

STARRETT L S CO
Form 10-K
September 21, 2010

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

FORM 10-K

(check one)

ANNUAL REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the fiscal year ended June 26, 2010

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE
SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____

Commission File No. 1-367

THE L.S. STARRETT COMPANY
(Exact name of registrant as specified in its charter)

MASSACHUSETTS
(State or other jurisdiction of
incorporation or organization)

04-1866480
(I.R.S. Employer
Identification No.)

121 CRESCENT STREET, ATHOL,
MASSACHUSETTS
(Address of principal executive offices)

01331
(Zip Code)

Registrant's telephone number, including area code 978-249-3551

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

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Title of each class	Name of each exchange on which registered
Class A Common - \$1.00 Per Share Par Value	New York Stock Exchange
Class B Common - \$1.00 Per Share Par Value	Not applicable

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Indicate by check mark if the Registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act.
Yes No

Indicate by check mark if the Registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act. Yes No

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§ 232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes No

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

Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)

Large Accelerated Filer Accelerated Filer
Non-Accelerated Filer Smaller Reporting Company
(Do not check if a smaller reporting company)

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

The Registrant had 5,812,328 and 856,629 shares, respectively, of its \$1.00 par value Class A and B common stock outstanding on December 27, 2009. On December 27, 2009, the last business day of the Registrant's second fiscal quarter, the aggregate market value of the common stock held by nonaffiliates was approximately \$53,106,325.

There were 5,872,414 and 812,175 shares, respectively, of the Registrant's \$1.00 par value Class A and Class B common stock outstanding as of August 31, 2010.

The exhibit index is located on pages 51-52.

DOCUMENTS INCORPORATED BY REFERENCE

The Registrant intends to file a definitive Proxy Statement for the Company's 2010 Annual Meeting of Stockholders within 120 days of the end of the fiscal year ended June 26, 2010. Portions of such Proxy Statement are incorporated by reference in Part III.

Portions of the Proxy Statement for October 20, 2010 Annual Meeting (Part III).

THE L.S. STARRETT COMPANY

FORM 10-K

FOR THE PERIOD ENDED JUNE 26, 2010

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All references in this Annual Report to "Starrett", the "Company", "we", "our" and "us" means The L.S. Starrett Company and its subsidiaries.

PART I

Item 1 - Business

General

Founded in 1880 by Laroy S. Starrett and incorporated in 1929, the Company is engaged in the business of manufacturing over 5,000 different products for industrial, professional and consumer markets. As a global manufacturer with major subsidiaries in Brazil (1956), Scotland (1958) and China (1997), the Company offers its broad array of products to the market through multiple channels of distribution throughout the world. The Company's products include precision tools, electronic gages, gage blocks, optical and vision measuring equipment, custom engineered granite solutions, tape measures, levels, chalk products, squares, band saw blades, hole saws, hacksaw blades, jig saw blades, reciprocating saw blades, M1® lubricant and precision ground flat stock. The Company's financial reporting is based upon one business segment.

Starrett® is brand recognized around the world for precision, quality and innovation.

Products

The Company's tools and instruments are sold throughout North America and in over 100 foreign countries. By far the largest consumer of these products is the metalworking industry including aerospace, medical, and automotive but other important consumers are marine and farm equipment shops, do-it-yourselfers and tradesmen such as builders, carpenters, plumbers and electricians.

For 130 years the Company has been a recognized leader in providing measurement solutions consisting of hand measuring tools and precision instruments such as micrometers, vernier calipers, height gages, depth gages, electronic gages, dial indicators, steel rules, combination squares, custom and non contact gaging and many other items. Skilled personnel, superior products, manufacturing expertise, innovation and unmatched service has earned the Company its reputation as the "Best in Class" provider of measuring application solutions for industry. During fiscal 2008, the Company enhanced its wireless data collection solutions, making them more customer-friendly and more software-compatible.

