

NATIONAL PRESTO INDUSTRIES INC  
Form 10-Q  
October 09, 2007

**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 October 1, 2006
- TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE TRANSITION PERIOD FROM \_\_\_\_ TO \_\_\_\_

Commission file number 1-2451

**NATIONAL PRESTO INDUSTRIES, INC.**

(Exact name of registrant as specified in its charter)

**WISCONSIN**

(State or other jurisdiction of incorporation or organization)

**39-0494170**

(I.R.S. Employer Identification No.)

**3925 NORTH HASTINGS WAY**

**EAU CLAIRE, WISCONSIN**

(Address of principal executive offices)

**54703-3703**

(Zip Code)

(Registrant's telephone number, including area code) 715-839-2121

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 \*

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Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer. See definition of "accelerated filer and large accelerated filer" in Rule 12b-2 of the Exchange Act.

Large accelerated filer                       Accelerated filer                       Non-accelerated filer

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).  
Yes     No

There were 6,836,688 shares of the Issuer's Common Stock outstanding as of August 29, 2007.

\* The following reports have not been filed: two quarterly Form 10-Q reports for 2007.

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### PART I FINANCIAL INFORMATION

**EXPLANATORY NOTE** The Company filed a Form 8-K containing financial information for the quarterly period ended October 1, 2006 on November 13, 2006. This report on Form 10-Q differs from the previously reported quarterly financial information as a result of several balance sheet and statement of cash flow restatements pertaining to the reclassification of 7-day variable rate demand notes to marketable securities, a change in goodwill and the product liability insurance reserve, along with the attendant effects on deferred taxes, stockholders' equity, and cash flows from operating and financing activities. (For a more detailed explanation, see the registrant's annual report on Form 10-K/A for the year ended December 31, 2005, Item 9A and Footnote R). Certain assets and liabilities have also been adjusted to reflect the final allocation of the Amron purchase price. In addition, it should be noted that the Form 10-K for the year ending December 31, 2006 was filed prior to the filing of this quarterly statement. Comments are also provided on what are now subsequent events which had not occurred as of the date the Form 8-K was filed.

### ITEM 1. FINANCIAL STATEMENTS

NATIONAL PRESTO INDUSTRIES, INC. AND SUBSIDIARIES

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CONSOLIDATED BALANCE SHEETS

October 1, 2006 and December 31, 2005

(Unaudited)

(Dollars in thousands)

|                                      | 2006     |           | 2005     |           |
|--------------------------------------|----------|-----------|----------|-----------|
| <b>ASSETS</b>                        |          |           |          |           |
| <b>CURRENT ASSETS:</b>               |          |           |          |           |
| Cash and cash equivalents            |          | \$41,528  |          | \$62,023  |
| Marketable securities                |          | 80,589    |          | 111,552   |
| Accounts receivable, net             |          | 57,434    |          | 32,284    |
| Inventories:                         |          |           |          |           |
| Finished goods                       | \$41,776 |           | \$20,771 |           |
| Work in process                      | 21,087   |           | 8,431    |           |
| Raw materials                        | 9,262    | 72,125    | 8,477    | 37,679    |
| Other current assets                 |          | 6,129     |          | 9,687     |
| Total current assets                 |          | 257,805   |          | 253,225   |
| <b>PROPERTY, PLANT AND EQUIPMENT</b> | 86,726   |           | 68,102   |           |
| Less allowance for depreciation      | 22,804   | 63,922    | 17,618   | 50,484    |
| <b>GOODWILL</b>                      |          | 5,086     |          | 3,556     |
| <b>OTHER ASSETS</b>                  |          | 150       |          | 150       |
|                                      |          | \$326,963 |          | \$307,415 |

The accompanying notes are an integral part of the financial statements.

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(Dollars in thousands)

|   | 2006       | 2005       |
|---|------------|------------|
| LIABILITIES                                   |            |            |
| CURRENT LIABILITIES:                          |            |            |
| Accounts payable                              | \$ 38,300  | \$ 18,084  |
| Federal and state income taxes                | 5,141      | 8,282      |
| Accrued liabilities                           | 18,082     | 14,138     |
| Total current liabilities                     | 61,523     | 40,504     |
| DEFERRED INCOME TAXES                         | 376        | 376        |
| COMMITMENTS AND CONTINGENCIES                 |            |            |
| STOCKHOLDERS EQUITY                           |            |            |
| Common stock, \$1 par value:                  |            |            |
| Authorized: 12,000,000 shares                 |            |            |
| Issued: 7,440,518 shares                      | \$ 7,441   | \$ 7,441   |
| Paid-in capital                               | 1,239      | 1,135      |
| Retained earnings                             | 275,270    | 277,033    |
| Accumulated other comprehensive income (loss) | (28 )      | (141 )     |
|   | 283,922    | 285,468    |
| Treasury stock, at cost                       | 18,858     | 18,933     |
| Total stockholders equity                     | 265,064    | 266,535    |
|   | \$ 326,963 | \$ 307,415 |

The accompanying notes are an integral part of the financial statements.

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NATIONAL PRESTO INDUSTRIES, INC.

