

CIRCOR INTERNATIONAL INC

Form 10-Q

May 05, 2011

[Table of Contents](#)

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

**FORM 10-Q**

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

For the quarterly period ended April 3, 2011.

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 Number 001-14962

**CIRCOR INTERNATIONAL, INC.**

(Exact name of registrant as specified in its charter)

Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**04-3477276**  
(I.R.S. Employer  
Identification No.)

**c/o CIRCOR, Inc.**  
**25 Corporate Drive, Suite 130, Burlington, MA**  
(Address of principal executive offices)

**(781) 270-1200**

**01803-4238**  
(Zip Code)

(Registrant's telephone number, including area code)

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

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 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.

Large accelerated filer ☐ Accelerated filer ☒

Non-accelerated filer ☐ (Do not check if a smaller reporting company) Smaller reporting company ☐

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

As of May 1, 2011, there were 17,233,577 shares of the Registrant's Common Stock, par value \$0.01 per share, outstanding.

**Table of Contents**

**CIRCOR INTERNATIONAL, INC.**

**TABLE OF CONTENTS**

	<b>Page</b>
<b>PART I. FINANCIAL INFORMATION</b>	
Item 1. Financial Statements	
<u>Consolidated Balance Sheets as of April 3, 2011 (Unaudited) and December 31, 2010</u>	3
<u>Consolidated Statements of Operations for the Three Months Ended April 3, 2011 and April 4, 2010 (Unaudited)</u>	4
<u>Consolidated Statements of Cash Flows for Three Months Ended April 3, 2011 and April 4, 2010 (Unaudited)</u>	5
<u>Notes to Consolidated Financial Statements (Unaudited)</u>	6
Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	15
Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u>	22
Item 4. <u>Controls and Procedures</u>	23
<b>PART II. OTHER INFORMATION</b>	
Item 1. <u>Legal Proceedings</u>	23
Item 1A <u>Risk Factors</u>	26
Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	26
Item 3. <u>Defaults Upon Senior Securities</u>	26
Item 4. <u>(Removed and Reserved)</u>	26
Item 5. <u>Other Information</u>	26
Item 6. <u>Exhibits</u>	27
<u>Signatures</u>	28
Certifications	

**Table of Contents****PART I FINANCIAL INFORMATION.****ITEM 1. FINANCIAL STATEMENTS.****CIRCOR INTERNATIONAL, INC.****CONSOLIDATED BALANCE SHEETS**

(In thousands, except per share data)

	<b>April 3, 2011 (Unaudited)</b>	<b>December 31, 2010</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 53,491	\$ 45,752
Short-term investments	107	101
Trade accounts receivable, less allowance for doubtful accounts of \$1,249 and \$822, respectively	141,280	138,860
Inventories	177,340	167,797
Income taxes refundable	1,806	1,625
Prepaid expenses and other current assets	13,200	5,749
Deferred income tax asset	20,422	20,111
Insurance receivables	38	38
Assets held for sale	542	542
 Total Current Assets	 408,226	 380,575
 <b>PROPERTY, PLANT AND EQUIPMENT, NET</b>	 100,251	 95,768
<b>OTHER ASSETS:</b>		
Goodwill	72,843	63,175
Intangibles, net	61,977	62,322
Deferred income tax asset	11,829	11,829
Other assets	11,582	2,526
 <b>TOTAL ASSETS</b>	 \$ 666,708	 \$ 616,195
 <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 86,099	\$ 80,577
Accrued expenses and other current liabilities	51,572	51,248
Accrued compensation and benefits	20,354	22,305
Asbestos liability	79,801	79,831
Income taxes payable	0	38
Notes payable and current portion of long-term debt	8,178	851
 Total Current Liabilities	 246,004	 234,850
 <b>LONG-TERM DEBT, NET OF CURRENT PORTION</b>	 22,858	 684
<b>DEFERRED INCOME TAXES</b>	400	0
<b>OTHER NON-CURRENT LIABILITIES</b>	22,740	23,841
<b>CONTINGENCIES AND COMMITMENTS (See Note 10)</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred stock, \$0.01 par value; 1,000,000 shares authorized; no shares issued and outstanding	0	0

# Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

Common stock, \$0.01 par value; 29,000,000 shares authorized; 17,202,100 and 17,112,688 shares issued and outstanding at April 3, 2011 and December 31, 2010, respectively	172	171
Additional paid-in capital	255,348	254,154
Retained earnings	103,631	96,389
Accumulated other comprehensive income	15,555	6,106
<b>Total Shareholders' Equity</b>	<b>374,706</b>	<b>356,820</b>
<b>TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY</b>	<b>\$ 666,708</b>	<b>\$ 616,195</b>

The accompanying notes are an integral part of these unaudited consolidated financial statements.

**Table of Contents****CIRCOR INTERNATIONAL, INC.****CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share data)

**(Unaudited)**

	<b>Three Months Ended</b>	
	<b>April 3, 2011</b>	<b>April 4, 2010</b>
Net revenues	\$ 203,370	\$ 146,269
Cost of revenues	147,160	103,550
<b>GROSS PROFIT</b>	<b>56,210</b>	<b>42,719</b>
Selling, general and administrative expenses	42,437	35,418
Leslie asbestos and bankruptcy charges (recoveries), net	1,001	(648)
<b>OPERATING INCOME</b>	<b>12,772</b>	<b>7,949</b>
Other (income) expense:		
Interest income	(43)	(43)
Interest expense	816	597
Other, net	915	(51)
<b>TOTAL OTHER EXPENSE</b>	<b>1,688</b>	<b>503</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>11,084</b>	<b>7,446</b>
Provision for income taxes	3,178	1,713
<b>NET INCOME</b>	<b>\$ 7,906</b>	<b>\$ 5,733</b>
Earnings per common share:		
Basic	\$ 0.46	\$ 0.34
Diluted	\$ 0.45	\$ 0.33
Weighted average number of common shares outstanding:		
Basic	17,163	17,051
Diluted	17,378	17,193
Dividends paid per common share	\$ 0.0375	\$ 0.0375

The accompanying notes are an integral part of these unaudited consolidated financial statements.

**Table of Contents****CIRCOR INTERNATIONAL, INC.****CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

	<b>Three Months Ended</b>	
	<b>April 3, 2011</b>	<b>April 4, 2010</b>
<b>OPERATING ACTIVITIES</b>		
Net income	\$ 7,906	\$ 5,733
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	3,575	3,228
Amortization	1,418	979
Compensation expense of share-based plans	1,136	843
Tax effect of share-based compensation	(256)	112
Loss on disposal of property, plant and equipment	2	0
Changes in operating assets and liabilities, net of effects from business acquisitions:		
Trade accounts receivable	1,421	(10,734)
Inventories	(4,622)	(4,332)
Prepaid expenses and other assets	(6,781)	(8,212)
Accounts payable, accrued expenses and other liabilities	416	9,609
Net cash provided by (used in) operating activities	4,215	(2,774)
<b>INVESTING ACTIVITIES</b>		
Additions to property, plant and equipment	(2,693)	(3,606)
Proceeds from the sale of property, plant and equipment	12	13
Purchase of investments	(1)	0
Business acquisitions, net of cash acquired	(20,221)	(340)
Net cash used in investing activities	(22,903)	(3,933)
<b>FINANCING ACTIVITIES</b>		
Proceeds from long-term borrowings	60,748	16,110
Payments of long-term debt	(34,778)	(15,972)
Dividends paid	(663)	(639)
Proceeds from the exercise of stock options	213	256
Tax effect of share-based compensation	256	(112)
Net cash (used in) provided by financing activities	25,776	(357)
Effect of exchange rate changes on cash and cash equivalents	651	(1,474)
<b>INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS</b>	<b>7,739</b>	<b>(8,538)</b>
Cash and cash equivalents at beginning of period	45,752	46,350
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$ 53,491</b>	<b>\$ 37,812</b>
Supplemental Cash Flow Information:		
Cash paid during the three months for:		
Income taxes	\$ 3,766	\$ 2,216

## Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

Interest	\$	599	\$	593
----------	----	-----	----	-----

The accompanying notes are an integral part of these unaudited consolidated financial statements.



**Table of Contents**

**CIRCOR INTERNATIONAL, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(1) Basis of Presentation**

The accompanying unaudited, consolidated financial statements have been prepared according to the rules and regulations of the United States Securities and Exchange Commission ( SEC ) and, in the opinion of management, reflect all adjustments, which include normal recurring adjustments, necessary for a fair presentation of the consolidated balance sheets, consolidated statements of operations and consolidated statements of cash flows of CIRCOR International, Inc. ( CIRCOR , the Company , us , we or our ) for the periods presented. We prepare our interim financial information using the same accounting principles as we use for our annual audited financial statements. Certain information and note disclosures normally included in the annual audited financial statements have been condensed or omitted in accordance with prescribed SEC rules. We believe that the disclosures made in our consolidated financial statements and the accompanying notes are adequate to make the information presented not misleading.

The consolidated balance sheet at December 31, 2010 is as reported in our audited financial statements as of that date. Our accounting policies are described in the notes to our December 31, 2010 financial statements, which were included in our Annual Report filed on Form 10-K. We recommend that the financial statements included in this Quarterly Report on Form 10-Q be read in conjunction with the financial statements and notes included in our Annual Report filed on Form 10-K for the year ended December 31, 2010.

We operate and report financial information using a 52-week fiscal year ending December 31. The data periods contained within our Quarterly Reports on Form 10-Q reflect the results of operations for the 13-week, 26-week and 39-week periods which generally end on the Sunday nearest the calendar quarter-end date. Operating results for the three months ended April 3, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011.

*Reclassifications*

Certain prior period financial statement amounts have been reclassified to conform to currently reported presentations.

**(2) Summary of Significant Accounting Policies**

The significant accounting policies used in preparation of these condensed consolidated financial statements for the three months ended April 3, 2011 are consistent with those discussed in Note 2 to the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2010. There were no new accounting pronouncements adopted during the three months ended April 3, 2011 that had a material impact on our financial statements.