The Company's saw product lines enjoy strong global brand recognition and market share. These products encompass a breadth of uses. During 2009, the Company introduced several new products including its ADVANZ carbide tipped products and its VERSATIX products with a patent pending tooth geometry designed for the cutting of structurals and small solids. This launch was further enhanced through the global introduction of new support programs and marketing collateral. These actions are aimed at positioning Starrett for global growth in wide band products for production applications as well as product range expansions for shop applications. A full line of complementary saw products, including hack, jig, reciprocating saw blades and hole saws provide cutting solutions for the building trades and are offered primarily through construction, electrical, plumbing and retail distributors. During fiscal 2008, the Company was issued a patent for its bi-metal unique® manufacturing process and products. This break-through Split Chip Advantage technology enables the Company to produce saw blades, which are up to 50% stronger and offer up to 170% more contact area than traditional electron beam (EB) products. This technology is now used on many of the Company's saw products.

Recent acquisitions have added to the Company's portfolio of custom measuring solutions that complement the Company's existing special gaging expertise. On July 17, 2007, the Company purchased all of the assets of Kinemetric Engineering. Kinemetric Engineering specializes in precision video-based metrology, specialty motion devices and custom engineered systems for measurement and inspection. Kinemetric Engineering brings a wealth of experience, engineering and manufacturing capability. This business unit also oversees the sales and support of the Company's high quality line of Starrett Optical Projectors, combining to make a very comprehensive product offering.

The Company's custom engineered granite product offering was further enhanced by the acquisition of Tru-Stone Technologies Inc. (Tru-Stone) in fiscal 2006. This strategic acquisition significantly improved the granite surface plate capabilities providing access to high-end metrology markets such as the electronics and flat panel display industry. The consolidation of the Company's granite surface plate operations with Tru-Stone provided savings in labor and operating expenses.

Personnel

At June 26, 2010, the Company had 1,744 employees, approximately 51% of whom were domestic. This represents a net decrease from June 27, 2009 of 24 employees. The headcount reduction was in international operations, primarily in Brazil.

None of the Company's operations are subject to collective bargaining agreements. In general, the Company considers relations with its employees to be excellent. Domestic employees hold a large share of Company stock resulting from various stock purchase plans. The Company believes that this dual role of owner-employee has strengthened employee morale over the years.

Competition

The Company is competing on the basis of its reputation as the best in class for quality, precision and innovation combined with its commitment to customer service and strong customer relationships. To that end, Starrett is increasingly focusing on providing customer centric solutions. Although the Company is generally operating in highly competitive markets, the Company's competitive position cannot be determined accurately in the aggregate or by specific market since none of its competitors offer all of the same product lines offered by the Company or serve all of the markets served by the Company.

The Company is one of the largest producers of mechanics' hand measuring tools and precision instruments. In the United States, there are three other major companies and numerous small competitors in the field, including direct foreign competitors. As a result, the industry is highly competitive. During fiscal 2010, there were no material changes in the Company's competitive position in spite of the current global economic crisis, which is accelerating the migration of American manufacturing jobs to lower cost countries. Internationally, the Company's significant investments in manufacturing and sales operations in China appear to have resulted in market share gains and enhanced brand recognition. The Company's products for the building trades, such as tape measures and levels, are under constant margin pressure due to a channel shift to large national home and hardware retailers. The Company is responding to such challenges by expanding its manufacturing operations in China. Certain large customers offer private labels ("own brand") that compete with Starrett branded products. These products are often sourced directly from low cost countries.

Saw products encounter competition from several domestic and international sources. The Company's competitive position varies by market segment and country. Continued research and development, new patented products and processes, and strong customer support have enabled the Company to compete successfully in both general and performance oriented applications.

Foreign Operations

The operations of the Company's foreign subsidiaries are consolidated in its financial statements. The subsidiaries located in Brazil, Scotland and China are actively engaged in the manufacturing and distribution of precision measuring tools, saw blades, optical and vision measuring equipment and hand tools. Subsidiaries in Canada, Argentina, Australia, New Zealand, Mexico and Germany are engaged in distribution of the Company's products. The Company expects its foreign subsidiaries to continue to play a significant role in its overall operations. A summary of the Company's foreign operations is contained in Note 15 to the Company's fiscal 2010 financial statements under the caption "OPERATING DATA" found in Item 8 of this Form 10-K.