CONSOLIDATED STATEMENTS OF EARNINGS

Three Months and Nine Months Ended October 1, 2006 and October 2, 2005

(Unaudited)

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(In thousands except per share data)

|   | Three Months Ended |          | Nine Months Ended |           |
|---|--------------------|----------|-------------------|-----------|
|   | 2006               | 2005     | 2006              | 2005      |
| Net sales   | \$81,531           | \$39,545 | \$184,598         | \$109,573 |
| Cost of sales                                     | 65,706             | 32,484   | 154,578           | 92,441    |
| Gross profit                                      | 15,825             | 7,061    | 30,020            | 17,132    |
| Selling and general expenses                      | 5,918              | 4,350    | 15,999            | 13,427    |
| Operating profit                                  | 9,907              | 2,711    | 14,021            | 3,705     |
| Other income                                      | 1,085              | 1,014    | 4,470             | 3,359     |
| Earnings before provision for income taxes        | 10,992             | 3,725    | 18,491            | 7,064     |
| Income tax provision                              | 3,812              | 1,068    | 5,779             | 1,557     |
| Net earnings                                      | \$7,180            | \$2,657  | \$12,712          | \$5,507   |
| Weighted average shares outstanding:              |                    |          |                   |           |
| Basic   | 6,832              | 6,826    | 6,831             | 6,825     |
| Diluted   | 6,833              | 6,828    | 6,832             | 6,827     |
| Net earnings per share:                           |                    |          |                   |           |
| Basic   | \$1.05             | \$0.39   | \$1.86            | \$0.81    |
| Diluted   | \$1.05             | \$0.39   | \$1.86            | \$0.81    |
| Cash dividends declared and paid per common share | \$                 | \$       | \$2.12            | \$1.67    |

The accompanying notes are an integral part of the financial statements.

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NATIONAL PRESTO INDUSTRIES, INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

Nine Months Ended October 1, 2006 and October 2, 2005

(Unaudited)

(Dollars in thousands)

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|   | 2006      |   | 2005     |
|---|-----------|---|----------|
| Cash flows from operating activities:   |           |   |          |
| Net earnings  | \$ 12,712 |   | \$ 5,507 |
| Adjustments to reconcile net earnings to net cash provided by operating activities: |           |   |          |
| Provision for depreciation  | 5,700     |   | 3,117    |
| Other   | 269       |   | 248      |
| Changes in:   |           |   |          |
| Accounts receivable   | (24,926   | ) | 4,522    |
| Inventories   | (32,537   | ) | (21,590  |
| Other current assets  | 1,066     |   | (322     |
| Accounts payable and accrued liabilities  | 23,016    |   | (157     |
| Federal and state income taxes  | (3,141    | ) | (3,378   |
| Net cash used in operating activities   | (17,841   | ) | (12,053  |
| Cash flows from investing activities:   |           |   |          |
| Marketable securities purchased   | (15,509   | ) | (68,987  |
| Marketable securities - maturities and sales  | 46,645    |   | 90,476   |
| Acquisition of property, plant and equipment  | (5,462    | ) | (8,819   |
| Acquisition of businesses, net of cash acquired                                     | (13,834   | ) | (1,500   |
| Sale of property, plant and equipment   | 6         |   | 9        |
| Net cash provided by investing activities   | 11,846    |   | 11,179   |
| Cash flows from financing activities:   |           |   |          |
| Dividends paid  | (14,476   | ) | (11,393  |
| Other   | (24       | ) | (73      |
| Net cash used in financing activities   | (14,500   | ) | (11,466  |
| Net decrease in cash and cash equivalents   | (20,495   | ) | (12,340  |
| Cash and cash equivalents at beginning of period                                    | 62,023    |   | 17,516   |
| Cash and cash equivalents at end of period  | \$ 41,528 |   | \$ 5,176 |

The accompanying notes are an integral part of the financial statements.

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NATIONAL PRESTO INDUSTRIES, INC., AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE A EARNINGS PER SHARE

The Company's basic net earnings per share amounts have been computed by dividing net earnings by the weighted average number of outstanding common shares. The Company's diluted net earnings per share is computed by dividing net earnings by the weighted average number of outstanding common shares and common share equivalents relating to stock options, when dilutive.

NOTE B BUSINESS SEGMENTS

In the following summary, operating profit (loss) represents earnings (loss) before other income, principally interest income and income taxes. The Company's segments operate discretely from each other with no shared manufacturing facilities. Costs associated with corporate activities (such as cash and marketable securities management) are included within housewares/small appliances for all periods presented.

|                                      | (in thousands) |          |           |          |
|--------------------------------------|----------------|----------|-----------|----------|
|                                      | Housewares/    |          |           |          |
|                                      | Small          | Defense  | Absorbent |          |
|                                      | Appliances     | Products | Products  | Total    |
| <b>Quarter ended October 1, 2006</b> |                |          |           |          |
| External net sales                   | \$29,264       | \$38,392 | \$13,875  | \$81,531 |
| Gross profit (loss)                  | 7,765          | 9,028    | (968)     | ) 15,825 |
| Operating profit (loss)              | 4,444          | 6,635    | (1,172)   | ) 9,907  |
| Total assets                         | 204,403        | 74,037   | 48,523    | 326,963  |
| Depreciation                         | 201            | 398      | 1,269     | 1,868    |
| Capital expenditures                 | 461            | 1,341    | 289       | 2,091    |
| <b>Quarter ended October 2, 2005</b> |                |          |           |          |
| External net sales                   | \$22,666       | \$8,709  | \$8,170   | \$39,545 |
| Gross profit (loss)                  | 6,005          | 2,224    | (1,168)   | ) 7,061  |
| Operating profit (loss)              | 2,756          | 1,345    | (1,390)   | ) 2,711  |
| Total assets                         | 217,942        | 24,775   | 48,478    | 291,195  |
| Depreciation                         | 236            | 77       | 707       | 1,020    |
| Capital expenditures                 | 197            | 387      | 3,009     | 3,593    |

