

SPS TECHNOLOGIES INC  
Form 10-Q  
August 14, 2001

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 quarter ended June 30, 2001  
Commission file number 1-4416

SPS TECHNOLOGIES, INC.

(Exact name of Registrant as specified in its Charter)

PENNSYLVANIA  
(State of incorporation)  
Two Pitcairn Place, Suite 200

23-1116110  
(I.R.S. Employer  
Identification No.)

165 Township Line Road  
Jenkintown, Pennsylvania  
(Address of principal executive offices)

19046  
(Zip Code)

(215) 517-2000  
(Registrant's telephone number, including area code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes  No

The number of shares of Registrant's Common Stock outstanding on August 6, 2001 was 13,091,150.

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SPS TECHNOLOGIES, INC. AND SUBSIDIARIES

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SPS TECHNOLOGIES, INC. AND SUBSIDIARIES  
STATEMENTS OF CONSOLIDATED OPERATIONS  
(Unaudited-Thousands of dollars, except share data)

Three Months Ended  
June 30

Six Months Ended  
June 30

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	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
Net sales	\$239,386	\$228,003	\$478,542	\$444,733
Cost of goods sold	<u>189,796</u>	<u>183,326</u>	<u>379,248</u>	<u>357,432</u>
Gross profit	49,590	44,677	99,294	87,301
Selling, general and administrative expense	27,274	25,248	54,564	48,801
Restructurings & impairments	<u>9,100</u>	<u>0</u>	<u>9,100</u>	<u>0</u>
Operating earnings	13,216	19,429	35,630	38,500
Other income (expense):				
Interest income	114	182	393	624
Interest expense	(5,123)	(5,721)	(10,234)	(10,264)
Other, net	<u>(27</u>	<u>390</u>	<u>(69</u>	<u>530</u>
	)	)	)	)
	<u>(5,036</u>	<u>(5,149</u>	<u>(9,910</u>	<u>(9,110</u>
	)	)	)	)
Earnings before income taxes	8,180	14,280	25,720	29,390
Provision for income taxes	<u>2,570</u>	<u>4,320</u>	<u>8,290</u>	<u>9,020</u>
Net earnings	<u>\$ 5,610</u>	<u>\$ 9,960</u>	<u>\$ 17,430</u>	<u>\$ 20,370</u>
Earnings per common share				
Basic	<u>\$ 0.43</u>	<u>\$ 0.79</u>	<u>\$ 1.35</u>	<u>\$ 1.61</u>
Diluted	<u>\$ 0.42</u>	<u>\$ 0.77</u>	<u>\$ 1.32</u>	<u>\$ 1.58</u>

See accompanying notes to condensed consolidated financial statements.

SPS TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONSOLIDATED BALANCE SHEETS  
(Thousands of dollars)

	Unaudited June 30, <u>2001</u>	December 31, <u>2000</u>
Assets		
Current assets		
Cash and cash equivalents	\$ 22,597	\$ 31,933
Accounts and notes receivable, less allowance for doubtful receivables of \$4,270 (2000 - \$3,815)	149,504	130,017
Inventories	180,185	161,584
Deferred income taxes	22,034	18,247
Prepaid expenses and other	<u>8,009</u>	<u>7,830</u>
Total current assets	382,329	349,611
Property, plant and equipment, net of accumulated depreciation of \$170,322 (2000 - \$165,162)	234,953	228,632
Other assets, principally goodwill	<u>236,825</u>	<u>232,279</u>
Total assets	<u>\$ 854,107</u>	<u>\$ 810,522</u>

See accompanying notes to condensed consolidated financial statements.

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	Unaudited June 30, <u>2001</u>	December 31, <u>2000</u>
Liabilities and shareholders' equity		
Current liabilities		
Notes payable and current portion of long-term debt	\$ 18,766	\$ 14,617
Accounts payable	81,556	77,093
Accrued expenses	76,179	65,679
Income taxes payable	<u>5,728</u>	<u>5,265</u>
Total current liabilities	<u>182,229</u>	<u>162,654</u>
Deferred income taxes	33,357	31,619
Long-term debt	249,243	243,586
Retirement obligations and other long-term liabilities	27,398	27,796
Shareholders' equity		
Preferred stock, par value \$1 per share, authorized 400,000 shares, issued none		
Common stock, par value \$0.50 per share, authorized 60,000,000 shares, issued 14,362,524 shares (14,210,886 shares in 2000)	7,181	7,105
Additional paid-in capital	125,059	117,665
Common stock in treasury, at cost, 1,271,374 shares (1,428,354 shares in 2000)	(24,687)	(26,626)
Retained earnings	290,990	273,560
Accumulated other comprehensive income		
Minimum pension liability	(718)	(718)

Cumulative translation adjustments	(33,103)	(26,119)
Fair value of derivative adjustments	<u>(2,842)</u>	<u>-</u>
	)	
Total shareholders' equity	<u>361,880</u>	<u>344,867</u>
Total liabilities and shareholders' equity	<u>\$ 854,107</u>	<u>\$ 810,522</u>

See accompanying notes to condensed consolidated financial statements.