Orders and Backlog

The Company generally fills orders from finished goods inventories on hand. Sales order backlog of the Company at any point in time is not significant. Total inventories amounted to \$46.2 million at June 26, 2010 and \$60.2 million at June 27, 2009. The Company uses the last-in, first-out (LIFO) method of valuing most domestic inventories (approximately 51% of all inventories). LIFO inventory amounts reported in the financial statements are

approximately \$25.2 million and \$33.7 million, respectively, lower than if determined on a first-in, first-out (FIFO) basis at June 26, 2010 and June 27, 2009.

Intellectual Property

When appropriate, the Company applies for patent protection on new inventions and currently owns a number of patents. Its patents are considered important in the operation of the business, but no single patent is of material importance when viewed from the standpoint of its overall business. As noted previously, during fiscal 2008 the Company was issued a patent for its bi-metal unique® manufacturing process and products. The Company relies on its continuing product research and development efforts, with less dependence on its current patent position. It has for many years maintained engineers and supporting personnel engaged in research, product development and related activities. The expenditures for these activities during fiscal years 2010, 2009 and 2008 were approximately \$0.9 million, \$1.6 million and \$2.4 million respectively, all of which were expensed in the Company's financial statements.

The Company uses trademarks with respect to its products and considers its trademark portfolio as one of its most valuable assets. All of the Company's important trademarks are registered and rigorously enforced.

Environmental

Compliance with federal, state, local, and foreign provisions that have been enacted or adopted regulating the discharge of materials into the environment or otherwise relating to protection of the environment is not expected to have a material effect on the capital expenditures, earnings and competitive position of the Company. Specifically, the Company has taken steps to reduce, control and treat water discharges and air emissions. The Company takes seriously its responsibility to the environment and has embraced renewable energy alternatives and expects to bring on line a new hydro – generation facility at its Athol, MA plant in 2011 to reduce its carbon foot print and energy costs, an investment in excess of \$1.0 million.

Strategic Activities

Globalization has had a profound impact on product offerings and buying behaviors of industry and consumers in North America and around the world, forcing the Company to adapt to this new, highly competitive business environment. The Company continuously evaluates most aspects of its business, aiming for new world-class ideas to set itself apart from its competition.

Our strategic concentration is on global brand building and providing unique customer value propositions through technically supported application solutions for our customers. Our job is to recommend and produce the best suited standard product or design and build custom solutions. The combination of the right tool for the right job with value added service will give us a competitive advantage. The Company continues its focus on lean manufacturing, plant consolidations, global sourcing and improved logistics to optimize its value chain.

The execution of these strategic initiatives has expanded the Company's manufacturing and distribution in developing economies which has increased its international sales revenues to 52% of its consolidated sales for fiscal 2010.

On September 21, 2006, the Company sold its Alum Bank, PA level manufacturing plant and relocated the manufacturing to the Dominican Republic, where production began in fiscal 2005. The tape measure production of the Evans Rule Division facilities in Puerto Rico and Charleston, SC has been transferred to the Dominican Republic. The Company vacated and plans to sell its Evans Rule facility in North Charleston, SC. This move has achieved labor savings while satisfying the demands of its customers for lower prices.

The Tru-Stone acquisition in April 2006 represented a strategic acquisition for the Company in that it provides an enhancement of the Company's granite surface plate capabilities. Profit margins for the Company's standard plate business have improved as the Company's existing granite surface plate facility was consolidated into Tru-Stone, where average gross margins have been higher. Along the same lines, the Kinemetric Engineering acquisition in July 2007 represented another strategic acquisition in the field of precision video-based metrology which, when combined with the Company's existing optical projection line, will provide a very comprehensive product offering.