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|  | (in thousands) |          |           |           |
|--|----------------|----------|-----------|-----------|
|  | Housewares/    |          |           |           |
|  | Small          | Defense  | Absorbent |           |
|  | Appliances     | Products | Products  | Total     |
| <b>Nine Months ended October 1, 2006</b> |                |          |           |           |
| External net sales                       | \$65,020       | \$82,154 | \$37,424  | \$184,598 |
| Gross profit (loss)                      | 15,270         | 18,656   | (3,906)   | ) 30,020  |
| Operating profit (loss)                  | 5,316          | 13,269   | (4,564)   | ) 14,021  |
| Total assets                             | 204,403        | 74,037   | 48,523    | 326,963   |
| Depreciation                             | 604            | 1,294    | 3,802     | 5,700     |
| Capital expenditures                     | 1,085          | 3,735    | 642       | 5,462     |
| <b>Nine Months ended October 2, 2005</b> |                |          |           |           |
| External net sales                       | \$58,022       | \$25,559 | \$25,992  | \$109,573 |
| Gross profit (loss)                      | 13,250         | 6,142    | (2,260)   | ) 17,132  |

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|                         |         |        |        |   |         |
|-------------------------|---------|--------|--------|---|---------|
| Operating profit (loss) | 3,069   | 3,527  | (2,891 | ) | 3,705   |
| Total assets            | 217,942 | 24,775 | 48,478 |   | 291,195 |
| Depreciation            | 809     | 220    | 2,088  |   | 3,117   |
| Capital expenditures    | 526     | 887    | 7,406  |   | 8,819   |

NOTE C PRODUCT WARRANTY

The Company's Housewares/Small Appliance Segment's products are generally warranted to the original owner to be free from defects in material and workmanship for a period of 1 to 12 years from date of purchase. The Company allows a 60-day over-the-counter initial return privilege through cooperating dealers. The Company services its products through a corporate service repair operation. The Company's service and warranty programs are competitive with those offered by other manufacturers in the industry. The Company determines its product warranty liability based on historical percentages which have remained relatively consistent over the years.

The product warranty liability is included in accounts payable on the balance sheet. The following table shows the changes in product warranty liability for the period:

|  | (in thousands) |          |
|--|----------------|----------|
|  | 2006           | 2005     |
| Beginning balance January 1                  | \$2,033        | \$1,698  |
| Accruals during the period                   | 1,867          | 1,694    |
| Charges / payments made under the warranties | (1,665 )       | (1,584 ) |
| Balance end of period                        | \$2,235        | \$1,808  |

NOTE D PLANT CLOSING

In November 2001, the Company announced that continued erosion of product pricing resulted in its decision to cease manufacturing housewares/small appliances in its U.S. plants, close those facilities, and purchase most products from the Orient. This transition from U.S. plant production to the Orient was completed during late 2002. The Company closed its manufacturing facilities in Alamogordo, New Mexico, during the third quarter of 2002 and donated the facility to the Otero County Economic Development Council during the fourth quarter of 2004. The Company effectively closed its Jackson, Mississippi, plant during the fourth quarter of 2002 and has modified this plant to serve as a warehousing and shipping facility.

The following table summarizes the plant closing accrual activities for the periods presented:

| (in thousands) | Total |
|----------------|-------|
|----------------|-------|



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|                         | <b>Employee<br/>Termination<br/>Benefits</b> |   | <b>Other<br/>Exit<br/>Costs</b> |        |
|-------------------------|--|---|---------------------------------|--------|
| Balance January 1, 2006 | \$ 385                                       |   | \$                              | \$ 385 |
| Charges in 2006         | (29)   | ) |                                 | (29)   |
| Balance October 1, 2006 | \$ 356                                       |   | \$                              | \$ 356 |
| Balance January 1, 2005 | \$ 470                                       |   | \$ 60                           | \$ 530 |
| Charges in 2005         | (67)   | ) | (60)                            | (127)  |
| Balance October 2, 2005 | \$ 403                                       |   | \$                              | \$ 403 |

The remaining employee termination benefits are for health care costs for workers who accepted early retirement at the time of the plant closing and will be extinguished over approximately the next two years.

On October 9, 2006, the Company decided to consolidate its adult incontinence production capabilities and, as a result, has begun the process of relocating its adult incontinence manufacturing equipment from its Marietta, Georgia facility to its Eau Claire, Wisconsin facility. This consolidation will take place during the 4th quarter of 2006 and the 1st quarter of 2007 and should ultimately help to improve the absorbent products segment's long-term manufacturing efficiencies. The company issued a W.A.R.N. (Worker Adjustment and Retraining Notification) notice on October 9, 2006. The Company subsequently during fourth quarter 2006, estimated the total cost of the relocation activities to be \$1,019,000, including \$829,000 for the disassembly, transportation, installation of machinery and equipment and other related costs and \$190,000 for one-time termination benefits to affected employees.

**NOTE E COMMITMENTS AND CONTINGENCIES**

On July 16, 2002, the Securities and Exchange Commission (SEC) filed a lawsuit in the federal district court in Chicago, Illinois, against National Presto Industries, Inc. alleging the Company operated as an unregistered investment company from 1992 through 2002. The case did not involve fraud, deceptive practices, or questionable accounting methods. The federal district judge granted the SEC's motion for summary judgment on October 31, 2005. On December 23, 2005, the judge ordered the Company to register under the Investment Company Act. As he barred the Company from operating in interstate commerce until the filing was completed, the Company immediately filed the requisite application, albeit under protest, indicating that it did not meet the filing criteria. The Company filed a notice of appeal from the decision to the Federal Circuit Court of Appeals in the 7th Circuit. On May 15, 2007, the appellate court reversed the lower court, ruling that the Company is not and has never been an investment company and that the Company was free to drop its registration under the Investment Company Act and operate under the Securities Exchange Act of 1934 whether or not the SEC gave its formal approval to that step. The decision is final as the time to request a rehearing en banc before the full panel of judges of the 7th Circuit and to petition the Supreme Court for a writ of mandamus has expired.