**(3) Share-Based Compensation**

As of April 3, 2011, we have one share-based compensation plan. The Amended and Restated 1999 Stock Option and Incentive Plan (the 1999 Stock Plan ), which was adopted by our Board of Directors and approved by our shareholders, permits the granting of the following types of awards to our officers, other employees and non-employee directors: incentive stock options; non-qualified stock options; deferred stock awards; restricted stock awards; unrestricted stock awards; performance share awards; cash-based awards; stock appreciation rights and dividend equivalent rights. The 1999 Stock Plan provides for the issuance of up to 3,000,000 shares of common stock (subject to adjustment for stock splits and similar events). New options granted under the 1999 Stock Plan could have varying vesting provisions and exercise periods. Options granted vest in periods ranging from one to six years and expire ten years after the grant date. Restricted stock units granted generally vest from three to six years. Vested restricted stock units will be settled in shares of our common stock. As of April 3, 2011, there were 184,949 stock options and 498,588 restricted stock units outstanding. In addition, there were 455,052 shares available for grant under the 1999 Stock Plan as of April 3, 2011. As of April 3, 2011, there were 13,286 outstanding restricted stock units that contain rights to nonforfeitable dividend equivalents and are considered participating securities that are included in our computation of basic and fully diluted earnings per share. There is no difference in the earnings per share amounts between the two class method and the treasury stock method, which is why we continue to use the treasury stock method.

## Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

For all of our stock option grants, the fair value of each grant was estimated at the date of grant using the Black-Scholes option pricing model. Black-Scholes utilizes assumptions related to volatility, the risk-free interest rate and the dividend yield and employee exercise behavior. Expected volatilities utilized in the model are based on the historic volatility of the Company's stock price. The risk free interest rate is derived from the U.S. Treasury Yield curve in effect at the time of the grant. In the first quarter of 2011, we granted 58,768 stock options.

The fair value of stock options granted during the three months ended April 3, 2011 of \$17.28 was estimated using the following weighted-average assumptions:

## Table of Contents

Risk-free interest rate	1.2%
Expected life (years)	5.8
Expected stock volatility	46.3%
Expected dividend yield	0.4%

We account for Restricted Stock Unit ( RSU ) Awards by expensing the weighted average fair value to selling, general and administrative expenses ratably over vesting periods ranging from three to six years. During the three months ended April 3, 2011 and April 4, 2010, we granted 63,372 and 130,226 RSU Awards with approximate fair values of \$39.00 and \$30.91 per RSU Award, respectively.

The CIRCOR Management Stock Purchase Plan, which is a component of the 1999 Stock Plan, provides that eligible employees may elect to receive restricted stock units in lieu of all or a portion of their pre-tax annual incentive bonus and, in some cases, make after-tax contributions in exchange for restricted stock units ( RSU MSPs ). In addition, non-employee directors may elect to receive restricted stock units in lieu of all or a portion of their annual directors' fees. Each RSU MSP represents a right to receive one share of our common stock after a three-year vesting period. RSU MSPs are granted at a discount of 33% from the fair market value of the shares of our common stock on the date of grant. This discount is amortized as compensation expense, to selling, general and administrative expenses, over a four year period. A total of 43,734 and 13,505 RSUs with per unit discount amounts representing fair values of \$17.28 and \$10.20 were granted under the CIRCOR Management Stock Purchase Plan during the three months ended April 3, 2011 and April 4, 2010, respectively.

Compensation expense related to our share-based plans for the three month periods ended April 3, 2011, and April 4, 2010 was \$1.1 million and \$0.8 million, respectively, and was recorded as selling, general and administrative expense. As of April 3, 2011, there was \$8.7 million of total unrecognized compensation costs related to our outstanding share-based compensation arrangements. That cost is expected to be recognized over a weighted average period of 3.1 years.

A summary of the status of all stock options granted to employees and non-employee directors as of April 3, 2011 and changes during the three month period then ended is presented in the table below (Options in thousands):

	Options	Weighted Average Exercise Price
Options outstanding at beginning of period	135	\$ 23.29
Granted	59	39.00
Exercised	(9)	24.32
Forfeited	0	N/A
Options outstanding at end of period	185	\$ 28.24
Options exercisable at end of period	92	\$ 20.38

The weighted average contractual term for stock options outstanding and options exercisable as of April 3, 2011 was 6.2 years and 2.8 years, respectively. The aggregate intrinsic value of stock options exercised during the three months ended April 3, 2011 was \$0.2 million and the aggregate intrinsic value of stock options outstanding and options exercisable as of April 3, 2011 was \$3.5 million and \$2.5 million, respectively.

A summary of the status of all RSU Awards granted to employees and non-employee directors as of April 3, 2011 and changes during the three month period then ended is presented in the table below (RSUs in thousands):

	RSUs	Weighted Average Grant Date Fair Value
RSU Awards outstanding at beginning of period	340	\$ 30.79
Granted	63	39.00
Settled	(82)	28.60
Cancelled	0	N/A
RSU Awards outstanding at end of period	321	\$ 32.98

## Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

RSU Awards vested and deferred at end of period	12	\$	34.64
---	----	----	-------

The aggregate intrinsic value of RSU Awards settled during the three months ended April 3, 2011 was \$3.3 million and the aggregate intrinsic value of RSU Awards outstanding and RSU Awards vested and deferred as of April 3, 2011 was \$15.1 million and \$0.6 million, respectively.

A summary of the status of all RSU MSPs granted to employees and non-employee directors as of April 3, 2011 and changes during the three month period then ended is presented in the table below (RSUs in thousands):

**Table of Contents**

	RSUs	Weighted Average Exercise Price
RSU MSPs outstanding at beginning of period	173	\$ 18.63
Granted	44	26.13
Settled	(39)	29.07
Cancelled	0	N/A
RSU MSPs outstanding at end of period	178	\$ 18.20
RSU MSPs vested and deferred at end of period	1	\$ 32.60

The aggregate intrinsic value of RSU MSPs settled during the three months ended April 3, 2011 was \$0.4 million and the aggregate intrinsic value of RSU MSPs outstanding and RSU MSPs vested and deferred as of April 3, 2011 was \$5.1 million and \$0.0 million, respectively.

**(4) Inventories**

Inventories consist of the following (In thousands):

	April 3, 2011	December 31, 2010
Raw materials	\$ 58,182	\$ 49,451
Work in process	80,015	80,402
Finished goods	39,143	37,944
	\$ 177,340	\$ 167,797

**(5) Goodwill and Intangible Assets**

The following table shows goodwill, by segment, as of April 3, 2011 (In thousands):

	Energy	Aerospace	Flow Technologies	Consolidated Total
Goodwill as of December 31, 2010	\$ 39,423	\$ 19,430	\$ 4,322	\$ 63,175
Acquisitions	8,757	0	0	8,757
Adjustments to preliminary purchase price allocation	0	0	(47)	(47)
Currency translation adjustments	796	96	66	958
Goodwill as of April 3, 2011	\$ 48,976	\$ 19,526	\$ 4,341	\$ 72,843

The table below presents gross intangible assets and the related accumulated amortization as of April 3, 2011 (In thousands):

	Gross Carrying Amount	Accumulated Amortization
Patents	\$ 6,068	\$ (5,517)
Trademarks and trade names	30,456	0
Land use rights	444	(59)
Customer relationships	37,590	(12,042)
Backlog	2,327	(1,194)
Other	7,244	(3,340)

# Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

Total	\$ 84,129	\$ (22,152)
-------	-----------	-------------

Net carrying value of intangible assets \$ 61,977

The table below presents estimated remaining amortization expense for intangible assets recorded as of April 3, 2011 (In thousands):

	2011	2012	2013	2014	2015	After 2015
Estimated amortization expense	\$ 3,246	\$ 3,855	\$ 3,808	\$ 3,473	\$ 3,445	\$ 13,694

**Table of Contents****(6) Segment Information**

The following table presents certain reportable segment information (In thousands):

	Energy	Aerospace	Flow Technologies	Corporate /Eliminations	Consolidated Total
<b>Three Months Ended April 3, 2011</b>					
Net revenues	\$ 99,170	\$ 32,109	\$ 72,091	\$ 0	\$ 203,370
Inter-segment revenues	306	1	92	(399)	0
Operating income (loss)	6,393	3,727	9,116	(6,464)	12,772
Interest income					(43)
Interest expense					816
Other income, net					915
Income before income taxes					11,084
Identifiable assets	329,427	191,610	188,850	(43,179)	666,708
Capital expenditures	1,058	544	800	291	2,693
Depreciation and amortization	2,000	1,343	1,501	157	5,001
<b>Three Months Ended April 4, 2010</b>					
Net revenues	\$ 57,722	\$ 27,274	\$ 61,273	\$ 0	\$ 146,269
Inter-segment revenues	139	0	174	(313)	0
Operating income (loss)	2,025	3,606	6,925	(4,607)	7,949
Interest income					(43)
Interest expense					597
Other expense, net					(51)
Income before income taxes					7,446
Identifiable assets	262,020	181,368	172,477	(50,475)	565,390
Capital expenditures	899	1,517	936	254	3,606
Depreciation and amortization	1,728	1,021	1,389	69	4,207

Each reporting segment is individually managed and has separate financial results that are reviewed by our chief operating decision-maker. Each segment contains related products and services particular to that segment. For further discussion of the products included in each segment refer to Note (1) of the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010.

In calculating operating income for each reporting segment, substantial administrative expenses incurred at the corporate level for the benefit of other reporting segments were allocated to the segments based upon specific identification of costs, employment related information or net revenues.

Corporate / Eliminations are reported on a net after allocations basis. Inter-segment intercompany transactions affecting net operating profit have been eliminated within the respective operating segments.

The operating loss reported in the Corporate / Eliminations column in the preceding table consists primarily of the following corporate expenses: compensation and fringe benefit costs for executive management and other corporate staff; corporate development costs (relating to mergers and acquisitions); human resource development and benefit plan administration expenses; legal, accounting and other professional and consulting fees; facilities, equipment and maintenance costs; and travel and various other administrative costs. The above costs are incurred in the course of furthering the business prospects of the Company and relate to activities such as: implementing strategic business growth opportunities; corporate governance; risk management; treasury; investor relations and shareholder services; regulatory compliance; and stock transfer agent costs.

The total assets for each operating segment have been reported as the Identifiable Assets for that segment, including inter-segment intercompany receivables, payables and investments in other CIRCOR companies. Identifiable assets reported in Corporate / Eliminations include both corporate assets, such as cash, deferred taxes, prepaid and other assets, fixed assets, as well as the elimination of all inter-segment intercompany assets. The elimination of intercompany assets results in negative amounts reported in Corporate / Eliminations for Identifiable Assets for the periods ended April 3, 2011 and April 4, 2010. Corporate Identifiable Assets after elimination of intercompany assets were \$37.0 million and \$23.8 million as of April 3, 2011 and April 4, 2010, respectively.