SEC Filings and Certifications

The Company makes its public filings with the Securities and Exchange Commission (“SEC”), including its Annual Report on Form 10-K, Quarterly Reports on Form 10-Q, Current Reports on Form 8-K and all exhibits and amendments to these reports, available free of charge at its website, www.starrett.com, as soon as reasonably practicable after the Company files such material with the SEC. Information contained on the Company’s website is not part of this Annual Report on Form 10-K.

Item 1A – Risk Factors

SAFE HARBOR STATEMENT UNDER THE PRIVATE SECURITIES LITIGATION REFORM ACT OF 1995

This Annual Report on Form 10-K and the Company’s 2010 Annual Report to Stockholders, including the President’s letter, contains forward-looking statements about the Company’s business, competition, sales, gross margins, expenditures, foreign operations, plans for reorganization, interest rate sensitivity, debt service, liquidity and capital resources, and other operating and capital requirements. In addition, forward-looking statements may be included in future Company documents and in oral statements by Company representatives to security analysts and investors. The Company is subject to risks that could cause actual events to vary materially from such forward-looking statements, including the following risk factors:

Risks Related to Financial Reporting: If we or our independent registered public accounting firm are unable to affirm the effectiveness of our internal control over financial reporting in future years, the market value of our common stock could be adversely affected. Our independent registered public accounting firm did audit and report on our internal controls over financial reporting as of June 26, 2010 and June 27, 2009 and identified material weaknesses in our internal controls over financial reporting. Management has implemented three of the five remediation steps outlined in our Annual Report on Form 10-K for fiscal 2009 and will complete the remaining steps before the end of the second quarter of fiscal 2011. Management has developed a plan to remediate the fiscal 2010 material weaknesses in our internal controls over financial reporting, which is outlined in Item 9a of this Annual Report on Form 10-K.

Risks Related to the Economy: The Company’s results of operations are materially affected by the conditions in the global economy. As a result of the global economic recession, U.S. and foreign economies have experienced significant declines in employment, household wealth, consumer spending, and lending. Businesses, including the Company and its customers, have faced weakened demand for their products and services, difficulty obtaining access to financing, increased funding costs, and barriers to expanding operations. The Company’s results of operations in fiscal 2009 and 2010 have been negatively impacted by the global economic recession; however, business activity has improved for the Company in the second half of fiscal 2010. The Company can provide no assurance that its improvement in the second half of fiscal 2010 will continue and its future results of operations will improve.

Risks Related to Reorganization: The Company continues to evaluate consolidation and reorganization of some of its manufacturing and distribution operations. There can be no assurance that the Company will be successful in these efforts or that any consolidation or reorganization will result in revenue increases or cost savings to the Company. The implementation of these reorganization measures may disrupt the Company’s manufacturing and distribution activities, could adversely affect operations, and could result in asset impairment charges and other costs that will be recognized if and when reorganization or restructuring plans are implemented or obligations are incurred.

Risks Related to Technology: Although the Company’s strategy includes investment in research and development of new and innovative products to meet technology advances, there can be no assurance that the Company will be successful in competing against new technologies developed by competitors.

Risks Related to Foreign Operations: Approximately 52% of the Company's sales and 56% of net assets related to foreign operations for fiscal 2010. Foreign operations are subject to special risks that can materially affect the sales, profits, cash flows and financial position of the Company, including taxes and other restrictions on distributions and payments, currency exchange rate fluctuations, political and economic instability, inflation, minimum capital requirements and exchange controls. The Company's Brazilian operations, which constitute over half of the Company's revenues from foreign operations, can be very volatile, changing from year to year due to the political situation, currency risk and the economy. As a result, the future performance of the Brazilian operations may be difficult to forecast.