Prior to the appellate court's decision, there was considerable discussion between the Company's outside counsel and the SEC staff on the manner in which financial information was to be presented during the period in which the appeal was pending. As a result of the controversy surrounding the SEC's staff's ultimate mandate that an investment company footnote be inserted into the Company's financial statements for the year ended December 31, 2005, the Company's predecessor independent registered public accountant, Grant Thornton LLP, withdrew its opinion for the years ending December 31, 2005, 2004, and 2003. Subsequently, the firm withdrew from the audit engagement as well. Despite the 7th Circuit Court of Appeals' decision, Grant Thornton LLP would not reinstate its opinions, necessitating the reaudit of all three years which in turn has delayed the re-filing of the Form 10-K/A for 2005, the filing of the Form 10-K for 2006, and the Form 10-Q's for 2006 and 2007. Timely filing of annual reports is a New York Stock Exchange requirement for maintenance of a listing. The Exchange has provided the Company with an extension until September 15, 2007 to file its 2006 annual report. The Exchange had provided the Company with an extension until September 15, 2007 to file its 2006 annual report which was met when the Form 10-K for the year ending December 31, 2006 was filed on August 27, 2007.

In addition, the Company is involved in other routine litigation incidental to its business. Management believes the ultimate outcome of this litigation will not have a material effect on the Company's consolidated financial position, liquidity, or results of operations.

NOTE F ACCUMULATED OTHER COMPREHENSIVE INCOME

The \$28,000 of accumulated comprehensive loss at October 1, 2006 reflects the unrealized loss, net of tax, of available-for-sale marketable security investments. Total comprehensive income net of tax effect was \$7,257,000 and \$2,764,000 for the three-month periods ended October 1, 2006 and October 2, 2005, respectively, and \$12,825,000 and \$5,689,000 for the nine-month periods ended October 1, 2006 and October 2, 2005, respectively.

NOTE G ADOPTION OF NEW ACCOUNTING STANDARDS

FIN 48

The Financial Accounting Standards Board (FASB) has published FASB Interpretation (FIN) No. 48 (FIN No. 48), Accounting for Uncertainty in Income Taxes, to address the noncomparability in reporting tax assets and liabilities resulting from a lack of specific guidance in FASB Statement of Financial Accounting Standards (SFAS) No. 109 (SFAS No. 109), Accounting for Income Taxes, on the uncertainty in income taxes recognized in an enterprise's financial statements. Specifically, FIN No. 48 prescribes (a) a consistent recognition threshold and (b) a measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return, and provides related guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure, and transition. FIN No. 48 will apply to fiscal years beginning after December 15, 2006, with earlier adoption permitted. The Company is currently evaluating the effect of adopting FIN No. 48 on its consolidated financial statements.

FASB 157

The Financial Accounting Standards Board (FASB) has issued Statement of Financial Accounting Standards (SFAS) No. 157 (SFAS No. 157), *Fair Value Measurements*, to eliminate the diversity in practice that exists due to the different definitions of fair value and the limited guidance for applying those definitions in GAAP that are dispersed among the many accounting pronouncements that require fair value measurements. SFAS No. 157 retains the exchange price notion in earlier definitions of fair value, but clarifies that the exchange price is the price in an orderly transaction between market participants to sell an asset or liability in the principal or most advantageous market for the asset or liability. Moreover, the SFAS states that the transaction is hypothetical at the measurement date, considered from the perspective of the market participant who holds the asset or liability. Consequently, fair value is defined as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date (an exit price), as opposed to the price that would be paid to acquire the asset or received to assume the liability at the measurement date (an entry price).

SFAS No. 157 also stipulates that, as a market-based measurement, fair value measurement should be determined based on the assumptions that market participants would use in pricing the asset or liability, and establishes a fair value hierarchy that distinguishes between (a) market

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participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (b) the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). Finally, SFAS No. 157 expands disclosures about the use of fair value to measure assets and liabilities in interim and annual periods subsequent to initial recognition. Entities are encouraged to combine the fair value information disclosed under SFAS No. 157 with the fair value information disclosed under other accounting pronouncements, including SFAS No. 107, *Disclosures about Fair Value of Financial Instruments*, where practicable. The guidance in this Statement applies for derivatives and other financial instruments measured at fair value under SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*, at initial recognition and in all subsequent periods.

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SFAS No. 157 is effective for financial statements issued for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, although earlier application is encouraged. Additionally, prospective application of the provisions of SFAS No. 157 is required as of the beginning of the fiscal year in which it is initially applied, except when certain circumstances require retrospective application. The Company does not expect the adoption of SFAS No. 157 to have a material effect on its consolidated financial statements.

### FASB 158

The Financial Accounting Standards Board (FASB) has issued Statement of Financial Accounting Standards (SFAS) No. 158 (SFAS No. 158), *Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans*, to require an employer to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare, and other postretirement plans in their financial statements. Previous standards required an employer to disclose the complete funded status of its plan only in the notes to the financial statements. Moreover, because those standards allowed an employer to delay recognition of certain changes in plan assets and obligations that affected the costs of providing benefits, employers reported an asset or liability that almost always differed from the plan's funded status. Under SFAS No. 158, a defined benefit postretirement plan sponsor that is a public or private company or a nongovernmental not-for-profit organization must (a) recognize in its statement of financial position an asset for a plan's overfunded status or a liability for the plan's underfunded status, (b) measure the plan's assets and its obligations that determine its funded status as of the end of the employer's fiscal year (with limited exceptions), and (c) recognize, as a component of other comprehensive income, the changes in the funded status of the plan that arise during the year but are not recognized as components of net periodic benefit cost pursuant to SFAS No. 87, *Employers' Accounting for Pensions*, or SFAS No. 106, *Employers' Accounting for Postretirement Benefits Other Than Pensions*. SFAS No. 158 also requires an employer to disclose in the notes to financial statements additional information on how delayed recognition of certain changes in the funded status of a defined benefit postretirement plan affects net periodic benefit cost for the next fiscal year. Under SFAS No. 158, an employer with publicly traded equity securities is required to initially recognize the funded status of a defined benefit postretirement plan and to provide the required disclosures as of the end of the fiscal year ending after December 15, 2006. Because the Company terminated its pension plan in 2004, the Company does not expect the adoption of SFAS No. 158 to have a material effect on its consolidated financial statements.

