FAIRCHILD CORP
Form 10-Q
February 09, 2006

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 December 31, 2005
Commission File Number 1-6560

THE FAIRCHILD CORPORATION

(Exact name of Registrant as specified in its charter)

Delaware
(State of incorporation or organization)

34-0728587
(I.R.S. Employer Identification No.)

1750 Tysons Boulevard, Suite 1400, McLean, VA 22102
(Address of principal executive offices)

(703) 478-5800
(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, or a non-accelerated filer:
[ ] Large accelerated file [X] 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 [X] No

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

Title of Class	Outstanding at December 31, 2005
Class A Common Stock, $0.10 Par Value	**22,604,761**
Class B Common Stock, $0.10 Par Value	**2,621,412**

THE FAIRCHILD CORPORATION INDEX TO QUARTERLY REPORT ON FORM 10-Q FOR THE PERIOD ENDED DECEMBER 31, 2005

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

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
December 31, 2005 (Unaudited) and September 30, 2005
(In thousands)

ASSETS

	12/31/05	9/30/05
Cash and cash equivalents	$ 12,993	$ 12,582
Short-term investments	6,935	15,698
Accounts receivable-trade, less allowances of $2,790 and $2,679	33,631	18,475
Inventories - finished goods	97,689	90,856
Current assets of discontinued operations	1,722	1,470
Prepaid expenses and other current assets	10,392	7,447
Total Current Assets	**163,362**	**146,528**
Property, plant and equipment, net of accumulated depreciation of $19,850 and $18,453	58,184	57,718
Noncurrent assets of discontinued operations	78,320	79,124
Goodwill and intangible assets	41,997	42,665
Investments and advances, affiliated companies	3,786	3,786
Prepaid pension assets	31,790	31,239
Deferred loan costs	1,660	1,839
Long-term investments	58,566	69,652
Notes receivable	5,797	6,787
Other assets	7,106	7,722
TOTAL ASSETS	**$ 450,568**	**$ 447,060**

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

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS
December 31, 2005 (Unaudited) and September 30, 2005
(In thousands)

LIABILITIES AND STOCKHOLDERS EQUITY

	12/31/05	9/30/05
CURRENT LIABILITIES:		
Bank notes payable and current maturities of long-term debt	$ 25,447	$ 20,902
Accounts payable	30,598	22,612
Accrued liabilities:		
Salaries, wages and commissions	9,390	10,187
Insurance	7,316	7,335
Interest	211	443
Other accrued liabilities	19,598	18,378
Income taxes	57	1,029
Current liabilities of discontinued operations	1,795	1,529
Total Current Liabilities	**94,412**	**82,415**
LONG-TERM LIABILITIES:		
Long-term debt, less current maturities	47,298	47,990
Fair value of interest rate contract		5,146
Other long-term liabilities	26,398	27,315
Pension liabilities	49,705	51,099
Retiree health care liabilities	27,108	27,459
Noncurrent income taxes	42,182	42,238
Noncurrent liabilities of discontinued operations	53,305	53,481
TOTAL LIABILITIES	**340,408**	**337,143**
STOCKHOLDERS' EQUITY:		
Class A common stock, $0.10 par value; 40,000 shares authorized, 30,480 shares issued and 22,605 shares outstanding; entitled to one vote per share	3,047	3,047
Class B common stock, $0.10 par value; 20,000 shares authorized, 2,621 shares issued and outstanding; entitled to ten votes per share	262	262
Paid-in capital	232,500	232,457
Treasury stock, at cost, 7,875 shares of Class A common stock	(76,352)	(76,352)
Retained earnings	22,089	20,206
Notes due from stockholders	(43)	(109)
Cumulative other comprehensive income	(71,343)	(69,594)
TOTAL STOCKHOLDERS' EQUITY	**110,160**	**109,917**
TOTAL LIABILITIES AND STOCKHOLDERS' EQUITY	**$ 450,568**	**$ 447,060**

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

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND OTHER COMPREHENSIVE INCOME (LOSS)

(Unaudited)

For The Three (3) Months Ended December 31, 2005 and 2004
(In thousands, except per share data)