Risks Related to Industrial Manufacturing Sector: The market for most of the Company's products is subject to economic conditions affecting the industrial manufacturing sector, including the level of capital spending by industrial companies and the general movement of manufacturing to low cost foreign countries where the Company does not have a substantial market presence. Accordingly, economic weakness in the industrial manufacturing sector may, and in some cases has, resulted in decreased demand for certain of the Company's products, which adversely affects sales and performance. Economic weakness in the consumer market will also adversely impact the Company's performance. In the event that demand for any of the Company's products declines significantly, the Company could be required to recognize certain costs as well as asset impairment charges on long-lived assets related to those products.

Risks Related to Competition: The Company's business is subject to direct and indirect competition from both domestic and foreign firms. In particular, low cost foreign sources have created severe competitive pricing pressures. Under certain circumstances, including significant changes in U.S. and foreign currency relationships, such pricing pressures tend to reduce unit sales and/or adversely affect the Company's margins.

Risks Related to Insurance Coverage: The Company carries liability, property damage, workers' compensation, medical and other insurance policies that management considers adequate for the protection of its assets and operations. There can be no assurance, however, that the coverage limits of such policies will be adequate to cover all claims and losses. Such uncovered claims and losses could have a material adverse effect on the Company. Depending on the risk, deductibles can be as high as 5% of the loss or \$500,000.

Risks Related to Raw Material and Energy Costs: Steel is the principal raw material used in the manufacture of the Company's products. The price of steel has historically fluctuated on a cyclical basis and has often depended on a variety of factors over which the Company has no control. The cost of producing the Company's products is also sensitive to the price of energy. The selling prices of the Company's products have not always increased in response to raw material, energy or other cost increases, and the Company is unable to determine to what extent, if any, it will be able to pass future cost increases through to its customers. The Company's inability to pass increased costs through to its customers could materially and adversely affect its financial condition or results of operations.

Risks Related to Stock Market Performance: Currently, the Company's domestic defined benefit pension plan is underfunded. The Company is not required to provide additional funds to the domestic pension fund; however, the future return on pension assets is insufficient to cover future obligations, creating an actuarially underfunded status. This has also occurred for the Company's UK plan, which was underfunded during fiscal 2008, 2009 and 2010.

Risks Related to Acquisitions: Acquisitions, such as the Company's acquisition of Tru-Stone in fiscal 2006 and Kinemetric Engineering in fiscal 2008, involve special risks, including the potential assumption of unanticipated liabilities and contingencies, difficulty in assimilating the operations and personnel of the acquired businesses, disruption of the Company's existing business, dissipation of the Company's limited management resources, and impairment of relationships with employees and customers of the acquired business as a result of changes in ownership and management. While the Company believes that strategic acquisitions can improve its competitiveness and profitability, the failure to successfully integrate and realize the expected benefits of such acquisitions could have

an adverse effect on the Company's business, financial condition and operating results.

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Risks Related to Investor Expectations: The Company's share price remained relatively stable in fiscal 2010 after a significant decline during fiscal 2009. The Company's earnings may not continue to grow at rates similar to the growth rates achieved in recent years and may fall short of either a prior quarter or investors' expectations. If the Company fails to meet the expectations of securities analysts or investors, the Company's share price may decline.

Risks Related to the Company's Credit Facility: Under the Company's credit facility with TD Bank, N.A., the Company is required to comply with certain financial covenants. While the Company believes that it will be able to comply with the financial covenants in future periods, its failure to do so would result in defaults under the credit facility unless the covenants are amended or waived. An event of default under the credit facility, if not waived, could prevent additional borrowing and could result in the acceleration of the Company's indebtedness. This could have an impact on the Company's ability to operate its business.

Risks Related to Information Systems: The efficient operation of the Company's business is dependent on its information systems, including its ability to operate them effectively and to successfully implement new technologies, systems, controls and adequate disaster recovery systems. In addition, the Company must protect the confidentiality of data of its business, employees, customers and other third parties. The failure of the Company's information systems to perform as designed or its failure to implement and operate them effectively could disrupt the Company's business or subject it to liability and thereby harm its profitability. For those reasons, the Company implemented a new Enterprise Resource Planning (ERP) system in its principal North American locations.