### FASB 159

In February 2007, the Financial Accounting Standards Board (FASB) issued Statement of Financial Accounting Standards (SFAS) No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities - Including an amendment of FASB Statement No. 115 (SFAS No. 159)*. SFAS No. 159 permits entities to elect to measure many financial instruments and certain other items at fair value. Upon adoption of SFAS No. 159, an entity may elect the fair value option for eligible items that exist at the adoption date. Subsequent to the initial adoption, the election of the fair value option may only be made at initial recognition of the asset or liability or upon a re-measurement event that gives rise to new-basis accounting. The decision about whether to elect the fair value option is applied on an instrument-by-instrument basis, is irrevocable and is applied only to an entire instrument and not only to specified risks, cash flows or portions of that instrument. SFAS No. 159 does not affect any existing accounting literature that requires certain assets and liabilities to be carried at fair value nor does it eliminate disclosure requirements included in other accounting standards. SFAS No. 159 is effective for fiscal years beginning after November 15, 2007. The Company is

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currently evaluating the impact of adopting SFAS No. 159 on its respective financial position and results of operations.

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### NOTE H BUSINESS ACQUISITION

On January 30, 2006, the Company purchased the assets of Amron, LLC, an Antigo, Wisconsin defense manufacturer of cartridge cases used in medium caliber (20-40mm) ammunition. The acquisition enhances the Company's position as a viable competitive force in medium caliber ammunition programs of the U.S. Department of Army. The original purchase price was \$24,000,000, consisting of a \$16,000,000 payment at closing and an \$8,000,000 earn-out amount, which was to be paid based upon certain earnings targets through December 31, 2010. A \$4,000,000 earn-out was accrued at December 31, 2006 and paid during the 1st quarter of 2007. On April 13, 2007, the Company reached an agreement with the seller, whereby the remaining \$4,000,000 earnout obligation was settled by a payment of \$2,400,000. Accordingly, the adjusted purchase price is \$22,400,000. The accrued earn-out at December 31, 2006 was added to goodwill. Likewise, the earn-out settlement payment made during the second quarter of 2007 will also be added to goodwill.

The acquisition was accounted for as a purchase with all assets recorded at fair market value. The excess of the purchase price over the net tangible assets has been recorded as goodwill and is included as part of the Company's defense products segment. The amounts allocated to goodwill are deductible for income tax purposes. Based upon the purchase price and fair value of the assets acquired, the following represents the allocation of the aggregate purchase price to the acquired net assets of Amron, LLC. This allocation differs from what was previously reported primarily because of appraisals of property plant and equipment that were finalized during the 4th quarter and adjustments to the purchase price.

|                                   | <b>(in thousands)</b> |
|-----------------------------------|-----------------------|
| Receivables                       | \$ 224                |
| Inventory                         | 1,909                 |
| Prepays                           | 68                    |
| Fixed Assets                      | 13,748                |
| Goodwill                          | 1,529                 |
| Total Assets Acquired             | \$ 17,478             |
| Less: Current Liabilities Assumed | (1,478 )              |
| Net Assets Acquired               | \$ 16,000             |

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The results of operations for the Company include those of Amron, LLC as of the date of closing. The following pro forma condensed consolidated results of operations have been prepared as if the acquisition of Amron had occurred as of January 1, 2005.

The unaudited pro forma condensed consolidated results of operations are not necessarily indicative of results that would have occurred had the acquisition occurred as of January 1, 2005, nor are they necessarily indicative of the results that may occur in the future.

|                                      | <b>(in thousands, except per share data)</b> |                        |
|--------------------------------------|--|------------------------|
|                                      | <b>Quarter Ending</b>                        | <b>Quarter Ending</b>  |
|                                      | <b>October 1, 2006</b>                       | <b>October 2, 2005</b> |
| Net Sales                            | \$81,531                                     | \$45,616               |
| Net Earnings                         | 7,180  | 2,739                  |
| Net Earnings per Share:              |  |                        |
| Basic                                | \$ 1.05                                      | \$ 0.40                |
| Diluted                              | 1.05   | 0.40                   |
| Weighted Average Shares Outstanding: |  |                        |
| Basic                                | 6,832  | 6,826                  |
| Diluted                              | 6,833  | 6,828                  |

|                                      | <b>(unaudited)</b>                           |                        |
|--------------------------------------|--|------------------------|
|                                      | <b>(in thousands, except per share data)</b> |                        |
|                                      | <b>Nine Months</b>                           | <b>Nine Months</b>     |
|                                      | <b>Ending</b>                                | <b>Ending</b>          |
|                                      | <b>October 1, 2006</b>                       | <b>October 2, 2005</b> |
| Net Sales                            | \$ 187,369                                   | \$ 129,147             |
| Net Earnings                         | 12,776                                       | 5,890                  |
| Net Earnings per Share:              |  |                        |
| Basic                                | \$ 1.87                                      | \$ 0.86                |
| Diluted                              | 1.87   | 0.86                   |
| Weighted Average Shares Outstanding: |  |                        |
| Basic                                | 6,831  | 6,825                  |
| Diluted                              | 6,832  | 6,827                  |

The foregoing information for the periods ended October 1, 2006, and October 2, 2005, is unaudited; however, in the opinion of management of the Registrant, it reflects all the adjustments, which were of a normal recurring nature, necessary for a fair statement of the results for the interim periods. The condensed consolidated balance sheet as of December 31, 2005, is summarized from consolidated financial statements, but does not include all the disclosures contained therein and should be read in conjunction with the 2005 annual report on Form 10-K/A. Interim results for the period are not indicative of those for the year.