**Table of Contents****(7) Earnings Per Common Share (In thousands, except per share amounts):**

	April 3, 2011		Three Months Ended		April 4, 2010	
	Net Income	Shares	Per Share Amount	Net Income	Shares	Per Share Amount
Basic EPS	\$ 7,906	17,163	\$ 0.46	\$ 5,733	17,051	\$ 0.34
Dilutive securities, common stock options	0	215	(0.01)	0	142	(0.01)
Diluted EPS	\$ 7,906	17,378	\$ 0.45	\$ 5,733	17,193	\$ 0.33

There were 93,514 and 294,749 anti-dilutive stock options and RSUs for the three months ended April 3, 2011 and April 4, 2010, respectively.

**(8) Financial Instruments***Fair Value*

The carrying amounts of cash and cash equivalents, trade receivables and trade payables approximate fair value because of the short maturity of these financial instruments. Short-term investments (principally guaranteed investment certificates) are carried at cost which approximates fair value at the balance sheet date. The fair value of our variable rate debt approximates its carrying amount.

*Foreign Currency Exchange Risk*

The Company is exposed to certain risks relating to its ongoing business operations, including foreign currency exchange rate risk and interest rate risk. The Company currently uses derivative instruments to manage foreign currency risk on certain business transactions denominated in foreign currencies. To the extent the underlying transactions hedged are completed, these forward contracts do not subject us to significant risk from exchange rate movements because they offset gains and losses on the related foreign currency denominated transactions. These forward contracts do not qualify as hedging instruments for accounting purposes and, therefore, do not qualify for fair value or cash flow hedge treatment. Any unrealized gains and losses on our contracts are recognized as a component of other expense in our consolidated statements of operations.

As of April 3, 2011, we had thirteen forward contracts with values as follows (in thousands):

Currency	Number	Contract Amount
U.S. Dollar/GBP	6	1,909 U.S. Dollars
Euro/U.S. Dollar	4	873 Euros
U.S. Dollar/Euro	3	5,000 U.S. Dollars

This compares to eighteen forward contracts as of December 31, 2010. The fair value asset of the derivative forward contracts as of April 3, 2011 was approximately \$0.2 million and is included in prepaid expenses and other current assets on our balance sheet. This compares to a fair value liability of approximately \$1.7 million that was included in accrued expenses and other current liabilities on our balance sheet as of December 31, 2010.

We have determined that the majority of the inputs used to value our foreign currency forward contracts fall within Level 2 of the fair value hierarchy, found under Accounting Standards Codification (ASC) Topic 820.1. The credit valuation adjustments, such as estimates of current credit spreads to evaluate the likelihood of default by us and our counterparties are Level 3 inputs. However, we have assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our foreign currency forward contracts and determined that the credit valuation adjustments are not significant to the overall valuation. As a result, we have determined that our derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

**(9) Comprehensive Income (Loss)**

## Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

Comprehensive income (loss) for the three months ended April 3, 2011 and April 4, 2010 consists of the following (In thousands):

	Three Months Ended	
	April 3, 2011	April 4, 2010
Net income	\$ 7,906	\$ 5,733
Cumulative translation adjustments	9,449	(7,305)
Total comprehensive (loss) income	\$ 17,355	\$ (1,572)

## **Table of Contents**

### **(10) Contingencies and Commitments**

#### **Asbestos Litigation**

##### *Introduction*

On July 12, 2010 (the Filing Date), our subsidiary Leslie Controls, Inc. (Leslie) filed a voluntary petition (the Bankruptcy Filing) under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the District of Delaware and, simultaneously, filed a pre-negotiated plan of reorganization (as amended, the Reorganization Plan or Plan) in an effort to permanently resolve Leslie's asbestos liability. On February 7, 2011, the U.S. Federal District Court for the District of Delaware (the District Court) affirmed the Bankruptcy Court's earlier order confirming Leslie's Reorganization Plan, thus clearing the way for Leslie to emerge from bankruptcy. On April 28, 2011, in accordance with the terms of the Reorganization Plan, Leslie emerged from bankruptcy free and clear of asbestos liabilities. The following discussion addresses both events occurring prior to the bankruptcy filing and events occurring thereafter.

##### *Events Pre-dating Leslie's Bankruptcy Filing*

Like many other manufacturers of fluid control products, Leslie, which we acquired in 1989, had been up to the date of the Bankruptcy Filing named as a defendant in product liability actions brought on behalf of individuals seeking compensation for their alleged asbestos exposure. In some instances, we also have been named individually and/or as alleged successor in interest in these cases. At the Filing Date, Leslie was a named defendant in approximately 1,340 active, unresolved asbestos-related claims filed in California, Texas, New York, Massachusetts, West Virginia, Rhode Island, Illinois and 23 other states. Approximately 713 of these claims involve claimants allegedly suffering from (or the estates of decedents who allegedly died from) mesothelioma, a fatal malignancy associated with asbestos exposure.

Leslie's asbestos-related claims generally involved its fluid control products. Leslie management believes that any asbestos was incorporated entirely within the product in a way that would not allow for any ambient asbestos during normal operation or during normal inspection and repair procedures. Leslie and its insurers' general strategy was to vigorously defend these claims. Nevertheless, while we strongly believe that exposure to Leslie's products did not cause asbestos-related illness to any plaintiff, juries and courts have reached a different conclusion in particular cases and could have done so in others.

Leslie resolved a number of asbestos-related claims in the few years prior to the Bankruptcy Filing for strategic reasons, including avoidance of defense costs and the possible risk of excessive verdicts. The amounts expended on asbestos-related claims in any year were generally impacted by the number of claims filed, the volume of pre-trial proceedings, and the number of trials and settlements.

##### *Leslie's Bankruptcy Filing and Subsequent Developments*

On the Filing Date, Leslie filed the Reorganization Plan in an effort to permanently resolve Leslie's asbestos liability. Key terms of the pre-negotiated Reorganization Plan include the creation of a trust pursuant to Section 524(g) of the U.S. Bankruptcy Code (the Trust) to be funded by (1) a contribution by Leslie consisting of (a) a \$1.0 million promissory note and (b) an assignment of any and all rights of Leslie (i) to proceeds under existing insurance policies that provide coverage for asbestos personal injury claims, and (ii) to \$2.625 million of proceeds from a settlement agreement between Leslie and one of its insurers, Continental Casualty, a CNA company (Continental) entered into in April 2010; and (2) a \$74.0 million cash contribution by CIRCOR. All current and future asbestos claims against Leslie, as well as all current and future derivative claims against CIRCOR or its affiliates or against Leslie's former parent company, Watts Water Technologies, Inc. (Watts), or its affiliates arising from Leslie's alleged asbestos liabilities, will be channeled to the Trust for review and payment, thus providing both Leslie and CIRCOR with permanent court protection from such claims. Under the Reorganization Plan, Leslie will remain a subsidiary of CIRCOR. The Reorganization Plan was negotiated with both a committee of key plaintiff attorneys representing Leslie's current asbestos claimants, and also with an independent representative of Leslie's future claimants.

The Bankruptcy Filing automatically stayed the prosecution or commencement of all asbestos-related claims against Leslie. On July 14, 2010, the Bankruptcy Court entered a temporary restraining order that barred the prosecution or commencement of claims against CIRCOR or Watts arising from Leslie's alleged asbestos liabilities, and, on August 9, 2010, the Bankruptcy Court granted Leslie's request for a preliminary injunction that barred the prosecution or commencement of such claims until final approval of the Reorganization Plan under which all such claims were permanently channeled to the Trust. Under the Bankruptcy Code, confirmation of the Reorganization Plan required the approval of at least 75% of current asbestos claimants as well as court approval. Leslie, in fact, ultimately received unanimous approval of the Plan from the asbestos claimants who voted and, on October 26 and 27, 2010, the Bankruptcy Court held hearings on confirmation of the Reorganization Plan (the Confirmation Hearings). At the Confirmation Hearings, certain of Leslie's insurers sought to object to the Reorganization Plan's confirmation. The Bankruptcy Court, however, determined that the terms of the Reorganization Plan were neutral to the rights of such insurers

## Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

and ruled that the insurers did not have standing to raise objections to confirmation. Because Leslie previously had resolved all of the other objections to confirmation of the Reorganization Plan, the Confirmation Hearings proceeded in an uncontested manner, and, on October 28, 2010, the Bankruptcy Court entered an order confirming the Reorganization Plan (the Confirmation Order ).

**Table of Contents**

Following issuance of the Confirmation Order, Leslie sought the required review and approval of the 524(g) trust aspects of the Reorganization Plan by the District Court. In connection with this review, those insurers who previously sought to object at the Confirmation Hearings filed oppositions to the affirmation by the District Court of the Plan, and, in addition, appealed certain rulings made by the Bankruptcy Court leading up to the issuance of the Confirmation Order. Leslie eventually resolved the concerns of the insurers, however, by agreeing to certain changes in the Plan language relative to insurance provisions. After Leslie sought and received from the Bankruptcy Court a revised Confirmation Order incorporating the agreed upon changes (the Revised Confirmation Order), an affirmation hearing was held by the District Court on February 4, 2011. Following that hearing, on February 7, 2011, the District Court entered an order approving the 524(g) trust aspects of the Reorganization Plan and affirming the Revised Confirmation Order (the District Court Order).

*Leslie's Emergence From Bankruptcy*

On April 28, 2011, pursuant to the terms of the Reorganization Plan, Leslie and CIRCOR funded the Trust, and Leslie emerged from Chapter 11 bankruptcy protection. As a result, all current and future asbestos related claims against Leslie, as well as all current and future derivative claims against CIRCOR, will now be permanently channeled to the Trust.

*Accounting Indemnity and Defense Cost Liabilities and Assets*

Leslie recorded an estimated liability associated with reported asbestos claims when it believed that a loss was both probable and could be reasonably estimated.

