidiaries unless the context indicates otherwise.

Our website is www.keithley.com. We make our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K and amendments to those reports filed with or furnished to the U.S. Securities and Exchange Commission available to the public free of charge through our website as soon as reasonably practicable after making such filings.

Keithley's business is to design, develop, manufacture and market complex electronic instruments and systems geared to the specialized needs of electronics manufacturers for high-performance production testing, process monitoring, product development and research. Our primary products are integrated systems used to source, measure, connect, control or communicate electrical direct current (DC), radio frequency (RF) or optical signals. Our customers are engineers, technicians and scientists in manufacturing, product development and research functions. During fiscal 2004, approximately 30 percent of our orders were received from the semiconductor industry. Approximately 15 percent came from research and education customers. Approximately 20 percent came from the wireless customer group. Approximately 25 percent came from the electronic components and subassemblies manufacturers customer group, which includes customers in automotive, computer and peripherals, medical equipment, aerospace and defense, and manufacturers of components other than optoelectronic components. Less than 5 percent came from the optoelectronics customer group, with the remainder coming from customers in a variety of other industries. Although our products vary in capability, sophistication, use, size and price, they generally test, measure and analyze electrical, RF, optical or physical properties. As such, we consider our business to be in a single industry segment.

Business Strategy

Our strategy for sales growth is straightforward. We have focused our efforts on identifying test applications in segments of the electronics industry that have high rates of technology change, long-term growth in demand, a meaningful market size, and leverage to our measurement capabilities and/or other test applications. Additionally, new products are an important factor in our sales growth strategy.

We work closely with our customers to build partnerships in order to anticipate their current and future measurement needs. A thorough understanding of their applications coupled with our precision measurement technology enables us to add value to our customers' processes improving the quality, throughput and yield of their products, as well as to determine which test applications we will choose to serve. We also can increase sales by adding new customers to our existing customer base utilizing our applications expertise. In addition to production test customers, we also recognize the importance of traditional research customers. Whether these customers are doing basic or applied research in a university or an industrial laboratory, they give us a first-hand look at new industry trends and technologies, and they permit us to establish

long-lasting relationships.

We leverage our applications expertise and product platforms to other industries. Keithley technology is deployed in hundreds of applications where the most accurate and precise measurements are required, known as high-reliability measurements, in such fields as high-performance production test, military/aerospace, medical electronics and automotive electronics. By concentrating on interrelated industries and product technologies, we are able to gain insight into measurement problems experienced by one set of customers that can be solved for others. Our applications knowledge and technology solutions in one area build credibility as we expand to related fields, often using the same measurement platforms that are proven among a variety of customers.

We regularly invest 10 to 13 percent of net sales on developing new products. We believe this gives us a competitive advantage by delivering a solution that meets customer needs without adding features and costs that are not required or desired by the customer.

Product Offerings

We have approximately 500 products used to source, measure, connect, control or communicate DC, RF or optical signals. Product offerings include integrated systems solutions and instruments and PC plug-in boards that can be used as system components or stand-alone solutions. Prices per product vary. Parametric test systems used by semiconductor wafer manufacturers generally range in price from \$150,000 to \$500,000 depending upon the configuration specified by the customer. Our semiconductor characterization system ranges in price from \$30,000 to \$75,000 depending upon the configuration and options. Bench top instruments generally range in price from \$1,000 to \$10,000 on a stand-alone basis and from \$15,000 to \$25,000 when used as a system. Switch systems generally range in price from \$2,000 to \$50,000. PC plug-in boards are used for process control and data collection applications, and in production test for machine builders and system integrators. Selling prices generally range from \$200 to \$4,000.

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New Products During Fiscal Year 2004

We develop new products for specific industry applications and for general purposes to serve a larger customer constituency. New products introduced during fiscal 2004 included the following:

We introduced three new products to expand our product offering for research and education customers with the Model 2182A Nanovoltmeter, Model 6220 DC Current Source and Model 6221 AC and DC Current Source. The Model 2182A Nanovoltmeter is optimized for making low noise measurements in metrology, nanotechnology, superconductivity, and other low voltage/resistance research applications. The Models 6220/6221 Current Sources combine ease of use with exceptionally low current noise. The 2182A brings a powerful new set of capabilities to researchers when used in conjunction with our model 6220 or 6221, which allows users to make resistance, pulsed I-V and differential conductance measurements. The combination also is useful in many nanotechnology applications because of its ability to measure resistance while dissipating very little power in the device under test.