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SPS TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONDENSED STATEMENTS OF CONSOLIDATED CASH FLOWS  
(Unaudited-Thousands of dollars)

	Six Months Ended <u>June 30,</u>	
	<u>2001</u>	<u>2000</u>
Net cash provided by operating activities (including depreciation and amortization of \$19,721 in 2001 and \$19,475 in 2000)	<u>\$ 23,425</u>	<u>\$ 31,490</u>
Cash flows provided by (used in) investing activities		
Additions to property, plant and equipment	(18,833)	(15,148)
Proceeds from sale of property, plant and equipment	267	4,332
Acquisitions of businesses, net of cash acquired	<u>(21,658)</u>	<u>(116,111)</u>
Net cash used in investing activities	<u>(40,224)</u>	<u>(126,927)</u>
	)	)
Cash flows provided by (used in) financing activities		
Proceeds from borrowings	38,987	101,506

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Reduction of borrowings	(32,136)	(27,694)
Purchases of treasury stock	-	(4,240)
Proceeds from exercise of stock options	<u>920</u>	<u>569</u>
Net cash provided by financing activities	<u>7,771</u>	<u>70,141</u>
Effect of exchange rate changes on cash	<u>(308)</u>	<u>(309)</u>
	)	)
Net increase (decrease) in cash and cash equivalents	(9,336)	(25,605)
Cash and cash equivalents at beginning of period	<u>31,933</u>	<u>50,479</u>
Cash and cash equivalents at end of period	<u>\$ 22,597</u>	<u>\$ 24,874</u>
Significant noncash investing and financing activities		
Issuance of treasury shares for businesses acquired	\$ 6,975	\$ 3,600
Debt assumed with businesses acquired	\$ 3,616	\$ 483
Acquisition of treasury shares for stock options exercised	\$ 1,795	\$ 336

See accompanying notes to condensed consolidated financial statements.

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SPS TECHNOLOGIES, INC. AND SUBSIDIARIES  
CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME  
(Unaudited - Thousands of dollars)

Three Months Ended  
June 30,

Six Months Ended  
June 30,

	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
Net earnings	\$ 5,610	\$ 9,960	\$17,430	\$20,370
Other comprehensive income (expense):				
Foreign currency translation adjustments	(1,903)	(2,530)	(6,984)	(4,268)
Changes in the fair value of derivatives	(3,109)	-	(2,931)	-
Cumulative effect of accounting change, net of tax	<u>-</u>	<u>-</u>	<u>89</u>	<u>-</u>
Total comprehensive income	<u>\$ 598</u>	<u>\$ 7,430</u>	<u>\$ 7,604</u>	<u>\$16,102</u>

See accompanying notes to condensed consolidated financial statements.

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SPS TECHNOLOGIES, INC. AND SUBSIDIARIES  
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited-Thousands of dollars, except share data)

1. Financial Statements

In the opinion of the Company's management, the accompanying unaudited, condensed consolidated financial statements contain all adjustments necessary to present fairly the financial position as of June 30, 2001, the results of operations for the three and six month periods ended June 30, 2001 and 2000, and cash flows for the six month periods ended June 30, 2001 and 2000. The December 31, 2000 balance sheet data was derived from audited financial statements, but does not include all disclosures required by generally accepted accounting principles. The accompanying financial statements contain only normal recurring adjustments. All financial information has been prepared in conformity with the accounting principles reflected in the financial statements included in the 2000 Annual Report filed on Form 10-K applied on a consistent basis.

2. Change in Accounting Policies

Effective January 1, 2001, the Company adopted the provisions of Statement of Financial Accounting Standards (SFAS) No. 133, "Accounting for Derivative Instruments and Hedging Activities," as amended by SFAS No. 138. The new standard requires that all derivative instruments be recorded on the balance sheet at their fair value. Changes in the fair value of derivatives are recorded each period in current earnings or other comprehensive income, depending on the use of the derivative and whether it qualifies for hedge accounting treatment. Based on market valuations for derivatives held as of January 1, 2001, the Company recorded net-of-tax, cumulative-effect-type adjustments to other comprehensive income of \$89 to recognize the fair value of all derivatives. The Company made no significant change



to its risk management strategies due to the adoption of SFAS No. 133.

The Company enters into derivative contracts to reduce the risk caused by variable interest rates and currency exchange rates. The Company is using interest rate swap agreements to modify a portion of its variable rate obligations to fixed rate obligations, thereby reducing the exposure to market rate fluctuations. A currency swap agreement is used by the Company to manage exposure related to an intercompany debt denominated in one currency that will be repaid in another currency. The Company has entered into a series of foreign currency forward contracts to buy certain foreign currencies each month over a future period of time at today's forward exchange rates. The Company formally assesses (both at the hedge's inception and on a quarterly basis) whether the derivatives that are used in hedging transactions have been highly effective in offsetting changes in the cash flows of hedged items and whether those derivatives may be expected to remain highly effective in future periods.

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As of June 30, 2001, all hedges outstanding were highly effective. The maximum remaining length of time of the interest rate swaps currently in place as of June 30, 2001 is approximately 4.5 years. The currency swap agreement matures on October 27, 2003. The maximum remaining length of time of the foreign currency forward contracts currently in place as of June 30, 2001 is approximately 2.5 years. The Company is exposed to credit loss in the event of nonperformance by the counterparties to the swap agreements and the foreign currency forward contracts. The Company does not anticipate nonperformance by the counterparties who are major financial institutions.