During 2007, we engaged Hamilton, Rabinovitz and Associates, Inc. (HR&A), a firm specializing in estimating expected liabilities of mass tort claims, to help us determine an estimate of Leslie's asbestos-related liabilities. Because Leslie's claims experience was both limited and variable, HR&A concluded that any estimate of pending or future liabilities of Leslie's asbestos claims would be highly uncertain from a statistical perspective. Leslie's management determined, however, that, by using its historical (albeit limited and variable) average cost by disease classification in resolving closed claims, and by applying this information to the mix of current open claims, it could make a reasonable estimate of the indemnity costs to be incurred in resolving such current open claims. As a result, Leslie recorded an initial liability of \$9.0 million during the fourth quarter of 2007 for the estimated indemnity cost associated with resolution of its then open claims.

Based on Leslie's discussions with HR&A regarding the impact of additional claims data on HR&A's conclusion regarding estimating future claim liabilities, Leslie requested that HR&A update its analysis annually to determine whether such additional data warranted any change to HR&A's analyses and conclusions regarding future estimation. As a result, during the fourth quarter of 2008, HR&A updated its analysis and reaffirmed its conclusion, at that time, that a forecast of the number and value of any future asbestos claims was unwarranted and highly uncertain from a statistical perspective. However, when again updating its analysis at management's request during the fourth quarter of 2009, HR&A concluded that Leslie now had claims experience sufficient to provide a reasonable estimate of the liability associated not only with Leslie's open asbestos claims but also with respect to future claims. As a result, during the fourth quarter of 2009, Leslie recorded an additional \$39.8 million to its asbestos liability accrual for the estimated indemnity costs associated with future claims anticipated to be filed during the next five years. Asbestos related defense costs continued to be expensed as incurred and were not included in any future claim reserves.

During the second quarter of 2010, as a result of Leslie's Bankruptcy Filing and Reorganization Plan, we accrued liabilities based on the terms of the Reorganization Plan. As of December 31, 2010, we therefore recorded net Leslie asbestos and bankruptcy liabilities for resolution of pending and future claims of \$79.8 million (all classified as a current liability). As of April 3, 2011 these balances remained virtually unchanged. A summary of Leslie's accrued liabilities, including contributions to the Trust under the Reorganization Plan for existing and future asbestos claims as well as incurred but unpaid asbestos defense cost liabilities and the related insurance recoveries, is provided below.

<b>In Thousands</b>	<b>April 3, 2011</b>	<b>December 31, 2010</b>
Existing claim indemnity liability	\$ 34	\$ 64
Amounts payable to 524(g) trust	77,625	77,625
Incurred defense cost liability	2,142	2,142
Insurance recoveries receivable	(38)	(38)
<b>Net Leslie asbestos and bankruptcy liability</b>	<b>\$ 79,763</b>	<b>\$ 79,793</b>

*First Quarter 2011 Experience and Financial Statement Impact*

## Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

The following table provides information regarding the ongoing pre-tax costs associated with Leslie's asbestos litigation through the three months ended April 3, 2011 as well as additional charges incurred. The \$1.0 million bankruptcy related charges for the period ending April 3, 2011 is comprised solely of bankruptcy related professional fees.

**Table of Contents**

(In Thousands)	Three Months Ended	
	April 3, 2011	April 4, 2010
Indemnity costs accrued (filed cases)	\$ 0	\$ 699
Adverse verdict interest costs (verdict appealed)	0	65
Defense cost incurred	0	3,731
Insurance recoveries adjustment	0	(3,652)
Insurance recoveries accrued	0	(1,491)
Bankruptcy related costs	1,001	0
Net pre-tax Leslie asbestos and bankruptcy charges (recoveries)	\$ 1,001	\$ (648)

*Insurance*

As of April 3, 2011, we believed that the aggregate amount of indemnity (on a cash basis) remaining on Leslie's primary layer of insurance was approximately \$1.8 million. From a financial statement perspective, however, after giving effect to our accrual for the estimated indemnity cost of resolving pending claims, Leslie had recorded the maximum amount of available primary layer insurance as of September 2008. As a result, asbestos related indemnity costs from that point forward were no longer partially offset by a corresponding insurance recovery. However, defense costs, which were recognized as incurred, continued to be and, but for the Bankruptcy Filing, would have continued to be partially offset by a 36% contribution from Leslie's remaining primary layer insurance carrier until such time as the aggregate amount of indemnity claims paid out (on a cash basis) by the remaining primary layer insurance carrier exceeded policy limits.

In addition to its primary layer of insurance, Leslie does have some available excess insurance coverage. However, some of this excess insurance lies above layers of excess insurance written by insolvent insurers which could affect when Leslie may be able to recover this excess insurance. Moreover, unlike primary policies under which defense costs do not erode policy limits, the terms of excess policies typically provide that covered defense costs do erode policy limits. Because the probability and amount of any recovery from excess carriers was uncertain, however, Leslie had not accrued an insurance receivable for such recovery as of the Filing Date. As discussed previously, under the Reorganization Plan, all remaining insurance proceeds are contributed to the Trust.

*Other Matters*

Smaller numbers of asbestos-related claims have also been filed against two of our other subsidiaries: Spence, the stock of which we acquired in 1984; and Hoke, the stock of which we acquired in 1998. Due to the nature of the products supplied by these entities, the markets they serve and our historical experience in resolving these claims, we do not believe that asbestos-related claims will have a material adverse effect on the financial condition, results of operations or liquidity of Spence or Hoke, or the financial condition, consolidated results of operations or liquidity of the Company.

**Standby Letters of Credit**

We execute standby letters of credit, which include bid bonds and performance bonds, in the normal course of business to ensure our performance or payments to third parties. The aggregate notional value of these instruments was \$49.0 million at April 3, 2011. Our historical experience with these types of instruments has been good and no claims have been paid in the current or past five fiscal years. We believe that the likelihood of demand for payments relating to the outstanding instruments is remote. These instruments have expiration dates ranging from less than one month to four years from April 3, 2011.

The following table contains information related to standby letters of credit instruments outstanding as of April 3, 2011 (In thousands):

Term Remaining	Maximum Potential Future Payments
0 - 12 months	\$ 31,210
Greater than 12 months	17,742
Total	\$ 48,952

**(11) Defined Pension Benefit Plans**

## Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

We maintain two pension benefit plans, a qualified noncontributory defined benefit plan and a nonqualified, noncontributory defined benefit supplemental plan that provides benefits to certain highly compensated officers and employees. To date, the supplemental plan remains an unfunded plan. These plans include significant pension benefit obligations which are calculated based on actuarial valuations. Key assumptions are made in determining these obligations and related expenses, including expected rates of return on plan assets and discount rates. Benefits are based primarily on years of service and employees' compensation.



**Table of Contents**

As of July 1, 2006, in connection with a revision to our retirement plan, we froze the pension benefits of our qualified noncontributory plan participants. Under the revised plan, such participants generally do not accrue any additional benefits under the defined benefit plan after July 1, 2006.

During the three months ended April 3, 2011, we made cash contributions of \$1.7 million to our qualified defined benefit pension plan. For the remainder of 2011, we expect to make voluntary cash contributions of approximately \$1.2 million to our qualified defined benefit pension plan, although global capital market and interest rate fluctuations may impact future funding requirements.

Additionally, substantially all of our U.S. employees are eligible to participate in a 401(k) savings plan. Under this plan, we make a core contribution and match a specified percentage of employee contributions, subject to certain limitations.

The components of net pension benefit expense are as follows (In thousands):

	Three Months Ended	
	April 3, 2011	April 4, 2010
Service cost-benefits earned	\$ 108	\$ 100
Interest cost on benefits obligation	540	534
Estimated return on assets	(610)	(506)
Prior service cost amortization	0	0
Loss amortization	85	73
Net periodic cost of defined pension benefit plans	\$ 123	\$ 201

**(12) Income Taxes**

As required by the Income Tax Topic of the ASC at April 3, 2011 and at December 31, 2010, we had \$1.5 million and \$1.6 million of unrecognized tax benefits, respectively, all of which would affect our effective tax rate if recognized in any future period.

We recognize interest and penalties related to uncertain tax positions in income tax expense. As of April 3, 2011, we have approximately \$0.1 million of accrued interest related to uncertain tax positions.

The Company files income tax returns in the U.S. federal jurisdiction and in various state, local and foreign jurisdictions. The Internal Revenue Service has concluded its examination of the Company for 2007. The Company is no longer subject to examination by the Internal Revenue Service for years prior to 2008 and is no longer subject to examination by the tax authorities in Italy for years prior to 2005. The Company is under examination for income tax filings in various state and foreign jurisdictions.

**(13) Guarantees and Indemnification Obligations**

As permitted under Delaware law, we have agreements whereby we indemnify certain of our officers and directors for certain events or occurrences while the officer or director is, or was, serving at our request in such capacity. The term of the indemnification period is for the officer's or director's lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. However, we have directors and officers' liability insurance policies that limit our exposure for events covered under the policies and should enable us to recover a portion of any future amounts paid. As a result of the coverage under these insurance policies, we believe the estimated fair value of these indemnification agreements based on Level 3 criteria as described under ASC Topic 820.1 is minimal and, therefore, we have no liabilities recorded from those agreements as of April 3, 2011.

We record provisions for the estimated cost of product warranties, primarily from historical information, at the time product revenue is recognized. While we engage in extensive product quality programs and processes, our warranty obligation is affected by product failure rates, utilization levels, material usage, service delivery costs incurred in correcting a product failure, and supplier warranties on parts delivered to us. Should actual product failure rates, utilization levels, material usage, service delivery costs or supplier warranties on parts differ from our estimates, revisions to the estimated warranty liability would be required.

The following table sets forth information related to our product warranty reserves for the three months ended April 3, 2011 (In thousands):

Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

Balance beginning December 31, 2010	\$ 2,508
Provisions	877
Claims settled	(250)
Currency translation adjustments	69
Balance ending April 3, 2011	\$ 3,204

## **Table of Contents**

### **(14) Business Acquisitions**

On February 4, 2011, we acquired certain assets of Valvulas S.F. Industria e Comercio Ltda. ( SF Valves ), a Sao Paulo, Brazil based manufacturer of valves for the energy market. SF Valves is reported in our Energy segment. We expect to finalize our acquisition accounting, including the fair valuation of tangible and intangible assets and liabilities as well as uncertain tax positions during the second quarter of 2011. The excess of the purchase price over the current estimated fair value of the net identifiable assets of \$8.8 million was recorded as goodwill and may be deductible for Brazilian tax purposes.