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

Forward-looking statements in this Management's Discussion and Analysis of Financial Condition and Results of Operations, elsewhere in this Form 10-Q, in the Company's 2006 Annual Report to Shareholders, in the Proxy Statement for the annual meeting held May 16, 2006, and in the Company's press releases and oral statements made with the approval of an authorized executive officer are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. There are certain important factors that could cause results to differ materially from those anticipated by some of the statements made herein. Investors are cautioned that all forward-looking statements involve risks and uncertainty. In addition to the factors discussed herein and in the notes to consolidated financial statements, among the other factors that could cause actual results to differ materially are the following: consumer spending and debt levels; interest rates; continuity of relationships with and purchases by major customers; product mix; the benefit and risk of business acquisitions; competitive pressure on sales and pricing; increases in material, freight/shipping, or production cost which cannot be recouped in product pricing; delays or interruptions in shipping or production from machine issues work or labor disruptions stemming from a unionized work force; changes in government requirements and funding of government contracts, failure of subcontractors or vendors to perform as required by contract; and the efficient start-up and utilization of capital equipment investments. Additional information concerning these and other factors is contained in the Company's Securities and Exchange Commission filings, copies of which are available from the Company without charge.

### Comparison Third Quarter 2006 and 2005

Readers are directed to Note B, Business Segments for data on the financial results of the Company's three business segments for the Quarters ended October 1, 2006 and October 2, 2005.

On a consolidated basis, sales increased by \$41,986,000 (106%), gross margins increased by \$8,764,000 (124%), selling and general expense increased by \$1,568,000 (36%), and other income increased by \$71,000 (7%). Earnings before the provision for income taxes increased by \$7,267,000 (195%), as did net earnings by \$4,523,000 (170%). Details concerning these changes can be found in the comments by segment below.

Housewares/small appliance net sales increased \$6,598,000 from \$22,666,000 to \$29,264,000, or 29%, primarily the result of an increase in units shipped. Defense net sales increased by \$29,683,000 from \$8,709,000 to \$38,392,000, or 341%, with approximately 65% of the increase attributable to sales related to the US Department of the Army 40mm Systems program and the remaining increase largely stemming from the expansion of the defense segment with the acquisition of Amron, LLC. (See Note H.) Absorbent products net sales increased by \$5,705,000 from \$8,170,000 to \$13,875,000, or 70%, primarily reflecting increased sales from the adult incontinence line of products.

Housewares/small appliance gross profits increased \$1,760,000 from \$6,005,000 (27% of sales) to \$7,765,000 (27% of sales), reflecting the increased sales volume mentioned above. Defense gross profits increased \$6,804,000 from \$2,224,000 (26% of sales) from the prior year's quarter to \$9,028,000 (24% of sales). The dollar increase likewise reflected the increased sales referenced above. Absorbent products improved slightly by \$200,000 from a negative \$1,168,000 to a negative \$968,000. The negative gross margins stemmed primarily from increased material costs, increased depreciation costs, and cost inefficiencies of a startup/learning curve nature related to the ramp-up of new state-of-the-art machinery.

The Company accrues for unexpended selling and advertising costs, primarily for housewares/small appliances, budgeted for the year against each quarter's sales. Selling and advertising charges included in selling expense in each quarter represent that percentage of the annual sales and advertising budget associated with that quarter's shipments. Revisions to this budget result in periodic changes to the accrued liability for committed selling and advertising expenditures. Housewares/small appliance selling and general expenses were relatively flat. Defense segment selling and general expenses increased by \$1,514,000, reflecting increased compensation and staffing commensurate with the segment's

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increased sales and earnings levels, as well as an incentive to key executives to promote rapid growth of the business, and the addition of Amron, LLC. (See Note H.) Absorbent segment selling and general expenses were also relatively flat.

The above items were responsible for the change in operating profit.

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Other income increased \$71,000 or 7%. The Company realized higher interest income from increased yields despite the fact that there were reduced dollars invested (due to the use of funds for expansion of the defense and absorbent products segments).

Earnings before provision for income taxes increased \$7,267,000 from \$3,725,000 to \$10,992,000. The provision for income taxes increased from \$1,068,000 to \$3,812,000, which resulted in an effective income tax rate increase from 29% to 35% as a result of increased earnings subject to income tax. Net earnings increased \$4,523,000 from \$2,657,000 to \$7,180,000, or 170%.

### Comparison of First Nine Months 2006 and 2005

Readers are directed to Note B, Business Segments for data on the financial results of the Company's three business segments for the Nine Months ended October 1, 2006 and October 2, 2005.

On a consolidated basis, sales increased by \$75,025,000 (69%), gross margins increased by \$12,888,000 (75%), selling and general expense increased by \$2,572,000 (19%), and other income increased by \$1,111,000 (33%). Earnings before the provision for income taxes increased by \$11,427,000 (162%), as did net earnings by \$7,205,000 (131%). Details concerning these changes can be found in the comments by segment below.

Housewares/small appliance net sales increased \$6,998,000 from \$58,022,000 to \$65,020,000, or 12%, primarily the result of an increase in units shipped. Defense net sales increased by \$56,595,000 from \$25,559,000 to \$82,154,000, or 221%, with approximately 60% of the increase attributable to sales related to the US Department of the Army 40mm Systems program and the remaining increase largely stemming from the expansion of the defense segment with the acquisition of Amron, LLC. (See Note H.) Absorbent products net sales increased by \$11,432,000 from \$25,992,000 to \$37,424,000, or 44%, primarily reflecting increased sales from the adult incontinence line of products.