The fair value of all derivatives were zero at the inception date and will be zero at the maturity of the derivatives. Throughout the term of the derivatives, the Company will adjust the derivatives to their fair value with an offsetting adjustment to other comprehensive income and current period earnings. Any change in fair value related to the derivative's hedge ineffectiveness and any component of the derivative's gain or loss excluded from the assessment of hedge effectiveness would be recognized in current period earnings. The net gain or loss recognized in earnings during the three month and six month periods ended June 30, 2001 was not material. Of the amount reported in accumulated other comprehensive income at June 30, 2001, the Company estimates that \$1,600 of losses are expected to be reclassified to current period earnings within the next twelve months. When the losses are reclassified into current period earnings, they will be reported on the same line as the underlying transaction. The net amount of gains included in the cumulative translation adjustment account for the currency swap agreement is \$335 for the second quarter of 2001 and \$1,358 for the six months ended June 30, 2001. If it is determined that a derivative is not highly effective as a hedge, the Company would discontinue hedge accounting prospectively and the gain or loss on the derivative remaining in accumulated other comprehensive income would be reclassified into earnings. In any situation in which hedge accounting was discontinued and the derivative remained outstanding, the Company would carry the derivative at its fair value on the balance sheet and recognize changes in the fair value in current period earnings.

### 3. Restructure of Operations

In June 2001, the Company announced plans to restructure and consolidate certain manufacturing operations. The elements of this plan include the closure of three manufacturing plants, relocation of certain product lines to existing facilities, outsourcing the manufacture of certain product lines to third parties, discontinuing production of certain product lines and further integrating and consolidating the operations of certain acquired companies. The statements of consolidated operations for the second quarter and six month periods of 2001 include a restructuring and impairments charge and a related inventory writedown charge that totals \$10,600 (\$7,000 or \$0.53 per share on an after-tax basis). The charge for the writedown of inventory related to discontinued product lines of \$1,500 is included in the cost of goods sold line of the statement of consolidated operations. The \$9,100 charge included in the statement of consolidated operations on the restructuring and impairments line consist of the following: costs of employee separations of \$5,300, writedown of machinery and equipment of \$1,800, lease termination cost of \$900 and other

non-recurring cost of \$1,100. In addition, the Company has estimated that it will incur approximately \$3,900 (\$2,500 or \$0.19 per share on an after-tax basis) for certain related costs that will be charged to the statement of consolidated operations as incurred. These costs consist of the following: losses during the wind-down period of \$2,600, cost to relocate equipment of \$800 and costs to start-up production of \$500. As of June 30, 2001, the Company has incurred \$550 (\$370 or \$.03 per share on an after-tax basis) for losses during the wind-down period.

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#### 4. Business Acquisitions

All acquisitions have been accounted for under the purchase method. The results of operations of the acquired businesses are included in the consolidated financial statements from the dates of acquisition.

On April 5, 2001, the Company acquired all of the outstanding stock of M. Argüeso & Co., Inc. (Argüeso) based in Mamaroneck, New York for approximately \$19,600. Consideration consisted of approximately \$12,600 in cash and debt assumed and 192,487 shares of the Company's common stock in treasury valued at \$6,975. Argüeso is a manufacturer and distributor of wax blends for use in the investment casting industry. Argüeso's products are used in a variety of investment casting applications in industries such as aerospace, power generation and medical. The excess of the purchase price over the fair value of the net assets acquired was approximately \$8,600 and has been recorded as goodwill and other intangible assets which are being amortized on a straight-line basis over 15 to 40 years.

On February 12, 2001, the Company and a group of investors acquired substantially all of the assets and business of AAA Aircraft Supply Co., Inc. (AAA) located in Windsor Locks, Connecticut for \$7,000. The Company's ownership percentage is 88.8 percent. AAA is a North American distributor of fasteners sold to the aerospace markets. The purchase price approximated the fair value of the net assets acquired.

On March 14, 2000, the Company acquired all of the outstanding shares of Avibank Mfg., Inc. (Avibank) based in Burbank, California for approximately \$115,900. Consideration consisted of approximately \$112,300 in cash and 110,652 shares of the Company's common stock in treasury valued at \$3,600. Avibank is a manufacturer of latches, hold open rods, quick release pins, structural panel fasteners, self-retaining bolts and expandable fasteners for aerospace markets. Avibank, through its AVK Industrial Products Division, also manufactures threaded inserts for the automotive and industrial markets. The excess of the purchase price over the fair value of the net assets acquired was approximately \$90,800 and has been recorded as goodwill, patents, trademarks and other intangible assets which are being amortized on a straight-line basis over 15 to 40 years.

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In 2000, the Company also completed two relatively smaller acquisitions in Europe. On January 10, 2000, the Company acquired certain operating assets of ULMA S.p.A. (ULMA) based in Milan, Italy for approximately \$2,300. ULMA is a full range manufacturer of flat, planetary and cylindrical thread roll dies used in metal forming. In December 2000, the Company acquired certain operating assets of DACAR S.A. based in Auxerre, France for approximately \$1,600. DACAR is a manufacturer of precision machined components and structural assemblies used by European aerospace suppliers.

The following unaudited pro forma consolidated results of operations are presented as if the Argüeso and Avibank acquisitions had been made at the beginning of the periods presented. The effects of the AAA, ULMA and DACAR acquisitions are not material and, accordingly, have been excluded from the pro forma presentation.