We introduced two new products specifically designed to serve the semiconductor industry. The Model S470 Parametric Test System is optimized for production testing of 200mm wafers at the 130nm CMOS node and below. Based on our production-proven Model S400 Series testers, the Model S470 provides a low cost-per-pin solution for our customers in both technology development and process monitoring. It is available with options such as RF testing at up to 40GHz, adaptive test software that automates first-level process diagnostics, and SECS/GEM for 200mm factory automation. The S680DC/RF Parametric Test System is the latest addition to our S600 Series family. The S680 is designed to help chipmakers of all sizes control their testing costs by increasing throughput and increasing equipment reuse. In addition, we upgraded our popular Model 4200 Semiconductor Characterization System with our Keithley Test Environment-Interactive (KTEI) software v5.0. Model 4200-SCS users will now have a standard test system for running stress-measure and reliability tests for device lifetime analysis and quality assurance in addition to semiconductor characterization tests.

We expanded the capabilities of our Model 2800 for the wireless industry. The GSM option for the 2800 RF Power Analyzer enables the 2800 to make GSM transmitter modulation quality measurements in addition to the complete suite of spectral power measurements already provided. This enables the 2800 to test more mobile phone handset types on a single production line.

The Model 2790A SourceMeter® Airbag Inflator DC Electrical Test System is designed to meet the testing requirements for airbag inflators and modules in one compact, cost-effective package for the automotive industry.

We also introduced two new cards for our Model 4500 Multi-Channel I-V Test System to appeal to a broader range of customers for automated testing in multi-head (multi-device under test) production test environments.

We continued to invest in solutions for emerging measurement needs such as nanotechnology with the introduction of our Nanotech Toolkit. The Nanotech Toolkit is a dedicated characterization system for use with our Model 4200-SCS and was specifically designed for a variety of tests that assist researchers in making the very precise and complex electrical measurements associated with nanotechnology.

Geographic Markets and Distribution

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During fiscal 2004, all of the Company's products were manufactured in Ohio and were sold throughout the world in over 70 countries. The Company's principal markets are the United States, Europe and the Pacific Basin.

In the United States, our products are sold by our own sales personnel and through direct marketing and catalog mailings. Outside the U.S., we market our products directly in countries in which we have sales offices and through distributors or manufacturers' representatives in other countries. Keithley has subsidiary sales and service offices located in Great Britain, Germany, France, the Netherlands, Switzerland, Italy and Japan. We also have sales offices in Belgium, Finland, Sweden, China, Korea, Taiwan, India and Singapore. Sales in markets outside the above named locations are made through independent sales representatives and distributors.

Sources and Availability of Raw Materials

Our products require a wide variety of electronic and mechanical components, most of which are purchased. We have multiple sources for the vast majority of the components and materials we use; however, there are some instances where the components are obtained from a sole-source supplier. If a sole-source supplier ceased to deliver, we could experience a temporary adverse impact on operations; however, we believe alternative sources could be developed quickly. Although shortages of purchased materials and components have been experienced from time to time, these items have generally been available as needed.

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Patents

Electronic instruments of the nature we design, develop and manufacture generally cannot be patented in their entirety. Although we hold patents with respect to certain of our products, we do not believe our business is dependent to any material extent upon any single patent or group of patents, because of the rapid rate of technological change in the industry.

Seasonal Trends and Working Capital Requirements

Our business is not subject to significant seasonal trends. However, many of the industries we serve, including but not limited to the semiconductor industry, the wireless communications industry, the optoelectronics industry and other sectors of the global electronics industry, have historically been cyclical. We do not have any unusual working capital requirements.