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

*This Quarterly Report on Form 10-Q contains certain statements that are forward-looking statements as that term is defined under the Private Securities Litigation Reform Act of 1995 (the Act ) and releases issued by the SEC. The words may, hope, should, expect, plan, anticipate, intend, believe, estimate, predict, potential, continue, and other expressions which are predictions of or indicate future events and trends and which do not relate to historical matters, identify forward-looking statements. We believe that it is important to communicate our future expectations to our stockholders, and we, therefore, make forward-looking statements in reliance upon the safe harbor provisions of the Act. However, there may be events in the future that we are not able to accurately predict or control and our actual results may differ materially from the expectations we describe in our forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause our actual results, performance or achievements to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, the cyclicity and highly competitive nature of some of our end markets which can affect the overall demand for and pricing of our products, changes in the price of and demand for oil and gas in both domestic and international markets, variability of raw material and component pricing, changes in our suppliers' performance, fluctuations in foreign currency exchange rates, our ability to continue operating our manufacturing facilities at efficient levels including our ability to continue to reduce costs, our ability to generate increased cash by reducing our inventories, our prevention of the accumulation of excess inventory, our ability to successfully implement our acquisition strategy, fluctuations in interest rates, our ability to continue to successfully defend product liability actions including asbestos-related claims, as well as the uncertainty associated with the current worldwide economic conditions and the continuing impact on economic and financial conditions in the United States and around the world as a result of terrorist attacks, current Middle Eastern conflicts and related matters. We advise you to read further about certain of these and other risk factors set forth in Part I, Item 1A, Risk Factors of our Annual Report filed on Form 10-K for the year ended December 31, 2010, together with subsequent reports we have filed with the SEC on Forms 10-Q and 8-K, which may supplement, modify, supersede, or update those risk factors. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.*

### **Overview**

CIRCOR International, Inc. designs, manufactures and markets valves and other highly engineered products and sub-systems used in the energy, aerospace and industrial markets. Within our major product groups, we develop, sell and service a portfolio of fluid-control products, subsystems and technologies that enable us to fulfill our customers' unique fluid-control application needs.

We have organized our business segment reporting structure into three segments: Energy, Aerospace, and Flow Technologies. Our Energy segment primarily serves large international energy projects, short-cycle North American energy markets, and the pipeline transmission equipment and services end markets. Our Aerospace segment primarily serves the commercial and military aerospace markets. Our Flow Technologies segment serves our broadest variety of end-markets, including power generation, industrial and commercial HVAC/steam, industrial and process markets and chemical and refining. The Flow Technologies segment also provides products specifically designed for U.S. and international navy applications.

We have been transforming our worldwide operations and culture through the development of lean manufacturing techniques ( Lean ) and the implementation of the CIRCOR Business System. The CIRCOR Business System is defined by our commitment to attracting, developing and refining the best talent and pursuing continuous improvement in all aspects of our business and operations. The CIRCOR Business System promotes improved shareholder value through a commitment to core competencies across all of our business units, including talent acquisition and retention, operational excellence, business integration and repositioning, global business development, and new product development.

Our primary objective is to enhance shareholder value through profitable growth of our diversified, multi-national company utilizing the CIRCOR Business System. We strive to be a global growth company with great operational execution. We are working to accomplish these objectives by focusing on key end-markets that have above average growth with highly engineered product and project opportunities including the up-stream and mid-stream oil and gas, power generation, process and aerospace markets using the CIRCOR Business System to excel at:

Talent Acquisition, Development and Retention;

15

## **Table of Contents**

Lean Enterprise, Six Sigma and Continuous Improvement;

Acquisition Integration and Repositioning;

Global Manufacturing and Supply Chain Management;

Global Business Development; and

New Product Development.

Through organic and acquisition-based growth our three to five year objectives are to double the size of CIRCOR, gain significant market positions in our key end-markets and build a global capability in high-growth emerging markets.

## **Basis of Presentation**

All significant intercompany balances and transactions have been eliminated in consolidation. Certain prior period financial statement amounts have been reclassified to conform to currently reported presentations. We monitor our business in three segments: Energy, Aerospace, and Flow Technologies.

We operate and report financial information using a 52-week fiscal year ending December 31. The data periods contained within our Quarterly Reports on Form 10-Q reflect the results of operations for the 13-week, 26-week and 39-week periods, which generally end on the Sunday nearest the calendar quarter-end date.

## **Critical Accounting Policies**

The following discussion of accounting policies is intended to supplement the section *Summary of Significant Accounting Policies* presented in Note 2 to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2010. These policies were selected because they are broadly applicable within our operating units. The expenses and accrued liabilities or allowances related to certain of these policies are initially based on our best estimates at the time of original entry in our accounting records. Adjustments are recorded when our actual experience, or new information concerning our expected experience, differs from underlying initial estimates. These adjustments could be material if our actual or expected experience were to change significantly in a short period of time. We make frequent comparisons of actual experience and expected experience in order to mitigate the likelihood of material adjustments.

There have been no significant changes from the methodology applied by management for critical accounting estimates previously disclosed in our most recent Annual Report on Form 10-K.

### *Revenue Recognition*

Revenue is recognized when products are delivered, title and risk of loss have passed to the customer, no significant post-delivery obligations remain and collection of the resulting receivable is reasonably assured. Shipping and handling costs invoiced to customers are recorded as components of revenues and the associated costs are recorded as cost of sales.

### *Cash, Cash Equivalents, and Short-term Investments*

Cash and cash equivalents consist of amounts on deposit in checking and savings accounts with banks and other financial institutions. Short-term investments primarily consist of guaranteed investment certificates which generally have short-term maturities and are carried at cost which generally approximates fair value.

### *Allowance for Inventory*

## Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

We typically analyze our inventory aging and projected future usage on a quarterly basis to assess the adequacy of our inventory allowances. We provide inventory allowances for excess, slow-moving, and obsolete inventories determined primarily by estimates of future demand. The allowance is measured on an item-by-item basis determined based on the difference between the cost of the inventory and estimated market value. The provision for inventory allowance is a component of our cost of revenues. Assumptions about future demand are among the primary factors utilized to estimate market value. Future demand is generally based on actual usage of inventory on a line item basis over the past two years and is adjusted for forecasted future demand, current backlog levels and/or existing market conditions. At the point of the loss recognition, a new, lower-cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

Our net inventory balance was \$177.3 million as of April 3, 2011, compared to \$167.8 million as of December 31, 2010. Our inventory allowance as of April 3, 2011 was \$16.9 million, compared with \$16.7 million as of December 31, 2010. Our provision for inventory obsolescence was \$0.9 million and \$1.5 million for the first quarter of 2011 and 2010, respectively. For the three months

## **Table of Contents**

ended April 3, 2011, we have experienced increases in organic revenue, orders, and backlog. We believe our inventory allowances remain adequate with the net realizable value of our inventory being higher than our current inventory cost.

If there were to be a sudden and significant decrease in demand for our products, significant price reductions, or if there were a higher incidence of inventory obsolescence because of changing technology and customer requirements, we could be required to increase our inventory allowances and our gross profit could be adversely affected.

### *Penalty Accruals*

Some of our customer agreements, primarily in our project related businesses, contain late shipment penalty clauses whereby we are contractually obligated to pay consideration to our customers if we do not meet specified shipment dates. The accrual for estimated penalties is shown as a reduction of revenue and is based on several factors including limited historical customer settlement experience and management's assessment of specific shipment delay information. Accruals related to these potential late shipment penalties as of April 3, 2011, and December 31, 2010 were \$9.2 million and \$7.9 million, respectively. As we conclude performance under these agreements, the actual amount of consideration paid to our customers may vary significantly from the amounts we currently have accrued.

### *Acquisition Accounting*

In connection with our acquisitions, we assess and formulate a plan related to the future integration of the acquired entity. This process begins during the due diligence process and is generally concluded within twelve months of the acquisition. Our methodology for determining the fair values relating to purchase acquisitions is determined through established valuation techniques for industrial manufacturing companies and we typically utilize third party valuation firms to assist in the valuation of certain tangible and intangible assets.

### *Legal Contingencies*

We are currently involved in various legal claims and legal proceedings, some of which may involve substantial dollar amounts. Periodically, we review the status of each significant matter and assess our potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount can be estimated, we accrue a liability for the estimated loss. Significant judgment is required in both the determination of probability and the determination as to whether an exposure can be reasonably estimated. Because of uncertainties related to these matters, accruals are based on the best information available at the time. As additional information becomes available, we reassess the potential liability related to our pending claims and litigation and may revise our estimates. Such revisions in the estimates of the potential liabilities could have a material adverse effect on our business, results of operations and financial position. For more information related to our outstanding legal proceedings, see *Contingencies and Commitments* in Note 10 of the accompanying consolidated financial statements as well as *Legal Proceedings* in Part II, Item 1 hereof.

### *Impairment Analysis*

As required by ASC Topic 350.1-3, *Goodwill and Intangible Assets*, we perform an annual assessment as to whether there was an indication that goodwill and certain intangible assets are impaired. We also perform impairment analyses whenever events and circumstances indicate that goodwill or certain intangibles may be impaired. In assessing the fair value of goodwill, we use our best estimates of future cash flows of operating activities and capital expenditures of the reporting unit, the estimated terminal value for each reporting unit and a discount rate based on the weighted average cost of capital.

If our estimates or related projections change in the future due to changes in industry and market conditions, we may be required to record additional impairment charges. The goodwill recorded on the consolidated balance sheet as of April 3, 2011 increased \$9.6 million to \$72.8 million compared to \$63.2 million as of December 31, 2010. This increase is primarily due to the acquisition of SF Valves. There were no indicators of impairment as of April 3, 2011.