Housewares/small appliance gross profits increased by \$2,020,000 from \$13,250,000 (23% of sales) to \$15,270,000 (24% of sales), reflecting the increased sales volume mentioned above. Defense gross profits increased \$12,514,000 from \$6,142,000 (24% of sales) from the prior period to \$18,656,000 (23% of sales). The dollar increase likewise reflected the increased sales referenced above. Absorbent products gross profit dropped \$1,646,000 to a negative \$3,906,000. The decline stemmed primarily from increased material costs, increased depreciation costs, and cost inefficiencies of a startup/learning curve nature related to the ramp-up of new state-of-the-art machinery.

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The accrual for unexpended advertising costs discussed in the Third Quarter comparison also applies to the first nine months. Housewares/small appliance selling and general expenses decreased \$227,000, largely attributable to decreases in the aforementioned accrual. Defense segment selling and general expenses increased by \$2,772,000, reflecting increased compensation and staffing commensurate with the segment's increased sales, as well as an incentive to key executives to promote rapid growth of the business, and earnings levels. Absorbent segment selling and general expenses were relatively flat.

The above items were responsible for the change in operating profit.

Other income increased \$1,111,000 or 33% as a result of higher interest income of \$536,000 resulting from increased yields on reduced dollars invested (due to the use of funds for expansion of the defense and absorbent products segments) and the receipt and recognition of approximately \$500,000 of insurance proceeds related to a 2004 loss of manufacturing equipment.

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Earnings before provision for income taxes increased \$11,427,000 from \$7,064,000 to \$18,491,000. The provision for income taxes increased from \$1,557,000 to \$5,779,000, which resulted in an effective income tax rate increase from 22% to 31% as a result of increased earnings subject to tax. Net earnings increased \$7,205,000 from \$5,507,000 to \$12,712,000, or 131%.

### **Liquidity and Capital Resources**

Cash used in operating activities was \$17,841,000 during the first nine months of 2006, as compared to \$12,053,000 used during the first nine months of 2005. The principal factors behind the increase in cash used can be found in the changes in the components of working capital within the Consolidated Statement of Cash Flows.

Net cash provided by investing activities during the first nine months of 2006 was \$11,846,000, as compared to \$11,179,000 during the first nine months of 2005. The change is attributable to two factors, one of which served to partially offset the other. First, more instruments matured and were placed in cash equivalents during the review period than in the prior year's period. The second and partially offsetting factor was the larger cash outlay experienced in the current review period stemming from the acquisition of Amron, LLC (see Note H) compared to the prior year's level of cash outlays for equipment used in the expansion of the absorbent products segment and modification of the Jackson, Mississippi plant to a warehousing and shipping facility.

Based on the accounting profession's 2005 interpretation of cash equivalents under FASB Statement No. 95, the company's variable rate demand notes have been classified as marketable securities. This interpretation, which is contrary to the interpretation that the Company's representative received directly from the FASB (which indicated it would not object to the Company's classification of variable rate demand notes as cash equivalents), and subsequent reclassification has resulted in a presentation of the Company's consolidated balance sheet that the Company believes understates the true liquidity of the Company's income portfolio. As of October 1, 2006 and December 31, 2005, \$49,983,000 and \$39,444,000 of variable rate demand notes are classified as marketable securities. These notes have structural features that allow the Company to



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tender them at par plus interest within any 7 day period for cash to the notes trustees or remarketers, and thus provide the liquidity of cash equivalents. Part of the change reflected in investing activities is simply the timing of the tendering of these notes.

Cash flows from financing activities for the first nine months of 2006 and 2005 primarily differed as a result of the \$.45 per share increase in the extra dividend paid during those periods.

Working capital decreased by \$16,439,000 to \$196,282,000 at October 1, 2006. The Company's current ratio was 4.2 to 1.0 at October 1, 2006, as compared to 6.3 to 1.0 at December 31, 2005.

As of October 1, 2006, there were approximately \$5,980,000, \$1,050,000, and \$890,000 of open equipment/facilities purchase commitments to expand the product lines in the defense, absorbent products, and housewares/small appliances segments, respectively. The Company expects to continue to evaluate acquisition opportunities that align with its business segments and will make further acquisitions as well as continue to make capital investments in these segments if the appropriate return on investment is projected.

The Company has substantial liquidity in the form of cash and short-term maturity marketable securities to meet all of its anticipated capital requirements, to make dividend payments, and to fund growth through acquisitions and other means. The company intends to continue its investment strategy of safety and short-term liquidity throughout its investment holdings. The interest rate environment is a function of national and international monetary policies as well as the growth and inflation rates of the U.S. and foreign economies and is not controllable by the Company.

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The Company may have additional plant closing costs stemming from its 2001-2002 plant closing (see Note D), but is not aware of any such costs. Plant closing activities are relatively unique and infrequent for the Company; therefore, these activities possess inherent risk that changes in previously recorded estimates could occur. On October 9, 2006, the Company decided to consolidate its adult incontinence production capabilities and, as a result, began the process of relocating its adult incontinence manufacturing equipment from its Marietta, Georgia facility to its Eau Claire, Wisconsin facility. The Company estimated the total cost of the relocation activities to be \$1,019,000, including \$829,000 for the disassembly, transportation, installation of machinery and equipment and other related costs and \$190,000 for one-time termination benefits to affected employees.

### **Critical Accounting Policies**

The preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States requires management to make certain estimates and assumptions that affect the amount of reported assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and revenues and expenses during the periods reported. Actual results may differ from those estimates. The Company reviewed the development and selection of the critical accounting policies and believes the following are the most critical accounting policies that could have an effect on the Company's reported results. These critical

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accounting policies and estimates have been reviewed with the Audit Committee of the Board of Directors.