Customers

Our customers generally are involved in production test, engineering research and development, electronic service or repair, and educational and governmental research. During the fiscal year ended September 30, 2004, no one customer accounted for more than 10% of our sales. We do not believe that the loss of any one customer would materially affect our sales or net income.

Backlog

Our backlog of unfilled orders amounted to approximately \$15,973,000 as of September 30, 2004 and approximately \$14,506,000 as of September 30, 2003. We expect that substantially all of the orders included in the 2004 backlog will be delivered during fiscal 2005. While past experience indicates that a portion of orders included in backlog may be canceled, we do not believe that cancellations will materially affect our future sales or net income.

Competition

The Company competes on the basis of quality, performance, service and price, with quality and performance frequently being dominant. There are many firms in the world engaged in the manufacture of electronic measurement instruments, some of which are larger and have greater financial resources than the Company. In general, we compete with a number of companies in specialized areas of other test and measurement products and one large broad line measurement products supplier, Agilent Technologies, Inc.

Research and Development

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Our engineering development activities are directed toward the development of new products that will complement, replace or add to the products currently included in our product line. We do not perform basic research, but on an ongoing basis we utilize new component and software technologies in the development of our products. The highly technical nature of our products and the rapid rate of technological change in the industry require a large and continuing commitment to engineering development efforts. Product development expenses were \$15,017,000 in 2004, \$13,488,000 in 2003 and \$13,987,000 in 2002, or approximately 11%, 13% and 14% of net sales, respectively, for each of the last three fiscal years.

Government Regulations

We believe our current operations and uses of property, plant and equipment conform in all material respects to applicable laws and regulations. Keithley has not experienced, nor do we anticipate, any material claim or material capital expenditure in connection with environmental laws and other regulations.

Employees

As of September 30, 2004, the Company employed approximately 632 persons, 173 of whom were located outside the United States. None of our employees are covered under the terms of a collective bargaining agreement, and we believe that relations with our employees are good.

Foreign Operations and Export Sales

Information related to foreign and domestic operations and export sales is contained in Note L of the Notes to the Consolidated Financial Statements included in Item 8 of this Annual Report.

Keithley has significant revenues from outside the United States which increase the complexity and risk to the Company. These risks include increased exposure to the risk of foreign currency fluctuations and the potential economic and political impacts from conducting business in foreign countries. With the exception of changes in the value of foreign currencies, which is not possible to predict, we believe our foreign subsidiaries and other larger international markets are in countries where the economic and political climate generally is stable.

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The Company's principal administrative, sales, marketing, manufacturing and development activities are conducted at two Company-owned buildings in Solon, Ohio. The two buildings total approximately 200,000 square feet and sit on approximately 33 acres of land. The Company also owns another 50,000 square foot building on 5.5 acres of land adjacent to its executive offices. This facility is currently being leased to others, but is available for expansion should additional space be required. The Company also maintains a number of sales and service offices in the United States and overseas. We believe the facilities owned and leased are well maintained, adequately insured and suitable for their present and intended uses.

ITEM 3 - LEGAL PROCEEDINGS.

We are subject to various litigation matters and claims that occur in the normal course of business. While the results of such litigation matters and claims cannot be predicted with certainty, management believes that their final outcome will not have a material adverse impact on the financial position or results of operations of the Company.

ITEM 4 - SUBMISSION OF MATTERS TO A VOTE OF SECURITY HOLDERS.

No matter was submitted to a vote of security holders during the fourth quarter of the fiscal year covered by this report.

EXECUTIVE OFFICERS OF THE REGISTRANT:

Certain information regarding our executive officers is set forth below:

<u>Name</u>	<u>Position</u>	<u>Age</u>
Joseph P. Keithley	Chairman of the Board of Directors, President and Chief Executive Officer	55
Philip R. Etsler	Vice President Human Resources	54
Alan S. Gaffney	Vice President Commercial Marketing and Information Systems	34
Mark A. Hoersten	Vice President Business Management	46
Larry L. Pendergrass	Vice President New Product Development	49
John A. Pesec	Vice President Worldwide Sales and Support	44
Mark J. Plush	Vice President and Chief Financial Officer	55
Linda C. Rae	Senior Vice President and General Manager	39
Gabriel A. Rosica	Executive Vice President	64

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Debra A. Sibila Corporate Controller

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Joseph P. Keithley was elected Chairman of the Board of Directors in February 1991. He was elected Chief Executive Officer in November 1993, and President in May 1994. He has been a Director since 1986, and was elected Vice Chairman of the Board in February 1988. Mr. Keithley joined the Company in 1976 and held various positions in production, customer service, sales and marketing prior to being elected Vice President of Marketing in 1986.