### *Income Taxes*

Significant management judgment is required in determining our provision for income taxes, deferred tax assets and liabilities and any valuation allowance. Our effective tax rates differ from the statutory rate due to the impact of research and product development tax credits, domestic manufacturing deductions, state taxes, and the tax impact of non-U.S. operations. Our effective tax rate was (0.9)%, (90.3)% and 44.9%, for the fiscal years ended December 31, 2010, 2009 and 2008, respectively. Our tax rate for 2010 included the tax impact of the \$31.4 million of 2010 Leslie bankruptcy related costs. Excluding this charge and related tax benefit, the 2010 effective tax rate would have been 23.7%. Our 2009 tax rate included the tax impact of a \$39.8 million non-cash asbestos charge for future claims anticipated over the next five years for which the tax

## Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

benefit was \$13.9 million. Excluding the non-cash asbestos charge, the 2009 effective tax rate would have been 26.0%. Our 2008 tax rate included the tax impact of an adjustment for goodwill and intangible impairment of \$141.3 million, for which the tax basis was \$32.8 million. Excluding the goodwill and impairment charge, the 2008 effective tax rate would have been 30.3%.



**Table of Contents**

For 2011, we expect an effective income tax rate of approximately 30.0%. Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and vice versa. Changes in the valuation of our deferred tax assets or liabilities, or changes in tax laws or interpretations thereof may also adversely affect our future effective tax rate. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

The Company has a net foreign deferred tax liability and a domestic deferred income tax asset. With regard to deferred income tax assets, we maintained a total valuation allowance of \$9.4 million and \$10.1 million at April 3, 2011 and December 31, 2010, respectively, due to uncertainties related to our ability to utilize certain of these assets, primarily consisting of certain foreign tax credits, state net operating losses and state tax credits carried forward. The valuation allowance is based on estimates of taxable income in each of the jurisdictions in which we operate and the period over which our deferred tax assets will be recoverable. If market conditions improve and future results of operations exceed our current expectations, our existing tax valuation allowances may be adjusted, resulting in future tax benefits. Alternatively, if market conditions deteriorate or future results of operations are less than expected, future assessments may result in a determination that some or all of the deferred tax assets are not realizable. Consequently, we may need to establish additional tax valuation allowances for all or a portion of the gross deferred tax assets, which may have a material adverse effect on our business, results of operations and financial condition. The Company has had a history of domestic taxable income, is able to avail itself of federal tax carryback provisions, has future taxable temporary differences and projects future domestic taxable income. We believe that after considering all of the available objective evidence, it is more likely than not that the results of future operations will generate sufficient taxable income to realize the remaining deferred tax assets.

*Pension Benefits*

We maintain two pension benefit plans, a qualified noncontributory defined benefit plan and a nonqualified, noncontributory defined benefit supplemental plan that provides benefits to certain highly compensated officers and employees. To date, the supplemental plan remains an unfunded plan. These plans include significant pension benefit obligations which are calculated based on actuarial valuations. Key assumptions are made in determining these obligations and related expenses, including expected rates of return on plan assets and discount rates. Benefits are based primarily on years of service and employees' compensation. As of July 1, 2006, in connection with a revision to our retirement plan, we froze the pension benefits of our qualified noncontributory plan participants. Under the revised plan, such participants generally do not accrue any additional benefits under the defined benefit plan after July 1, 2006 and instead receive enhanced benefits associated with our defined contribution 401(k) plan in which substantially all of our U.S. employees are eligible to participate.

During the three months ended April 3, 2011, we made cash contributions of \$1.7 million to our qualified defined benefit pension plan. For the remainder of 2011, we expect to make voluntary cash contributions of approximately \$1.2 million to our qualified defined benefit pension plan, although global capital market and interest rate fluctuations may impact future funding requirements.

**Results of Operations for the Three Months Ended April 3, 2011 Compared to the Three Months Ended April 4, 2010**

The following tables set forth the results of operations, percentage of net revenues and the period-to-period percentage change in certain financial data for the three months ended April 3, 2011 and April 4, 2010:

	Three Months Ended April 3, 2011		Three Months Ended April 4, 2010 (Dollars in thousands)		% Change
Net revenues	\$ 203,370	100.0%	\$ 146,269	100.0%	39.0%
Cost of revenues	147,160	72.4	103,550	70.8	42.1
Gross profit	56,210	27.6	42,719	29.2	31.6
Selling, general and administrative expenses	42,437	20.9	35,418	24.2	19.8
Leslie asbestos and bankruptcy charges (recoveries), net	1,001	0.5	(648)	(0.4)	(254.5)
Operating income	12,772	6.3	7,949	5.4	60.7
Other (income) expense:					
Interest expense, net	773	0.4	554	0.4	39.5
Other (income) expense, net	915	0.4	(51)	(0.0)	(1,894.1)

# Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

Total other expense	1,688	0.8	503	0.3	235.6
Income before income taxes	11,084	5.5	7,446	5.1	48.9
Provision for income taxes	3,178	1.6	1,713	1.2	85.5
Net income	\$ 7,906	3.9%	\$ 5,733	3.9%	37.9%

*Net Revenues*

**Table of Contents**

Net revenues for the three months ended April 3, 2011 increased by \$57.1 million, or 39.0%, to \$203.4 million from \$146.3 million for the three months ended April 4, 2010. The increase in net revenues for the three months ended April 3, 2011 was attributable to the following:

Segment	Three Months Ended		Total Change (In thousands)	Acquisitions	Operations	Foreign Exchange
	April 3, 2011	April 4, 2010				
Energy	\$ 99,170	\$ 57,722	\$ 41,448	\$ 2,189	\$ 37,571	\$ 1,688
Aerospace	32,110	27,274	4,836	3,699	1,001	136
Flow Technologies	72,090	61,273	10,817	1,152	8,886	779
Total	\$ 203,370	\$ 146,269	\$ 57,101	\$ 7,040	\$ 47,458	\$ 2,603

The Energy segment accounted for 49% of net revenues for the three months ended April 3, 2011 compared to 40% for the three months ended April 4, 2010. The Aerospace segment accounted for 16% of net revenues for the three months ended April 3, 2011 compared to 18% for the three months ended April 4, 2010. The Flow Technologies segment accounted for 35% of net revenues for the three months ended April 3, 2011 compared to 42% for the three months ended April 4, 2010.

Energy segment revenues increased by \$41.4 million, or 72%, for the quarter ended April 3, 2011 compared to the quarter ended April 4, 2010. The increase was primarily driven by \$37.6 million of organic growth across the segment including large international projects and short-cycle North American businesses. The increase is also due to \$2.2 million from the first quarter 2011 acquisition of SF Valves and \$1.7 million of favorable foreign currency fluctuations. Orders for this segment increased \$47.5 million to \$113.7 million for the three months ended April 3, 2011 compared to \$66.2 million for the same period in 2010 due to strength in all areas, but particularly with large international projects, which has rebounded from the low order intake recorded during the first quarter of 2010. Backlog for our Energy segment has increased by \$67.7 million to \$203.1 million as of April 3, 2011 compared to \$135.4 million as of April 4, 2010. During the first quarter of 2011 we saw a rebound in large international projects as well as continued strength in short-cycle North American businesses. We believe order rates for the remainder of 2011 will be at levels higher than 2010.

Aerospace segment revenues increased by \$4.8 million, or 18%, for the quarter ended April 3, 2011 compared to the quarter ended April 4, 2010. The increase was driven primarily by the August 2010 acquisition of Castle Precision Industries ( Castle ) and the April 2010 acquisition of Ateliers de Navarre ( ADN ) increasing revenues by \$3.7 million. Organic growth accounted for a \$1.0 million increase with favorable foreign currency fluctuations adding an additional \$0.1 million. Orders for this segment decreased \$2.0 million to \$32.8 million for the three months ended April 3, 2011 compared to \$34.8 million for the same period in 2010. This order decrease was primarily due to the timing of military landing gear orders partially offset by the positive impact of acquisitions. Order backlog increased \$14.3 million to \$135.3 million as of April 3, 2011 compared to \$121.0 million as of April 4, 2010, driven primarily by our acquisition of Castle. We believe there have been signs that the commercial aerospace markets will see year over year improvement during 2011, however, military markets continue to have some uncertainty for 2011 due to limited budgets and the winding down of military activities in Iraq.

Flow Technologies segment revenues increased by \$10.8 million, or 18%, for the quarter ended April 3, 2011 compared to the quarter ended April 4, 2010. The revenue increase was due to organic growth of \$8.9 million, primarily attributable to continued semiconductor strength and a moderate rebound in process and industrial markets along with \$1.1 million from the Mazda Ltd. ( Mazda ) acquisition in the second quarter of 2010. An additional increase of \$0.8 million was due to favorable foreign currency fluctuations. This segment's customer orders increased \$5.9 million to \$75.0 million for the three months ended April 3, 2011 compared to \$69.1 million for the same period in 2010 with improvement in most markets except sampling and maritime. Order backlog grew \$6.7 million to \$80.7 million as of April 3, 2011 compared to \$74.0 million as of April 4, 2010, driven broadly across most of our businesses with the exception of sampling. We believe most of our markets will be improving over 2011.

*Gross Profit*

Consolidated gross profit increased \$13.5 million, or 32%, to \$56.2 million for the quarter ended April 3, 2011 compared to \$42.7 million for the quarter ended April 4, 2010. Consolidated gross margin decreased 160 basis points to 27.6% for the quarter ended April 3, 2011 from 29.2% for the quarter ended April 4, 2010.

Gross profit for the Energy segment increased \$7.6 million, or 56%, for the quarter ended April 3, 2011 compared to the quarter ended April 4, 2010. The gross profit increase was due primarily to the organic revenue increases and continued margin improvement, principally in short-cycle

## Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

North American businesses. In addition, gross profit increased \$0.5 million due to the SF Valves acquisition and \$0.4 million due to higher foreign exchange rates compared to the U.S. dollar. Gross margins declined 210 basis points to 21.2% for the quarter ended April 3, 2011 compared to 23.3% for the same period in 2010. The decline was driven primarily by pricing pressures, especially in large international projects, and by unfavorable product mix. These were partially offset by favorable volume and productivity.

**Table of Contents**

Gross profit for the Aerospace segment increased \$1.5 million, or 14%, for the quarter ended April 3, 2011 compared to the quarter ended April 4, 2010. This gross profit increase was due primarily to the August 2010 acquisition of Castle and the April 2010 acquisition of ADN with an additional \$0.1 million due to organic growth and \$0.1 million due to favorable foreign currency fluctuations. Gross margins declined 100 basis points to 36.3% for the quarter ended April 3, 2011 primarily due to an unfavorable product mix.