Risks Related to Litigation and Changes in Laws, Regulations and Accounting Rules: Various aspects of the Company's operations are subject to federal, state, local or foreign laws, rules and regulations, any of which may change from time to time. Generally accepted accounting principles may change from time to time, as well. In addition, the Company is regularly involved in various litigation matters that arise in the ordinary course of business. Litigation, regulatory developments and changes in accounting rules and principles could adversely affect the Company's business operations and financial performance.

Item 1B – Unresolved Staff Comments

None.

Item 2 - Properties

The Company's principal plant and its corporate headquarters are located in Athol, MA on about 15 acres of Company-owned land. The plant consists of 25 buildings, mostly of brick construction of varying dates, with approximately 535,000 square feet.

The Company's Webber Gage Division in Cleveland, OH, owns and occupies two buildings totaling approximately 50,000 square feet.

The Company-owned facility in Mt. Airy, NC consists of one building totaling approximately 320,000 square feet. It is occupied by the Company's Saw Division, Ground Flat Stock Division and a distribution center. A separate 36,000 square foot building which formerly housed the distribution center was vacated in November 2008 and is currently listed for sale.

The Company's Evans Rule Division owns a 173,000 square foot building in North Charleston, SC. In fiscal 2006, manufacturing operations were moved to a new 50,000 square foot facility in the Dominican Republic from both the North Charleston site and the former Mayaguez, Puerto Rico operations. The Company now occupies a 3,400 square foot leased office in North Charleston for administrative personnel and has the North Charleston property listed for sale.

The Company's subsidiary in Itu, Brazil owns and occupies several buildings totaling 209,000 square feet. The Company's subsidiary in Jedburgh, Scotland owns and occupies a 175,000 square foot building. Two wholly owned subsidiaries in Suzhou and Shanghai (People's Republic of China) lease approximately 41,000 square feet and 5,000 square feet, respectively. The Company signed a lease in fiscal 2009 for a new 133,000 square foot building in Suzhou to accommodate our need for increased manufacturing space. We plan to close the Shanghai distribution center and sales office and consolidate all operations into the new building.

In addition, the Company operates warehouses and/or sales-support offices in the U.S., Canada, Australia, New Zealand, Mexico, Germany, Japan, and Argentina.

A warehouse in Glendale, AZ encompassing 35,000 square feet was closed in fiscal 2006 and the building was sold during fiscal 2008.

With the acquisition of Tru-Stone in fiscal 2006, the Company added a 90,000 square foot facility in Waite Park, MN.

With the acquisition of Kinematic Engineering in fiscal 2008, the Company added a 9,000 square foot leased facility in Laguna Hills, CA, which was expanded to 14,000 square feet.

The Company has vacated a sales office in Kennesaw, GA and has terminated the lease.

In the Company's opinion, all of its property, plants and equipment are in good operating condition, well maintained and adequate for its needs.

Item 3 - Legal Proceedings

The Company is, in the ordinary course of business, from time to time involved in litigation that is not considered material to its financial condition or operations.

Item 4 - Reserved

PART II

Item 5 - Market for the Company's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities

The Company's Class A common stock is traded on the New York Stock Exchange. Quarterly dividend and high/low closing market price information is presented in the table below. The Company's Class B common stock is generally nontransferable, except to lineal descendants, and thus has no established trading market, but it can be converted into Class A common stock at any time. The Class B common stock was issued on October 5, 1988, and the Company has paid the same dividends thereon as have been paid on the Class A common stock since that date. On June 26, 2010, there were approximately 1,533 registered holders of Class A common stock and approximately 1,222 registered holders of Class B common stock.

Quarter Ended	Dividends	High	Low
September 2008	0.12	28.50	13.50
December 2008	0.12	21.80	9.51
March 2009	0.12	16.31	5.30
June 2009	0.12	11.42	6.01
September 2009	0.12	11.18	6.55
December 2009	0.06	11.75	8.53
March 2010	0.06	11.67	8.74
June 2010	0.06		