Philip R. Etsler has been Vice President of Human Resources since February 1990. He joined the Company in January 1986 as Personnel Director, which was an executive officer position.

Alan S. Gaffney was elected Vice President Commercial Marketing and Information Systems in May 2003. He joined Keithley in July 1999 as Direct Marketing Manager. He became Director of Worldwide Communications and Marketing Support in May 2000. Prior to joining Keithley, Mr. Gaffney held the position of Sales and Marketing Manager at Diebold, Inc., a global provider of self-service transaction solutions, security systems and services to financial institutions, retailers, colleges and universities, healthcare facilities and utilities.

Mark A. Hoersten was elected Vice President Business Management in May 2003. He joined Keithley in June 1980 as a Design Engineer and held various positions in product development and marketing until September 1997 when Mr. Hoersten became the Director of Marketing. He was promoted to Telecommunications Test Business Manager in July 1999, and General Manager in April 2001.

Larry L. Pendergrass joined Keithley in May 2003 as Vice President, New Product Development. Prior to joining Keithley, Mr. Pendergrass had over 20 years experience in research and development, product development, and manufacturing engineering in various roles including Section Manager, Project Manager and Project Leader with Agilent Technologies and Hewlett-Packard.

John A. Pesec was elected Vice President Worldwide Sales and Support in September 2002. Mr. Pesec joined Keithley in July 1990 and held various positions including Director of Pacific Basin Operations from February 1995 to January 1998, Director Semiconductor Sales from January 1998 to March 1999, Director of Sales from March 1999 to April 2001, and Managing Director Worldwide Sales from April 2001 to September 2002.

Mark J. Plush was elected Vice President and Chief Financial Officer in October 1998. Mr. Plush joined the Company in March 1982 as Controller and was elected an executive officer in February 1989.

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Linda C. Rae was elected Senior Vice President and General Manager in May 2003. Ms. Rae joined Keithley in September 1995 as a Product Marketer and held various marketing positions including Component Test Business Manager from July 1999 to June 2000, Business Manager of Optoelectronics from June 2000 to April 2001, and General Manager from April 2001 to May 2003.

Gabriel A. Rosica was elected Executive Vice President in April 2001. He joined Keithley in February of 1996 as General Manager and became Senior Vice President in January 1997. Prior to joining the Company, Mr. Rosica was a member of the Company's Board of Directors from 1993 to 1996. While serving on the Company's Board, he held various positions with Bailey Controls Company including Chief Operating Officer, Senior Vice President of Systems Operations, and Senior Vice President, Americas, Pacific & Far East of Elsas Bailey.

Debra A. Sibila was elected a Corporate Officer in May 2004. She joined Keithley in July 2003 as Corporate Controller. Prior to joining Keithley Instruments, Inc., Ms. Sibila was Division Controller for Goodrich Power Systems, which was acquired from TRW. Ms. Sibila was with TRW for 20 years and held a variety of accounting and finance positions.

PART II.

ITEM 5 - MARKET FOR THE REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES.

The Company's Common Shares trade on the New York Stock Exchange under the symbol KEI. The high and low prices shown below are sales prices of the Company's Common Shares as reported on the NYSE. There is no established public trading market for the Class B Common Shares; however, they are readily convertible on a one-for-one basis into Common Shares.