Gross profit for the Flow Technologies segment increased \$4.5 million, or 24%, for the quarter ended April 3, 2011 compared to the quarter ended April 4, 2010. Organic growth in most markets resulted in a \$3.8 million increase in gross profit, while the Mazda acquisition in May 2010 added \$0.4 million and favorable foreign currency fluctuations added another \$0.3 million. Gross margins expanded 160 basis points due to increased volume and the associated leverage principally in the semiconductor and industrial markets.

*Selling, General and Administrative Expenses*

Selling, general and administrative expenses increased \$7.0 million, or 20%, to \$42.4 million for the quarter ended April 3, 2011 compared to \$35.4 million for the three months ended April 4, 2010. Selling, general and administrative expenses as a percentage of revenues decreased 330 basis points to 20.9% for the three months ended April 3, 2011 compared to 24.2% for the three months ended April 4, 2010.

Selling, general and administrative expenses for the Energy segment increased 28%, or \$3.2 million, compared to the first quarter 2010. Organic increases inclusive of incremental investment in growth initiatives accounted for \$2.5 million of the total increase. In addition, the SF Valves acquisition in the first quarter of 2011 added \$0.5 million and foreign currency fluctuations added \$0.2 million.

Selling, general and administrative expenses for the Aerospace segment increased 21%, or \$1.3 million, compared to the first quarter 2010. This increase was principally due to the Castle acquisition.

Selling, general and administrative expenses for the Flow Technologies segment increased 7%, or \$0.9 million, compared to the first quarter 2010. This increase was principally due to a \$0.3 million increase attributable to the Mazda acquisition and a \$0.5 million operational increase related primarily to inflation and growth programs. An additional \$0.1 million increase was due to foreign currency fluctuations.

Corporate selling, general and administrative expenses increased \$1.6 million to \$6.2 million in the first quarter of 2011 from \$4.6 million for the same period in 2010. The increase was primarily due to higher incentive costs, share based compensation and professional fees.

*Leslie Asbestos and Bankruptcy Related Charges, Net*

Asbestos and bankruptcy related charges are primarily associated with our Leslie subsidiary in the Flow Technologies segment. Net asbestos and bankruptcy related charges increased \$1.6 million to a \$1.0 million expense for the three months ended April 3, 2011 compared to a net recovery of \$0.6 million for the three months ended April 4, 2010. The \$1.0 million expense in the first quarter 2011 was due to bankruptcy related charges. The three months ended April 4, 2010, included an insurance recovery of \$3.7 million related to the settlement of a dispute with one of our insurance providers partially offset by \$3.1 million of asbestos settlement and defense costs.

*Special & Impairment Charges*

For the three months ended April 3, 2011 and April 4, 2010, we did not record any special or impairment charges.

*Operating Income*

The change in operating income for the three months ended April 3, 2011 compared to the three months ended April 4, 2010 was as follows:

Segment	Three Months Ended		Total Change	Acquisitions	Operations	Foreign Exchange
	April 3, 2011	April 4, 2010	(Dollars In thousands)			
Energy	\$ 6,393	\$ 2,025	\$ 4,368	\$ 79	\$ 4,141	\$ 148
Aerospace	3,727	3,606	120	(146)	236	30
Flow Technologies	9,116	6,925	2,191	79	1,958	154
Corporate	(6,464)	(4,607)	(1,856)	0	(1,857)	1

Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

Total	\$ 12,772	\$ 7,949	\$ 4,823	\$ 12	\$ 4,478	\$ 333
-------	-----------	----------	----------	-------	----------	--------

## **Table of Contents**

Operating income increased 61%, or \$4.8 million, for the three months ended April 3, 2011 compared to the three months ended April 4, 2010, on a 39% increase in revenues.

Operating income for the Energy segment increased \$4.4 million, or 216%, for the first quarter 2011, as operating margin increased 290 basis points to 6.4% on a revenue increase of 72%, compared to the first quarter 2010. These increases were driven primarily by the improved margins and revenue in the North American short-cycle businesses, partially offset by pricing pressures and costs on large international projects.

Operating income for the Aerospace segment increased \$0.1 million, or 3%, for the first quarter of 2011 compared to the first quarter of 2010. The increase in operating income was due primarily to the organic revenue growth partially offset by higher costs associated with the integration of Castle.

Operating income for the Flow Technologies segment increased \$2.2 million, or 32%, for the first quarter of 2011 compared to the first quarter of 2010. The operating income in the first quarter 2011 includes \$0.7 million of Leslie asbestos and bankruptcy related charges whereas the operating income in the same period 2010 includes \$0.6 million of Leslie asbestos and bankruptcy related recoveries. The remaining increase was primarily due to increased volume and the associated leverage.

### *Interest Expense, Net*

Interest expense, net, increased \$0.2 million for the three months ended April 3, 2011 compared to the three months ended April 4, 2010. This increase in interest expense was primarily due to higher fees and interest on higher average borrowings associated with our revolving credit facility.

### *Provision for Taxes*

The effective income tax rate was 28.7% and 23.0% for the first quarters of 2011 and 2010, respectively. The increase in the income tax rate for the first quarter 2011 compared to the first quarter 2010 was primarily due to a negative tax impact of foreign dividends and a higher proportion of U.S. domestic income versus foreign income taxed at lower income tax rates.

### *Net Income*

Net income increased \$2.2 million to \$7.9 million in the first quarter 2011 on 39% higher revenues, compared to the same quarter in 2010. This increase is primarily the result of organic volume increases and profitability across all segments, partially offset by higher Leslie asbestos and bankruptcy charges and provision for taxes.

## **Liquidity and Capital Resources**

Our liquidity needs arise primarily from capital investment in machinery, equipment and the improvement of facilities, funding working capital requirements to support business growth initiatives, acquisitions, dividend payments, and debt service costs. Excluding our first quarter results in 2010 and 2009, we have historically generated cash from operations. We believe we remain in a strong financial position, with resources available for reinvestment in existing businesses, strategic acquisitions and managing our capital structure on a short and long-term basis.

The following table summarizes our cash flow activities for the three months ended April 3, 2011 (In thousands):

Cash flow provided (used in):	
Operating activities	\$ 4,215
Investing activities	(22,903)
Financing activities	25,776
Effect of exchange rates on cash and cash equivalents	651
Increase in cash and cash equivalents	\$ 7,739

During the three months ended April 3, 2011, we generated \$4.2 million in cash from operating activities compared to \$2.8 million used during the three months ended April 4, 2010. The higher amount of cash provided by operating activities was primarily due to working capital

## Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

reductions compared to the prior period and higher net income during the three months ended April 3, 2011, compared to the same period in 2010. The \$22.9 million used by investing activities consisted primarily of business acquisition costs related to the acquisition of SF Valves. Financing activities provided \$25.8 million, which included a net \$26.0 million of debt borrowings and \$0.2 million in proceeds from the exercise of stock options offset by \$0.6 million used to pay dividends to shareholders.

As of April 3, 2011, total debt was \$31.0 million compared to \$1.5 million at December 31, 2010. During the first quarter of 2011, we borrowed an additional \$26.6 million from our existing credit facilities, a majority of which was used for the acquisition of



## **Table of Contents**

SF Valves. Total debt as a percentage of total shareholders' equity was 8% as of April 3, 2011 compared to less than 1% as of December 31, 2010.

In July 2009, we entered into a three and one half year unsecured credit agreement ( "2009 Credit Agreement" ) that provided for a \$190 million revolving line of credit and terminated the previously available \$125 million revolving credit facility that we entered into in December 2005. The 2009 Credit Agreement included a \$30 million accordion feature for a maximum facility size of \$220 million and also allowed for additional indebtedness not to exceed \$80 million. As of April 3, 2011, we had borrowings of \$21.0 million outstanding under our credit facility and \$49.0 million was allocated to support outstanding letters of credit.

On May 2, 2011, we entered into a new five year unsecured credit agreement ( "2011 Credit Agreement" ), provided as Exhibit 10.1 herewith, that provides for a \$300 million revolving line of credit and terminated the 2009 Credit Agreement. The 2011 Credit Agreement includes a \$150 million accordion feature for a maximum facility size of \$450 million. The 2011 Credit Agreement also allows for additional indebtedness not to exceed \$80 million. There has been no material change in our financial covenants from our 2009 Credit Agreement, which are explained in more detail below. We anticipate using this 2011 Credit Agreement to fund potential acquisitions, to support our organic growth initiatives and working capital needs, and for general corporate purposes.

Certain of our loan agreements contain covenants that require, among other items, maintenance of certain financial ratios and also limit our ability to: enter into secured and unsecured borrowing arrangements; issue dividends to shareholders; acquire and dispose of businesses; invest in capital equipment; transfer assets among domestic and international entities; participate in certain higher yielding long-term investment vehicles; and issue additional shares of our stock. The two primary financial covenants are leverage ratio and interest coverage ratio. We were in compliance with all financial covenants related to our existing debt obligations at April 3, 2011 and December 31, 2010 and we believe it is reasonably likely that we will continue to meet such covenants in the near future.

The ratio of current assets to current liabilities was 1.66:1 at April 3, 2011, compared to 1.62:1 at December 31, 2010. Cash and cash equivalents were \$53.5 million as of April 3, 2011, compared to \$45.8 million as of December 31, 2010.

On November 4, 2010, we filed with the SEC a shelf registration statement on Form S-3 under which we may issue up to \$400 million of securities including debt securities, common stock, preferred stock, warrants to purchase any such securities and units comprised of any such securities (the "Securities" ). The registration statement was declared effective by the SEC on December 17, 2010. We may offer these Securities from time to time in amounts, at prices and on terms to be determined at the time of sale. We believe that with this registration statement, we will have greater flexibility to take advantage of financing opportunities, acquisitions and other business opportunities when and if such opportunities arise. Depending on market conditions, we may issue securities under this or future registration statements or in private offerings exempt from registration requirements.

In 2011, we expect to generate positive cash flow from operating activities sufficient to support our capital expenditures and pay dividends approximating \$2.6 million based on our current dividend practice of paying \$0.15 per share annually. Based on our expected cash flows from operations and contractually available borrowings under our credit facilities, we expect to have sufficient liquidity to fund working capital needs and future growth. We continue to search for strategic acquisitions; a larger acquisition may require additional borrowings and/or the issuance of our common stock.

### **Off-Balance Sheet Arrangements**

We have no off-balance sheet arrangements, other than operating leases, that have or are reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors.