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Six Months Ended  
June 30,  
2001    2000

Net sales	\$484,071	\$472,527
Net earnings	17,320	20,926
Basic earnings per common share	1.34	1.62
Diluted earnings per common share	1.31	1.59

The pro forma consolidated results of operations include adjustments to give effect to amortization of goodwill and other intangibles, interest expense on acquisition debt, shares of common stock issued and the related income tax effects. The unaudited pro forma information is not necessarily indicative of the results of operations that would have occurred had the purchase been made at the beginning of the periods presented or the future results of the combined operations.

5. Inventories

	<u>June 30,</u> <u>2001</u>	<u>December 31,</u> <u>2000</u>
Finished goods	\$ 76,619	\$ 70,188
Work-in-process	56,866	51,093
Raw materials and supplies	39,491	34,273
Tools	<u>7,209</u>	<u>6,030</u>
	<u>\$180,185</u>	<u>\$ 161,584</u>

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6. Environmental Contingency

The Company has been identified as a potentially responsible party by various federal and state authorities for clean up or removal of waste from various disposal sites. At June 30, 2001, the accrued liability for environmental remediation represents management's best estimate of the undiscounted costs related to environmental remediation which are considered probable and can be reasonably estimated. The Company has not included any insurance recovery in the accrued environmental liability. The measurement of the liability is evaluated quarterly based on currently available information. Management believes the overall costs of environmental remediation will be incurred over an extended period of time. As the scope of the Company's environmental liability becomes more clearly defined, it is possible that additional reserves may be necessary. Accordingly, it is possible that the Company's results of operations in future quarterly or annual periods could be materially affected. Management does not anticipate that its consolidated financial condition will be materially affected by environmental remediation costs in excess of amounts accrued.

## 7. Per Share Data

Basic earnings per common share is calculated using the average shares of common stock outstanding, while diluted earnings per common share reflects the potential dilution that could occur if stock options were exercised. Earnings per share are computed as follows:

	Three Months Ended		Six Months Ended	
	June 30		June 30	
	2001	2000	2001	2000
Net earnings	\$ <u>5,610</u>	\$ <u>9,960</u>	\$ <u>17,430</u>	\$ <u>20,370</u>
Average shares of common stock outstanding used to compute basic earnings per common share	13,031,794	12,681,612	12,937,403	12,650,218
Additional common shares to be issued assuming exercise of stock options, net of shares assumed reacquired	<u>257,654</u>	<u>220,767</u>	<u>264,898</u>	<u>221,507</u>
Shares used to compute dilutive effect of stock options	<u>13,289,448</u>	<u>12,902,379</u>	<u>13,202,301</u>	<u>12,871,725</u>
Basic earnings per share	\$ <u>0.43</u>	\$ <u>0.79</u>	\$ <u>1.35</u>	\$ <u>1.61</u>
Diluted earnings per share	\$ <u>0.42</u>	\$ <u>0.77</u>	\$ <u>1.32</u>	\$ <u>1.58</u>

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## 8. Segment Information

The Company has four reportable segments: Aerospace Fasteners and Components, Engineered Fasteners and Components, Specialty Materials and Alloys and Magnetic Products. The Aerospace Fasteners and Components segment consist of business units which produce precision fasteners and fastening systems and structural and other metal components for critical applications in the aerospace machinery markets. The Engineered Fasteners and Components segment consist of business units which produce precision fasteners and fastening systems, structural and other metal components and consumable tools for critical applications in the automotive and industrial machinery markets. The Specialty Materials and Alloys segment produces specialty metals, superalloys and ceramic cores for aerospace, industrial gas turbine, medical and other general industrial applications. The Magnetic Products segment produces magnetic materials and products used in automotive, telecommunications, aerospace, reprographic, computer and advertising specialty applications.

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	Three Months Ended		Six Months Ended	
	<u>June 30</u>		<u>June 30</u>	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
Net sales:				
Aerospace Fasteners and Components	\$ 89,272	\$ 79,499	\$179,080	\$151,506
Engineered Fasteners and Components	74,190	81,518	148,228	157,673
Specialty Materials and Alloys	45,760	32,186	85,306	64,768
Magnetic Products	<u>30,164</u>	<u>34,800</u>	<u>65,928</u>	<u>70,786</u>
Total net sales	<u>\$239,386</u>	<u>\$228,003</u>	<u>\$478,542</u>	<u>\$444,733</u>
Operating earnings before restructurings and impairments:				
Aerospace Fasteners and Components	\$ 11,485	\$ 6,073	\$ 21,527	\$ 14,225
Engineered Fasteners and Components	5,348	7,892	10,756	13,884
Specialty Materials and Alloys	6,958	4,479	13,229	8,830
Magnetic Products	1,425	3,945	5,268	7,321
Unallocated Corporate Costs	<u>(2,900)</u>	<u>(2,960)</u>	<u>(6,050)</u>	<u>(5,760)</u>
	)	)	)	)
	22,316	19,429	44,730	38,500
Restructurings and impairments	<u>(9,100)</u>	<u>-</u>	<u>(9,100)</u>	<u>-</u>
	)	)	)	)
Total operating earnings	<u>\$ 13,216</u>	<u>\$ 19,429</u>	<u>\$ 35,630</u>	<u>\$ 38,500</u>

## 9. Recently Issued Accounting Standards

In July 2001, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 141, "Business Combinations." This statement requires the purchase method of accounting be used for all business combinations initiated after June 30, 2001, and establishes specific criteria for the recognition of intangible assets separately from goodwill. The Company will follow the requirements of this statement for all business acquisitions made after June 30, 2001.