Fiscal 2004	High	Low	Cash Dividends Per Common Share	Cash Dividends Per Class B Common Share
First Quarter	\$ 19.16	\$ 14.16	\$.0375	\$.0300
Second Quarter	25.73	18.35	.0375	.0300
Third Quarter	22.90	19.23	.0375	.0300
Fourth Quarter	22.07	15.61	.0375	.0300
Fiscal 2003				
First Quarter	\$ 13.92	\$ 8.01	\$.0375	\$.0300
Second Quarter	14.13	9.90	.0375	.0300
Third Quarter	15.20	10.60	.0375	.0300
Fourth Quarter	17.84	13.90	.0375	.0300

The approximate number of shareholders of record of Common Shares and Class B Common Shares, including those shareholders participating in the Dividend Reinvestment Plan, as of December 1, 2004 was 2,473 and 4, respectively.

Equity Compensation Plan Information as of September 30, 2004

Plan category	Number of securities to be issued upon exercise of outstanding options (a)	Weighted-average exercise price of outstanding options (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	3,404,846	\$ 19.88	1,811,012 ⁽¹⁾
Equity compensation plans not approved by security holders			
Total	3,404,846	\$ 19.88	1,811,012⁽¹⁾

⁽¹⁾ Includes 247,638 shares available for issuance under the 1993 Employee Stock Purchase and Dividend Reinvestment Plan.

Purchases of Equity Securities

On December 10, 2003, the Company announced its Board of Directors had approved an open market stock repurchase program (the 2003 program). Under the terms of the 2003 program, the Company may purchase up to 2,000,000 Common Shares, which represented approximately 13 percent of the outstanding shares at the time the program was approved, over a three-year period. The purpose of the 2003 program is to

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offset the dilutive effect of stock option and stock purchase plans. Common Shares held in treasury may be reissued in settlement of stock purchases under these plans. The 2003 program replaced the prior program, which expired in December 2003 and had substantially the same terms as the 2003 program. There were no shares repurchased in fiscal 2004. During fiscal 2003, the Company repurchased 243,200 shares at an average price per share of \$11.41 under the repurchase program that expired in December 2003.

ITEM 6 - SELECTED FINANCIAL DATA.

The following table sets forth consolidated selected financial data for the Company. The financial data should be read in conjunction with the Financial Statements and Notes thereto, included in Item 8 of this Annual Report, and with Management's Discussion and Analysis of Financial Condition and Results of Operations, included in Item 7 of this Annual Report.

(In thousands of dollars except for per share data)	For the years ended September 30,				
	2004	2003	2002	2001	2000
Operating Results:					
Net sales	\$ 140,248	106,718	96,922	149,692	150,561
Gross margin percentage	61.1%	55.3%	56.2%	60.1%	61.1%
Income (loss) before income taxes	\$ 15,541	(4,361)	(5,046)	26,199	32,471
Net income (loss)	\$ 11,381	(4,192)	(3,080)	17,392	21,045
Basic earnings (loss) per share	\$ 0.71	(0.27)	(0.20)	1.11	1.43
Diluted earnings (loss) per share	\$ 0.69	(0.27)	(0.20)	1.05	1.30
Common Stock Information:					
Cash dividends per Common Share	\$ 0.150	0.150	0.150	0.140	0.103
Cash dividends per Class B Common Share	\$ 0.120	0.120	0.120	0.112	0.082
Weighted average number of shares outstanding- diluted	16,544	15,487	15,687	16,583	16,168
At fiscal year-end:					
Dividend payout ratio	21.7%	n/m	n/m	13.3%	7.9%
Shareholders' equity per share	\$ 6.26	5.33	5.81	5.90	4.77
Closing market price	\$ 17.45	14.15	12.15	14.35	70.00
Balance Sheet Data:					
Total assets	\$ 136,666	114,186	120,371	123,600	112,338
Current ratio	3.3	3.4	3.9	4.5	3.0
Long-term debt				3,000	3,000
Total debt	\$ 440	409	539	3,000	3,225
Total debt-to-capital	0.4%	0.5%	0.6%	3.1%	4.1%
Shareholders' equity	\$ 101,577	84,763	92,448	93,946	75,773
Other Data:					
Return on average shareholders' equity	12.2%	-4.7%	-3.3%	20.5%	35.2%
Return on average total assets	9.1%	-3.6%			