	Three Months Ended	
	12/31/05	**12/31/04**
REVENUE:		
Net sales	$ 51,310	$ 64,352
Rental revenue	237	137
	51,547	**64,489**
COSTS AND EXPENSES:		
Cost of goods sold	32,088	42,556
Cost of rental revenue	56	43
Selling, general & administrative (See note 7)	28,073	32,642
Pension & postretirement	928	1,260
Other income, net	(573)	(1,749)
Amortization of intangibles	128	143
	60,700	74,895
OPERATING LOSS	**(9,153)**	**(10,406)**
Interest expense	(3,072)	(3,504)
Interest income	321	336
Net interest expense	(2,751)	(3,168)
Investment income	928	131
Increase in fair market value of interest rate contract	836	1,675
Loss from continuing operations before taxes	(10,140)	(11,768)
Income tax provision	(65)	(70)
Equity in loss of affiliates, net	(42)	(200)
Loss from continuing operations	(10,247)	(12,038)
Earnings (loss) from discontinued operations, net	(370)	440
Gain on disposal of discontinued operations, net	12,500	12,500
NET EARNINGS	**$ 1,883**	**$ 902**
Other comprehensive income (loss), net of tax:		
Foreign currency translation adjustments	(1,047)	2,430
Minimum pension liability		(1,376)
Unrealized holding changes on derivatives	299	27
Unrealized periodic holding changes on securities	(1,001)	1,828
Other comprehensive income (loss)	(1,749)	2,909
COMPREHENSIVE INCOME	**$ 134**	**$ 3,812**
BASIC AND DILUTED EARNINGS (LOSS) PER SHARE:		
Loss from continuing operations	$ (0.41)	$ (0.48)

	Three Months Ended	
Earnings (loss) from discontinued operations, net	(0.02)	0.02
Gain on disposal of discontinued operations, net	0.50	0.50
NET EARNINGS	**$ 0.07**	**$ 0.04**
Weighted average shares outstanding:		
Basic	25,226	25,195
Diluted	25,226	25,195

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

THE FAIRCHILD CORPORATION AND CONSOLIDATED SUBSIDIARIES

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (Unaudited)

For The Three (3) Months Ended December 31, 2005 and 2004

(In thousands)

	12/31/05	12/31/04
Cash flows from operating activities:		
Net earnings	$ 1,883	$ 902
Depreciation and amortization	1,746	1,872
Amortization of deferred loan fees	258	373
Stock compensation expense	43	
Unrealized holding gain on interest rate contract	(836)	(1,675)
Undistributed (earnings) loss of affiliates, net	43	200
Change in trading securities	9,456	5,959
Change in operating assets and liabilities	(20,925)	(23,079)
Non-cash charges and working capital changes of discontinued operations	905	563
Net cash used for operating activities	(7,427)	(14,885)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(2,341)	(2,362)
Net proceeds received from sales of investment securities, net	8,851	4,555
Equity investment in affiliates	(43)	258
Changes in notes receivable	831	212
Investing activities of discontinued operations	(98)	(325)
Net cash provided by investing activities	7,200	2,338
Cash flows from financing activities:		
Proceeds from issuance of debt	12,768	7,587
Debt repayments	(7,456)	(4,047)
Payment of interest rate contract	(4,310)	
Payment of financing fees	(100)	(17)
Loan repayments from stockholders'	66	469
Net cash used for financing activities of discontinued operations	(165)	(208)
Net cash provided by financing activities	803	3,784
Effect of exchange rate changes on cash	(165)	900
Net change in cash and cash equivalents	411	(7,863)
Cash and cash equivalents, beginning of the year	12,582	12,849
Cash and cash equivalents, end of the period	$ 12,993	$ 4,986

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

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

1. FINANCIAL STATEMENTS

The condensed consolidated balance sheet as of December 31, 2005, and the condensed consolidated statements of operations and other comprehensive income (loss) and cash flows for the periods ended December 31, 2005 and 2004 have been prepared by us, without audit. In the opinion of management, all adjustments necessary to present fairly the financial position, results of operations and cash flows at December 31, 2005, and for all periods presented, have been made. These adjustments include certain reclassifications to reflect the sale of Fairchild Aerostructures and the pending sale of our shopping center as discontinued operations. The condensed consolidated balance sheet at September 30, 2005 was derived from the audited financial statements as of that date.

The condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial statements and the Securities and Exchange Commission s instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, certain information and footnote disclosures normally included in complete financial statements prepared in accordance with generally accepted accounting principles have been condensed or omitted. These condensed consolidated financial statements should be read in conjunction with the financial statements and notes thereto included in our 2005 Annual Report on Form 10-K. The results of operations for the periods ended December 31, 2005 and 2004 are not necessarily indicative of the operating results for the full year. Certain amounts in the prior period financial statements have been reclassified to conform to the current presentation.

The financial position and operating results of our foreign operations are consolidated using, as the functional currency, the local currencies of the countries in which they are located. The balance sheet accounts are translated at exchange rates in effect at the end of the period, and the statement of operations accounts are translated at average exchange rates during the period. The resulting translation gains and losses are included as a separate component of stockholders equity. Foreign currency transaction gains and losses are included in our statement of operations in the period in which they occur.

Stock-Based Compensation

In December 2004, the Financial Accounting Standards Board issued Statement of Financial Accounting Standards No. 123R, Share-Based Payment. Statement 123R amends certain aspects of Statement 123 and now requires a public entity to measure the cost of employee services received in exchange for an award of equity instruments based on the grant-date fair value of the award. In accordance with Statement 123R, we have elected to implement Statement 123R on a modified prospective basis, and to use the Black-Scholes valuation model in calculating fair value of the cost of stock-based employee compensation plans. That cost will be recognized on a straight-line basis over the period during which an employee is required to provide service in exchange for the award, (usually the vesting period). No compensation cost is recognized for equity instruments for which employees do not render the requisite service. We adopted Statement 123R on October 1, 2005, and accordingly, we recognized $43 of compensation cost in the first quarter ended December 31, 2005. No tax benefit and deferred tax asset were recognized on the compensation cost because of our domestic full valuation allowance against deferred tax assets.

As permitted by Statement of Financial Accounting Standards No. 123, Accounting for Stock-Based Compensation , and prior to adoption of Statement 123R, we used the intrinsic value based method of accounting prescribed by Accounting Principles Board Opinion No. 25, for our stock-based employee compensation plans. Since the exercise price and the fair value of the underlying stock were the same on the grant date, no compensation cost was recognized for the granting of stock options to our employees in the three months ended December 31, 2004. If stock options previously granted were accounted for based on their fair value as determined under Statement 123, our pro forma results for the three months ended December 31, 2004, would be as follows:

	12/31/04
Net earnings, as reported	$ 902
Total stock-based employee compensation expense determined under the fair value based method for all awards, net of tax	(91)
Pro forma net earnings	$ 811
Basic and diluted earnings per share:	
As reported	$ 0.04
Pro forma	$ 0.03

The pro forma effects of applying SFAS 123 may not be representative of the effects on reported net results for future years. Our employee stock option plan ends in April 2006, and no new plan is being proposed at this time. No grants were issued during the three months ended December 31, 2005 or December 31, 2004. On December 31, 2005, we had outstanding stock option awards of 767,087, of which 633,483 stock option awards were vested.

2. CASH EQUIVALENTS AND INVESTMENTS

Cash equivalents and investments at December 31, 2005 consist primarily of investments in United States government securities, investment grade corporate bonds, and equity securities which are recorded at market value. Restricted cash equivalent investments are classified as short-term or long-term investments depending upon the length of the restriction period. Investments in common stock of public corporations are recorded at fair market value and classified as trading securities or available-for-sale securities. Other investments do not have readily determinable fair values and consist primarily of investments in preferred and common shares of private companies and limited partnerships. A summary of the cash equivalents and investments held by us follows:

	December 31, 2005		September 30, 2005	
	Aggregate		Aggregate	
	Fair Value	Cost Basis	Fair Value	Cost Basis
Cash and cash equivalents:				
U.S. government securities	$	$	$ 16	$ 16
Money market and other cash funds	12,993	12,993	12,566	12,566
Total cash and cash equivalents	$ 12,993	$ 12,993	$ 12,582	$ 12,582
Short-term investments:				
Money market funds - restricted	$ 5,743	$ 5,743	$ 4,965	$ 4,965
Trading securities - equity securities	1,192	1,192	10,733	10,733
Total short-term investments	$ 6,935	$ 6,935	$ 15,698	$ 15,698
Long-term investments:				
U.S. government securities - restricted	$ 3	$ 3	$ 9,547	$ 9,547
Money market funds - restricted	9,965	9,965	10,672	10,672
Corporate bonds - restricted	23,560	24,252	23,741	24,319
Equity securities - restricted	15,452	15,065	15,459	14,831
Available-for-sale equity securities	4,662	3,612	5,309	3,612
Other investments	4,924	4,924	4,924	4,924
Total long-term investments	$ 58,566	$ 57,821	$ 69,652	$ 67,905
Total cash equivalents and investments	$ 78,494	$ 77,749	$ 97,932	$ 96,185

On December 31, 2005 and September 30, 2005, we had restricted investments of $54,723 and $64,383 respectively, all of which are maintained as collateral for certain debt facilities, our interest rate contract liquidated prior to December 31, 2005, the Esser put option, environmental matters, and escrow arrangements. On December 31, 2005 and September 30, 2005, we had cash of $4,228 and $9,070, respectively, held by our European subsidiaries which have debt agreements that place certain restrictions on the amount of cash that may be transferred outside the borrowing companies. For additional information on Debt see Note 3.

On December 31, 2005, we had gross unrealized holding gains from available-for-sale securities of $1,679 and gross unrealized losses from available-for-sale securities of $932. On September 30, 2005, we had gross unrealized holding gains from available-for-sale securities of $2,445 and gross unrealized losses from available-for-sale securities of $697.

3. DEBT

At December 31, 2005 and September 30, 2005, notes payable and long-term debt consisted of the following:

	Dec. 31, 2005	Sept. 30, 2005
Revolving credit facilities - Fairchild Sports	$ 13,676	$ 8,917
Current maturities of long-term debt	11,771	11,985
Total notes payable and current maturities of long-term debt	25,447	20,902
Term loan agreement - Fairchild Sports	23,038	25,301
Promissory note - Real Estate	13,000	13,000
CIT revolving credit facility - Aerospace	10,252	8,164
GMAC credit facility - Fairchild Sports	3,696	3,650
Capital lease obligations	3,933	4,597
Other notes payable, collateralized by assets	5,150	5,263
Less: current maturities of long-term debt	(11,771)	(11,985)
Net long-term debt	47,298	47,990
Total debt	$ 72,745	$ 68,892

Credit Facilities at Fairchild Sports

At December 31, 2005, our German subsidiary, Hein Gericke Deutschland GmbH and its German partnership, PoloExpress, had outstanding borrowings of $33.3 million due under its credit facilities with Stadtsparkasse Düsseldorf and HSBC Trinkaus & Burkhardt KGaA. The revolving credit facility provides a credit line of 10.0 million ($10.3 million outstanding, and $1.5 million available at December 31, 2005), at interest rates of 3.5% over the three-month Euribor (6.0% at December 31, 2005), and matures annually. Outstanding borrowings under the term loan facility have blended interest rates, with $18.4 million bearing interest at 1% over the three-month Euribor rate (3.5% at December 31, 2005), with an interest rate cap protection in which our interest expense would not exceed 6% on 50% of debt, and the remaining $4.6 million bearing interest at a fixed rate of 6%. The term loans mature on March 31, 2009, and are secured by the assets of Hein Gericke Deutschland GmbH and PoloExpress and specified guarantees provided by the German State of North Rhine-Westphalia.

The loan agreements require Hein Gericke Deutschland and PoloExpress to maintain compliance with certain covenants. The most restrictive of the covenants requires Hein Gericke Deutschland to maintain equity of 44.5 million ($52.7 million at December 31, 2005), as defined in the loan contracts. No dividends may be paid by Hein Gericke Deutschland unless such covenants are met and dividends may be paid only up to its consolidated after tax profits. As of December 31, 2005, Hein Gericke borrowed approximately $8.2 million (7.0 million) from our subsidiary, Fairchild Holding Corp., which is not subject to restriction against repayment. The loan agreements have certain restrictions on other forms of cash flow from Hein Gericke Deutschland. At December 31, 2005, we were in compliance with the loan covenants.

At December 31, 2005, our subsidiary, Hein Gericke UK Ltd had outstanding borrowings of $3.7 million (£2.1 million) on its £5.0 million ($8.6 million) credit facility with GMAC. The loan bears interest at 2.25% above the base rate of Lloyds TSB Bank Plc and matures on April 30, 2007. We must pay a 0.75% per annum non-utilization fee on the available facility. The financing is secured by the inventory of Hein Gericke UK Ltd and an investment with a fair market value of $4.1 million at December 31, 2005.

Under an $8.0 million line of credit agreement with City National Bank that expires on June 30, 2006, our subsidiary, IFW may borrow up to $3.0 million for working capital needs and the remainder for letters of credit. Letters of credit which mature may be converted to a banker s acceptance with a maturity date of up to 90 days. Interest is payable monthly at the bank s prime interest rate. The interest rate at December 31, 2005 was 7.25%. At December 31, 2005, $1.4 million and $2.0 million were outstanding under this facility in the form of banker s acceptance notes and for working capital requirements, respectively. The line of credit is collateralized by substantially all assets of IFW, is guaranteed by us, and contains financial covenants. The most restrictive covenants include maintaining a tangible net worth plus subordinated debt of not less than $5.5 million and a ratio of total senior liabilities to tangible net worth plus subordinated debt of not more than 2-to-1. The Company was in compliance with these covenants as of December 31, 2005.

Credit Facility at Aerospace Segment

At December 31, 2005, we have outstanding borrowings of $10.3 million on a $20.0 million asset based revolving credit facility with CIT. The amount that we can borrow under the facility is based upon inventory and accounts receivable at our aerospace segment and $1.7 million was available for future borrowings at December 31, 2005. Borrowings under the facility are collateralized by a security interest in the assets of our aerospace segment. The loan bears interest at 1.0% over prime (8.25% at December 31, 2005) and we pay a non-usage fee of 0.5%. The credit facility matures in January 2007.

Promissory Note - Real Estate

At December 31, 2005, we have an outstanding loan of $13.0 million with Beal Bank, SSB. The loan is evidenced by a Promissory Note dated as of August 26, 2004, and is secured by a mortgage lien on the Company s real estate in Huntington Beach CA, Fullerton CA and Wichita KS. Interest on the note is at the rate of one-year LIBOR (determined on an annual basis), plus 6% (10.26% at December 31, 2005), and is payable monthly. The loan matures on October 31, 2007, provided that the Company may extend the maturity date for one year, during which time the interest rate shall be one-year LIBOR plus 8%. The promissory note agreement contains a prepayment penalty of 5% if prepaid after September 2005, and before September 2006; and 3% if prepaid between September 2006 and October 30, 2007. On December 31, 2005, approximately $1.2 million of the loan proceeds were held in escrow to fund specific improvements to the mortgaged property.

Guarantees

At December 31, 2005, we included $1.8 million as debt for guarantees assumed by us of retail shop partners indebtedness incurred for the purchase of store fittings in Germany. These guarantees were issued by our subsidiary in the sports & leisure segment. In addition, at December 31, 2005, approximately $1.5 million of bank loans received by retail shop partners in the sports & leisure segment were guaranteed by our subsidiaries and are not reflected on our balance sheet because these loans have not been assumed by us.

Letters of Credit

We have entered into standby letter of credit arrangements with insurance companies and others, issued primarily to guarantee payment of our workers compensation liabilities. At December 31, 2005, we had contingent liabilities of $1,961, on commitments related to outstanding letters of credit which were secured by restricted cash collateral.

4. PENSIONS AND POSTRETIREMENT BENEFITS

The Company and its subsidiaries sponsor three qualified defined benefit pension plans and several other postretirement benefit plans. The components of net periodic benefit cost from these plans are as follows:

	Pension Benefits Three Months		Postretirement Benefits Three Months	
	12/31/05	**12/31/04**	**12/31/05**	**12/31/04**
Service cost	$ 97	$ 107	$ 6	$ 22
Interest cost	2,626	2,795	519	737
Expected return on plan assets	(3,405)	(3,555)		
Amortization of:				
Prior service cost	90	78	(278)	(54)
Actuarial (gain)/loss	894	810	379	320
Net periodic benefit cost	$ 302	$ 235	$ 626	$ 1,025

Our funding policy is to make the minimum annual contribution required by the Employee Retirement Income Security Act of 1974 or local statutory law. Based upon our actuary s current assumptions and projections, we do not expect additional cash contributions to the largest pension plan to be required until 2009. Current actuarial projections indicate contribution requirements of $1,180 in 2009, $1,970 in 2010 and a total of $11,420 in 2011 through 2015. We are required to make annual cash contributions of approximately $0.3 million to fund a small pension plan.

5. EARNINGS PER SHARE

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

	Three Months Ended	
Basic loss per share:	**12/31/05**	**12/31/04**
Loss from continuing operations	$ (10,247)	$ (12,038)