In July 2001, the FASB also issued SFAS No. 142, "Goodwill and Other Intangible Assets." This statement requires that goodwill and intangible assets deemed to have an indefinite life no longer be amortized but be tested for impairment at least annually. The amortization period of intangible assets with finite lives will no longer be limited to forty years. This statement is effective for fiscal years beginning after December 15, 2001. The Company will adopt SFAS No. 142 in the first quarter of 2002. The impact of adopting this standard has not been determined at this time.

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## SPS TECHNOLOGIES, INC. AND SUBSIDIARIES

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

#### Introduction

Excluding the cost to complete the 2001 restructuring plan, the Company's sales and operating earnings improved over the corresponding periods in the prior year. The increase in operating results is primarily attributable to the impact of businesses acquired in 2000 and 2001 and strong demand for the Company's superalloy products from the industrial gas and aerospace turbine engine markets. In June 2001, the company announced plans to restructure and consolidate certain under-performing operations which, when completed, are expected to increase annual operating profit by \$8.8 million and reduce sales revenue by one percent. In the first six months of 2001, the Company completed two acquisitions which complement its existing businesses.

#### Net Sales

Net sales increased \$11.4 million, or 5.0 percent, in the second quarter of 2001 and \$33.8 million, or 7.6 percent, for the six month period ended June 30, 2001 compared to the same periods in 2000.

The Company's Aerospace Fasteners and Components segment sales increased \$9.8 million, or 12.3 percent, in the second quarter of 2001 and \$27.6 million, or 18.2 percent, for the six months ended June 30, 2001 compared to the same periods in 2000 due primarily to recently acquired businesses. Sales of products by companies acquired in 2000 and 2001 (primarily Avibank, DACAR and AAA Aircraft Supply) increased Aerospace Fasteners and Components segment sales by \$8.3 million in the second quarter and \$26.8 million for the six months ended June 30, 2001. This segment is experiencing strong end market demand in North America and Europe. This segment's incoming orders increased \$20.2 million in the second quarter and \$48.6 million for the six months ended June 30, 2001. Due to a strong level of incoming orders and the success in obtaining new business with long term agreements with customers, the Company expects the trend of increasing sales by the aerospace fastener and components segment to continue throughout 2001 and into 2002.

Sales of a recently acquired business (M. Argüeso & Co., Inc. on April 5, 2001) increased Specialty Materials and Alloys segment sales by \$5.1 million in the second quarter and six month period of 2001. Excluding the sales of this recently acquired business, this segment's sales increased \$8.5 million, or 26.3 percent, in the second quarter of 2001

and \$15.4 million, or 23.8 percent, for the six months ended June 30, 2001 compared to the same periods in 2000. These higher sales are the result of strong demand for proprietary alloys from the industrial gas and aerospace turbine markets. On March 29, 2001, the Company announced its intent to purchase a vacuum induction melting furnace to expand production capacity at its Cannon-Muskegon subsidiary. The new furnace is estimated to be delivered in December of 2001 and when fully operational is expected to add five million pounds of vacuum melt capacity, an increase of 56 percent. The capacity expansion is in response to continued growth in the industrial gas and aerospace turbine markets in North America, Europe and Asia, as well as expanding applications for the Company's proprietary superalloys, which are sold to those markets.

The Company's Engineered Fasteners and Components segment sales decreased \$7.3 million, or 9.0 percent, in the second quarter of 2001 and \$9.4 million, or 6.0 percent, for the six months ended June 30, 2001 compared to the same periods in 2000. The Magnetic Products segment sales decreased \$4.6 million, or 13.3 percent, in the second quarter and \$4.9 million, or 6.9 percent, for the six months ended June 30, 2001, compared to the same periods in 2000. These decreases are the result of lower demand from the automotive, truck, general industrial and electronic markets. Incoming orders for these segments decreased \$18.2 million for the second quarter and \$25.0 million for the six months ended June 30, 2001. Due to the weakness in incoming orders, the Company expects the trend of lower sales compared to the prior year to continue throughout 2001.

#### Operating Earnings

	<u>Three Months Ended</u> <u>June 30</u>		<u>Six Months Ended</u> <u>June 30</u>	
	<u>2001</u>	<u>2000</u>	<u>2001</u>	<u>2000</u>
Operating earnings before nonrecurring charges and wind-down losses:				
Aerospace Fasteners and Components	\$ 12,867	\$ 10,048	\$ 22,909	\$ 18,800
Engineered Fasteners and Components	5,567	7,892	10,975	13,884
Specialty Materials and Alloys	7,328	4,479	13,599	8,830
Magnetic Products	1,502	3,945	5,345	7,321
Unallocated Corporate Costs	<u>(2,900)</u>	<u>(2,960)</u>	<u>(6,050)</u>	<u>(5,760)</u>
	)	)	)	)
	24,364	23,404	46,778	43,075

Nonrecurring charges and wind-down losses	<u>(11,148)</u>	<u>(3,975)</u>	<u>(11,148)</u>	<u>(4,575)</u>
	)	)	)	)
Total operating earnings	<u>\$ 13,216</u>	<u>\$ 19,429</u>	<u>\$ 35,630</u>	<u>\$ 38,500</u>

Operating earnings of the Company decreased \$6.2 million, or 32.0 percent, in the second quarter of 2001 and \$2.9 million, or 7.5 percent, for the six month period ended June 30, 2001 compared to the same periods in 2000. Operating earnings in 2001 include an \$11.1 million charge for the cost to restructure and consolidate certain under-performing operations as described below in the section entitled "Summary of the Restructure Actions". Operating earnings were reduced by \$4.0 million in the second quarter of 2000 and \$4.6 million for the six months ended June 30, 2000 due to the amortization of the inventory step-up that resulted from the acquisition of Avibank. This non-recurring charge, which related to purchase accounting for the acquisition of Avibank on March 14, 2000, reduced net income for the second quarter of 2000 by \$2.5 million, or \$0.19 per share and six months ended June 30, 2000, by \$3.0 million, or \$0.23 per share.