**Inventories:** New Housewares/Small Appliance product introductions are an important part of the Company's sales to offset the morbidity rate of other Housewares/Small Appliance products and/or the effect of lowered acceptance of seasonal products due to weather conditions. New products entail unusual risks and have occasionally in the past resulted in losses related to obsolete or excess inventory as a result of low or diminishing demand for a product. There were no such obsolescence issues that had a material effect during the current period and, accordingly, the Company did not record a reserve for obsolete product. In the future should product demand issues arise, the Company may incur losses related to the obsolescence of the related inventory.

**Insurance:** The Company is subject to product liability claims in the normal course of business and is self-insured for health care costs. The Company is partly insured for product liability claims, and therefore records an accrual for known claims and incurred but not reported claims, including an estimate for related legal fees in the Company's consolidated financial statements. The Company utilizes historical trends and other analysis to assist in determining the appropriate accrual. An increase in the number or magnitude of claims could have a material impact on the Company's financial condition and results of operations.

### **New Accounting Pronouncements**

Please refer to Note G for information related to the effect of adopting new accounting pronouncements on the Company's consolidated financial statements.

## **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's interest income on cash equivalents and marketable securities is affected by changes in interest rates in the United States. Cash equivalents include money market funds. Based on the accounting profession's 2005 interpretation of cash equivalents under FASB Statement No. 95, the Company's seven-day variable rate demand notes now are classified as marketable securities rather than as cash equivalents. The demand notes are highly liquid instruments with interest rates set every 7 days that can be tendered to the trustee or remarketer upon 7 days notice for payment of principal and accrued interest amounts. The 7-day tender feature of these variable rate demand notes is further supported by an irrevocable letter of credit from highly rated U.S. banks. To the extent a bond is not remarketed at par plus accrued interest, the difference is drawn from the bank's letter of credit. The balance of the Company's investments is held primarily in fixed and variable rate municipal bonds with an average life of less than one year. Accordingly, changes in interest rates have not had a material effect on the Company, and the Company does not anticipate that future exposure to interest rate market risk will be material. The Company uses sensitivity analysis to determine its exposure to changes in interest rates.

The Company has no history of, and does not anticipate in the future, investing in derivative financial instruments. Most transactions with international customers are entered into in U.S. dollars, precluding the need for foreign currency cash flow hedges. The Company's

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manufacturing contracts with its foreign suppliers contain provisions to share the impact of fluctuations in the exchange rate between the U.S. Dollar and the Hong Kong Dollar above and below a fixed range contained in the contracts. All transactions with the foreign suppliers were within the exchange rate range specified in the contracts during 2006, 2005, and 2004. There is no similar provision applicable to the Chinese Yuan, which until 2005 had been tied to the U.S. Dollar. To the extent there are further revaluations of the Yuan vis-à-vis the U.S. Dollar, it is anticipated that any potential material impact from such revaluations will be to the cost of products secured via purchase orders issued subsequent to the revaluation. Foreign translation gains/losses are immaterial to the financial statements for both periods presented.

### ITEM 4. CONTROLS AND PROCEDURES

Reference is made to Item 9A of Form 10-K for the year ended December 31, 2006 filed on August 27, 2007.

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## PART II OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

See Note E in the Notes to Consolidated Financial Statements set forth under Part I - Item 1 above.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

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There were no purchases or sales of securities during the quarter ended October 1, 2006.

### ITEM 6. EXHIBITS

|               |   |
|---------------|---|
| Exhibit 3(i)  | Restated Articles of Incorporation - incorporated by reference from Exhibit 3 (i) of the Company's annual report on Form 10-K/A for the year ended December 31, 2005                                      |
| Exhibit 3(ii) | By-Laws - incorporated by reference from Exhibit 3 (ii) of the Company's quarterly report on Form 10-Q for the quarter ended October 3, 1999  |
| Exhibit 9     | Voting Trust Agreement - incorporated by reference from Exhibit 9 of the Company's quarterly report on Form 10-Q for the quarter ended July 6, 1997   |
| Exhibit 10.1  | 1988 Stock Option Plan - incorporated by reference from Exhibit 10.1 of the Company's quarterly report on Form 10-Q for the quarter ended July 6, 1997  |
| Exhibit 10.2  | Form of Incentive Stock Option Agreement under the 1988 Stock Option Plan - incorporated by reference from Exhibit 10.2 of the Company's quarterly report on Form 10-Q for the quarter ended July 6, 1997 |
| Exhibit 10.3  | Form of Material Contract for Retired Executive Officer - incorporated by reference from Exhibit 10.3 of the Company's annual report on Form 10-K for the year ended December 31, 2006                    |
| Exhibit 11    | Statement regarding computation of per share earnings   |
| Exhibit 31.1  | Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| Exhibit 31.2  | Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002  |
| Exhibit 32.1  | Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |
| Exhibit 32.2  | Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002  |

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### SIGNATURES

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

NATIONAL PRESTO INDUSTRIES, INC.

Date: October 9, 2007

/s/ M. J. Cohen  
M. J. Cohen, Chair of the Board,  
Chief Executive Officer, President  
(Principal Executive Officer)

/s/ M. J. Cohen  
Interim Chief Financial Officer  
(Principal Accounting Officer)

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**National Presto Industries, Inc.**

**Exhibit Index**

| Exhibit Number | Exhibit Description   |
|----------------|---|
| 11             | Computation of Earnings per Share   |
| 31.1           | Chief Executive Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2           | Chief Financial Officer Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32.1           | Chief Executive Officer Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| 32.2           | Chief Financial Officer Certification pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |