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Excluding the non-recurring charges noted above, the operating earnings of the Company increased from \$23.4 million, or 10.3 percent of sales, for the second quarter of 2000 to \$24.4 million, or 10.2 percent of sales, for the second quarter of 2001. Operating earnings of the Company increased from \$43.1 million, or 9.7 percent of sales, for the six months ended June 30, 2000 to \$46.8 million for the six months ended June 30, 2001. Consistent with the trend in sales volume, the operating profit margins have improved in the Aerospace Fasteners and Components segment and Specialty Materials and Alloys segment while the operating profit margins have decreased in the Engineered Fasteners and Components segment and Magnetic Products segment.

Operating earnings of the Aerospace Fasteners and Components segment increased \$2.8 million, or 28.1 percent, in the second quarter of 2001 and \$4.1 million, or 21.9 percent for the six months ended June 30, 2001. Operating earnings by businesses acquired in 2000 and 2001 (primarily Avibank, DACAR and AAA Aircraft Supply) increased this segment's operating earnings by \$2.6 million in the second quarter of 2001 and \$5.1 million for the six months ended June 30, 2001. Difficulties in ramping up production at the other aerospace plants after the significant drop in production in 2000 negatively impacted aerospace margins. Aerospace operating profit margins improved in the second quarter of 2001 compared to the first quarter of 2001 and further improvement is expected in the second half of 2001.

The operating earnings of the Specialty Materials and Alloys segment increased from \$8.8 million, or 13.6 percent of sales, for the first six months of 2000 to \$13.6 million, or 15.9 percent of sales for the first six months of 2001. This increase in earnings is due primarily to the increase in sales discussed above.

The operating earnings of the Engineered Fasteners and Components segment decreased from \$13.9 million, or 8.8 percent of sales, for the six months ended June 30, 2000 to \$11.0 million, or 7.4 percent of sales, for the six months ended June 30, 2001. Lower earnings are due primarily to the decrease in sales discussed above. The 2000 operating earnings of this segment include two non-recurring items. On March 31, 2000 the Company sold its Coventry, England facility for \$2.5 million, resulting in a gain of \$0.9 million. The Company's operations located in a portion of this building have continued to occupy a portion of the facility under a lease arrangement. The operating earnings for the six months ended June 30, 2000, also include approximately \$0.9 million for the cost of employee separations at certain manufacturing plants in England and Ireland. All costs were expended prior to December 31, 2000.



Operating earnings of the Magnetic Products segment decreased from \$7.3 million, or 10.3 percent of sales, for the six months ended June 30, 2000 to \$5.3 million, or 8.1 percent of sales, for the six months ended June 30, 2001. This decrease is the result of lower sales of this segment's higher margin products for telecommunications and computer applications in the electronics markets. Partially offsetting the decrease in operating profit is the improved operating performance by the Company's magnetic wound core manufacturing operation in Adelanto, California. This operation has recorded a small operating profit in 2001 compared to an operating loss of approximately \$1.5 million in the first six months of 2000.

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Summary of the Restructure Actions

As discussed in note 3 to the financial statements, the Company announced plans in June 2001 to restructure and consolidate certain under-performing operations which, when completed, are expected to increase annual operating profit by \$8.8 million and reduce sales revenue by one percent. As a result of these actions, the Company recorded a pretax charge in the second quarter of 2001 of approximately \$10.6 million (\$7.0 million on an after-tax basis or \$0.53 per share) related to headcount reductions, costs to exit the facilities to be closed and writedowns of inventory and other assets associated with the affected product lines. In addition, the Company will incur losses during the wind-down period at the facilities that will be closed and will incur start-up and training costs at those plants where product lines have been transferred. These losses and expenses will be recognized as incurred and will be approximately \$3.9 million (\$2.5 million on an after-tax basis or \$0.19 per share). The Company expects that these actions will be substantially completed by the end of the year. Once completed, this plan is expected to reduce employment by 337 people and reduce annual wages, salaries and fringe benefits by \$13.1 million.

As of June 30, 2001, the Company has incurred \$356 thousand (all for the cost of employee separations) related to the \$10.6 million charge accrued. As of June 30, 2001 the Company has incurred \$550 thousand for wind-down losses of the \$3.9 million estimated to be expensed as incurred.

In the Aerospace Fasteners and Components segment, the Company's facility in Las Vegas, Nevada will be closed. Certain production will be relocated to existing facilities in Montreal, Canada; Salt Lake City, Utah; and Nashville, Tennessee while other production will be discontinued.

In the Engineered Fasteners and Components segment, the Company's facility in Smethwick, England, which manufactures pushrods for gasoline and diesel engines, will be closed and this product line will be relocated to the Company's facility in Shannon, Ireland. The Company's automotive fastener plants in Waterford, Michigan and Cleveland, Ohio will be further integrated and consolidated. The Waterford plant, previously called Terry Machine, was acquired in 1998. The Company's precision tool business, which has grown through acquisitions, also will further integrate product lines and streamline management.

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In the Specialty Materials and Alloys segment, certain high pressure ceramic core product lines will be phased out in order to provide additional manufacturing space, kiln capacity and management and technical resources to support the Company's fast growing low pressure ceramic core business, which manufactures sophisticated cores for industrial gas turbines.

In the Magnetic Products segment, the Company's hard ferrite manufacturing facility in Sevierville, Tennessee will be closed and production of hard ferrite magnets will be transferred to an Asian third party supplier under an exclusive manufacturing and distribution agreement.

#### Other Income and Expense

Due to lower levels of debt, interest expense decreased from \$5.7 million in the second quarter of 2000 to \$5.1 million in the second quarter of 2001. For the six months ended June 30, 2001, average debt and interest expense was consistent with the same period in 2000. In 2000, the Company sold excess land in Brazil and realized a gain of approximately \$570 thousand. This gain is included in the "Other, net" line of the Statement of Consolidated Operations for the six months ended June 30, 2000.

#### Orders and Backlog

Incoming orders for the second quarter of 2001 were \$250.2 million compared to \$237.1 million for the second quarter of 2000, a 5.5 percent increase. Incoming orders for the six months ended June 30, 2001 were \$508.9 million compared to \$460.3 million for the same period in 2000, a 10.6 percent increase. Orders received by companies acquired in 2000 and 2001 (primarily Avibank, DACAR, AAA Aircraft Supply and M. Argüeso & Co., Inc.) increased total Company orders by \$15.3 million in the second quarter and \$40.0 million for the six months ended June 30, 2001. Excluding acquisitions, incoming orders for the Specialty Materials and Alloys segment increased \$0.6 million for the second quarter and \$14.9 million for the six months ended June 30, 2001. The backlog of orders, which represent firm orders with delivery scheduled within 12 months, at June 30, 2001 was \$337.2 million, compared to \$290.2 million on the same day a year ago and \$294.2 million at December 31, 2000.

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#### Acquisitions

As discussed in Note 4 to the financial statements, the Company acquired all of the outstanding stock of M. Argüeso & Co., Inc. (Argüeso) based in Mamaroneck, New York for approximately \$19,600 on April 5, 2001. Argüeso is a manufacturer and distributor of wax blends for use in the investment casting industry. Argüeso's products are used in a variety of investment casting applications in industries such as aerospace, power generation and medical. Argüeso's sales for the twelve months ended December 31, 2000 were approximately \$21.0 million. This acquisition advances the Company's strategy of expanding the breadth of its product offerings and technical support to the investment casting industry.

On February 12, 2001, the Company and a consortium of investors acquired substantially all of the assets and business of AAA Aircraft Supply Co., Inc. (AAA) located in Windsor Locks, Connecticut for \$7.0 million. The Company's ownership percentage is 88.8 percent. AAA is a North American distributor of fasteners sold to the aerospace markets. For the year ended December 31, 2000, AAA sales were approximately \$14.0 million. The acquisition of AAA will improve the Company's ability to supply products on a just-in-time basis to Pratt & Whitney and facilitates the Company's participation in United Technologies' movement towards a Point-of-Service supply concept.

#### Liquidity and Capital Resources

Management considers liquidity to be the ability to generate adequate amounts of cash to meet its needs and capital resources to be the resources from which such cash can be obtained, principally from operating and external sources. The Company believes that capital resources available to it will be sufficient to meet the needs of its business, both on

a short-term and long-term basis.

Cash flow provided or used by operating activities, investing activities and financing activities is summarized in the Condensed Statements of Consolidated Cash Flows. For the six months ended June 30, 2001, net cash provided by operating activities decreased by \$8.1 million compared to the first six months of 2000. This decrease in net cash provided by operations is due primarily to an increase in cash used to fund working capital (\$9.8 million).

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The decrease in cash used in investing activities is due to the cash payment in March 2000 for the acquisition of Avibank (\$112.3 million). Cash payments in 2001 for acquisitions were primarily for AAA Aircraft Supply (\$6.6 million) and Argüeso (\$9.0 million). The Company spent \$18.8 million for capital expenditures in the first six months of 2001 and is forecasting approximately \$48.0 million for the full year of 2001, an increase of \$9.7 million from the 2001 budgeted amount reported on Form 10-K for the year ended December 31, 2000. This increase is primarily the result of the expansion of superalloy production capacity announced on March 29, 2001 and discussed above.

The Company's total debt to equity ratio was 74 percent at June 30, 2001, compared to 75 percent at December 31, 2000. Total debt was \$268.0 million at June 30, 2001 and \$258.2 million at December 31, 2000. As of June 30, 2001, under the terms of its existing credit agreements, the Company is permitted to incur an additional \$174.3 million in debt.

#### Forward-Looking Statements

Certain statements in Management's Discussion and Analysis of Financial Condition and Results of Operations contain "forward-looking" information, within the meaning of the Private Securities Litigation Reform Act of 1995, that involve risk and uncertainty. Statements such as the Company's expectations that the trend of increasing sales by the aerospace fasteners and components segment will continue throughout 2001 and into 2002, delivery of the new vacuum induction melting furnace in December 2001 and its installation resulting in an additional five million pounds of capacity, the trend of lower sales of engineered fasteners and components and magnetic products will continue throughout 2001, further improvement in aerospace operating profit margins for the second half of 2001, operating performance benefits of the 2001 restructuring plan, losses and expenses of approximately \$3.9 million as a result of the restructure actions, completion of the restructure plan by the end of the year, the Company's expectation to reduce employment by 337 people and reduce annual wages, salaries and fringe benefits by \$13.1 million and future benefits from operational synergies with newly acquired companies are "forward-looking" statements contained in Management's Discussion and Analysis of Financial Condition and Results of Operations. Actual future results may differ materially depending on a variety of factors, such as: the effects of competition on products and pricing, fluctuations in raw material prices, customer satisfaction and qualification issues, labor disputes, worldwide political and economic stability, successful execution of the restructuring plan on a timely basis and changes in fiscal policies, laws and regulations on a national and international basis. The Company undertakes no obligation to publicly release any forward-looking information to reflect anticipated or unanticipated events or circumstances after the date of this document.

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SPS Technologies, Inc and Subsidiaries

#### Item 3. Quantitative and Qualitative Disclosures about Market Risk

The Company's primary market risk exposures are foreign currency exchange rate and interest rate risk. Fluctuations in foreign currency exchange rates affect the Company's results of operations and financial position. As discussed in Note 1 to the financial statements on Form 10-K for the year ended December 31, 2000, the Company uses forward exchange contracts and one currency swap agreement to minimize exposure and reduce risk from exchange rate fluctuations affecting the results of operation. Because the largest portion of the Company's foreign operations are in countries with relatively stable currencies, namely, England, Ireland and Canada, the foreign currency exchange rate risk to the Company's financial position is not significant. However, the Company has operations in Brazil, China and other foreign countries which increases its exposure to foreign currency fluctuations. Fluctuations in interest rates primarily affect the Company's results of operations. Because a majority of the Company's debt is in fixed rate obligations (as disclosed in Note 8 to the financial statements on Form 10-K for the year ended December 31, 2000), the Company has effectively limited its exposure to fluctuations in interest rates.

A description of the Company's financial instruments is provided in Notes 1 and 15 to the financial statements on Form 10-K for the year ended December 31, 2000. Assuming an instantaneous 10 percent strengthening of the United States dollar versus foreign currencies for which forward exchange contracts and currency rate swap agreements existed and a 10 percent change in the interest rate on the Company's variable rate debt had all occurred on June 30, 2001, the Company's results of operations, cash flow and financial position would not have been materially affected.

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SPS TECHNOLOGIES, INC. AND SUBSIDIARIES

PART II

OTHER INFORMATION

Item 4. Submission of Matters to Vote of Security Holders

- (a) The Annual Meeting of Shareholders was held on April 30, 2001.
- (b) The name of each director elected at the Annual Meeting as the Company's three Class I directors, each to hold office until the 2004 Annual Meeting of Shareholders, is as follows:

Charles W. Grigg  
Richard W. Kelso  
James W. Zug

The name of each other director whose term of office continued after the meeting is as follows:

Raymond P. Sharpe  
James F. O'Connor  
Harry J. Wilkinson

Eric M. Ruttenberg  
John S. Thompson

(c) 1. The results of the election of directors with respect to each nominee for office was as follows:

	<u>For</u>	<u>Withheld</u>
Charles W. Grigg	10,643,310	1,003,834
Richard W. Kelso	11,569,857	77,287
James W. Zug	11,544,237	102,907

2. A proposal to amend the SPS 1988 Long Term Incentive Stock Plan received 10,814,141 votes for and 695,170 votes against, with 137,833 abstentions and 0 broker non-votes.

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SPS TECHNOLOGIES, INC. AND SUBSIDIARIES

PART II

OTHER INFORMATION

Item 6. Exhibits and Reports on Form 8-K

(a) Exhibits  
NONE.

(b) The following reports on Form 8-K were filed during the quarter ended June 30, 2001:

(1) A Form 8-K was filed on April 9, 2001, stating that the Company entered into an Amended and Restated Rights Agreement, effective April 6, 2001 between SPS Technologies, Inc. and Mellon Investor Services LLC as Rights Agent, that effects: 1) the change of name of ChaseMellon Shareholders Services, L.L.C. to Mellon Investor Services LLC, and 2) the deletion of the requirement that the Continuing Directors approve redemption of the Rights following a Stock Acquisition Date. This Agreement was filed as Exhibit 1 to the Company's Form 8-A/A filed on April 9, 2001, and incorporated herein by reference.

(2) A Form 8-K was filed on June 11, 2001, stating that the Company issued a press release on June 6, 2001. The press release was filed as Exhibit 99.1 to the Company's Form 8-K filed on June 11, 2001, and incorporated herein by reference.

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SPS TECHNOLOGIES, INC. AND SUBSIDIARIES

SIGNATURES

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

SPS TECHNOLOGIES, INC.  
(Registrant)

Date: August 6, 2001

\s\William M. Shockley  
William M. Shockley  
Vice President,  
Chief Financial Officer

Mr. Shockley is signing on behalf of the registrant and as the Chief Financial Officer of the registrant.