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

### **Interest Rate Sensitivity Risk**

As of April 3, 2011, our primary interest rate risk is related to borrowings under our revolving credit facility. The interest rate for our revolving credit facility fluctuates with changes in short-term interest rates. We had \$21.0 million borrowed under our revolving credit facility as of April 3, 2011. Based upon expected levels of borrowings under our credit facility in 2011, an increase in variable interest rates of 100 basis points would have an effect on our annual results of operations and cash flows of \$0.6 million.

**Foreign Currency Exchange Risk**

The Company is exposed to certain risks relating to its ongoing business operations, including foreign currency exchange rate risk and interest rate risk. The Company currently uses derivative instruments to manage foreign currency risk on certain business transactions denominated in foreign currencies. To the extent the underlying transactions hedged are completed, these forward contracts do not subject us to significant risk from exchange rate movements because they offset gains and losses on the related foreign currency denominated transactions. These forward contracts do not qualify as hedging instruments for accounting purposes

**Table of Contents**

and, therefore, do not qualify for fair value or cash flow hedge treatment. Any unrealized gains and losses on our contracts are recognized as a component of other expense in our consolidated statements of operations.

As of April 3, 2011, we had thirteen forward contracts with values as follows (in thousands):

Currency	Number	Contract Amount
U.S. Dollar/GBP	6	1,909 U.S. Dollars
Euro/U.S. Dollar	4	873 Euros
U.S. Dollar/Euro	3	5,000 U.S. Dollars

This compares to eighteen forward contracts as of December 31, 2010. The fair value asset of the derivative forward contracts as of April 3, 2011 was approximately \$0.2 million and is included in prepaid expenses and other current assets on our balance sheet. This compares to a fair value liability of approximately \$1.7 million that was included in accrued expenses and other current liabilities on our balance sheet as of December 31, 2010.

We have determined that the majority of the inputs used to value our foreign currency forward contracts fall within Level 2 of the fair value hierarchy, found under ASC Topic 820.1. The credit valuation adjustments, such as estimates of current credit spreads to evaluate the likelihood of default by ourselves and our counterparties are Level 3 inputs. However, we have assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our foreign currency forward contracts and determined that the credit valuation adjustments are not significant to the overall valuation. As a result, we have determined that our derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

**ITEM 4. CONTROLS AND PROCEDURES.****Evaluation of Disclosure Controls and Procedures**

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) as of the end of the period covered by this report on Form 10-Q. Based on this evaluation, our principal executive officer and principal financial officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were designed and were effective to give reasonable assurance that information we disclose in reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to management, including our principal executive and financial officers, to allow timely decisions regarding disclosure and that such information is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms.

**Changes in Internal Controls Over Financial Reporting**

We have made no changes in our internal controls over financial reporting during the quarter ended April 3, 2011 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

**PART II OTHER INFORMATION.****ITEM 1. LEGAL PROCEEDINGS.****Asbestos Litigation***Introduction*

On July 12, 2010 (the "Filing Date"), our subsidiary Leslie Controls, Inc. ("Leslie") filed a voluntary petition (the "Bankruptcy Filing") under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the District of Delaware and, simultaneously, filed a pre-negotiated plan of reorganization (as amended, the "Reorganization Plan" or "Plan") in an effort to permanently resolve Leslie's asbestos liability. On February 7, 2011, the U.S. Federal District Court for the District of Delaware (the "District Court") affirmed the Bankruptcy Court's earlier order confirming Leslie's

## Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

Reorganization Plan, thus clearing the way for Leslie to emerge from bankruptcy. On April 28, 2011, in accordance with the terms of the Reorganization Plan, Leslie emerged from bankruptcy free and clear of asbestos liabilities. The following discussion addresses both events occurring prior to the bankruptcy filing and events occurring thereafter.

### *Events Pre-dating Leslie's Bankruptcy Filing*

Like many other manufacturers of fluid control products, Leslie, which we acquired in 1989, had been up to the date of the Bankruptcy Filing named as a defendant in product liability actions brought on behalf of individuals seeking compensation for their alleged asbestos exposure. In some instances, we also have been named individually and/or as alleged successor in interest in these cases. At the Filing Date, Leslie was a named defendant in approximately 1,340 active, unresolved asbestos-related claims filed in California, Texas, New York, Massachusetts, West Virginia, Rhode Island, Illinois and 23 other states. Approximately 713 of these

## **Table of Contents**

claims involve claimants allegedly suffering from (or the estates of decedents who allegedly died from) mesothelioma, a fatal malignancy associated with asbestos exposure.

Leslie's asbestos-related claims generally involved its fluid control products. Leslie management believes that any asbestos was incorporated entirely within the product in a way that would not allow for any ambient asbestos during normal operation or during normal inspection and repair procedures. Leslie and its insurers' general strategy was to vigorously defend these claims. Nevertheless, while we strongly believe that exposure to Leslie's products did not cause asbestos-related illness to any plaintiff, juries and courts have reached a different conclusion in particular cases and could have done so in others.

Leslie resolved a number of asbestos-related claims in the few years prior to the Bankruptcy Filing for strategic reasons, including avoidance of defense costs and the possible risk of excessive verdicts. The amounts expended on asbestos-related claims in any year were generally impacted by the number of claims filed, the volume of pre-trial proceedings, and the number of trials and settlements.

### *Leslie's Bankruptcy Filing and Subsequent Developments*

On the Filing Date, Leslie filed the Reorganization Plan in an effort to permanently resolve Leslie's asbestos liability. Key terms of the pre-negotiated Reorganization Plan include the creation of a trust pursuant to Section 524(g) of the U.S. Bankruptcy Code (the "Trust") to be funded by (1) a contribution by Leslie consisting of (a) a \$1.0 million promissory note and (b) an assignment of any and all rights of Leslie (i) to proceeds under existing insurance policies that provide coverage for asbestos personal injury claims, and (ii) to \$2.625 million of proceeds from a settlement agreement between Leslie and one of its insurers, Continental Casualty, a CNA company ("Continental") entered into in April 2010; and (2) a \$74.0 million cash contribution by CIRCOR. All current and future asbestos claims against Leslie, as well as all current and future derivative claims against CIRCOR or its affiliates or against Leslie's former parent company, Watts Water Technologies, Inc. ("Watts"), or its affiliates arising from Leslie's alleged asbestos liabilities, will be channeled to the Trust for review and payment, thus providing both Leslie and CIRCOR with permanent court protection from such claims. Under the Reorganization Plan, Leslie will remain a subsidiary of CIRCOR. The Reorganization Plan was negotiated with both a committee of key plaintiff attorneys representing Leslie's current asbestos claimants, and also with an independent representative of Leslie's future claimants.

The Bankruptcy Filing automatically stayed the prosecution or commencement of all asbestos-related claims against Leslie. On July 14, 2010, the Bankruptcy Court entered a temporary restraining order that barred the prosecution or commencement of claims against CIRCOR or Watts arising from Leslie's alleged asbestos liabilities, and, on August 9, 2010, the Bankruptcy Court granted Leslie's request for a preliminary injunction that barred the prosecution or commencement of such claims until final approval of the Reorganization Plan under which all such claims were permanently channeled to the Trust. Under the Bankruptcy Code, confirmation of the Reorganization Plan required the approval of at least 75% of current asbestos claimants as well as court approval. Leslie, in fact, ultimately received unanimous approval of the Plan from the asbestos claimants who voted and, on October 26 and 27, 2010, the Bankruptcy Court held hearings on confirmation of the Reorganization Plan (the "Confirmation Hearings"). At the Confirmation Hearings, certain of Leslie's insurers sought to object to the Reorganization Plan's confirmation. The Bankruptcy Court, however, determined that the terms of the Reorganization Plan were neutral to the rights of such insurers and ruled that the insurers did not have standing to raise objections to confirmation. Because Leslie previously had resolved all of the other objections to confirmation of the Reorganization Plan, the Confirmation Hearings proceeded in an uncontested manner, and, on October 28, 2010, the Bankruptcy Court entered an order confirming the Reorganization Plan (the "Confirmation Order").

Following issuance of the Confirmation Order, Leslie sought the required review and approval of the 524(g) trust aspects of the Reorganization Plan by the District Court. In connection with this review, those insurers who previously sought to object at the Confirmation Hearings filed oppositions to the affirmation by the District Court of the Plan, and, in addition, appealed certain rulings made by the Bankruptcy Court leading up to the issuance of the Confirmation Order. Leslie eventually resolved the concerns of the insurers, however, by agreeing to certain changes in the Plan language relative to insurance provisions. After Leslie sought and received from the Bankruptcy Court a revised Confirmation Order incorporating the agreed upon changes (the "Revised Confirmation Order"), an affirmation hearing was held by the District Court on February 4, 2011. Following that hearing, on February 7, 2011, the District Court entered an order approving the 524(g) trust aspects of the Reorganization Plan and affirming the Revised Confirmation Order (the "District Court Order").

### *Leslie's Emergence From Bankruptcy*

On April 28, 2011, pursuant to the terms of the Reorganization Plan, Leslie and CIRCOR funded the Trust, and Leslie emerged from Chapter 11 bankruptcy protection. As a result, all current and future asbestos related claims against Leslie, as well as all current and future derivative claims against CIRCOR, will now be permanently channeled to the Trust.

### *Accounting Indemnity and Defense Cost Liabilities and Assets*

## Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

Leslie recorded an estimated liability associated with reported asbestos claims when it believed that a loss was both probable and could be reasonably estimated.

**Table of Contents**

During 2007, we engaged Hamilton, Rabinovitz and Associates, Inc. ( HR&A ), a firm specializing in estimating expected liabilities of mass tort claims, to help us determine an estimate of Leslie's asbestos-related liabilities. Because Leslie's claims experience was both limited and variable, HR&A concluded that any estimate of pending or future liabilities of Leslie's asbestos claims would be highly uncertain from a statistical perspective. Leslie's management determined, however, that, by using its historical (albeit limited and variable) average cost by disease classification in resolving closed claims, and by applying this information to the mix of current open claims, it could make a reasonable estimate of the indemnity costs to be incurred in resolving such current open claims. As a result, Leslie recorded an initial liability of \$9.0 million during the fourth quarter of 2007 for the estimated indemnity cost associated with resolution of its then open claims.

Based on Leslie's discussions with HR&A regarding the impact of additional claims data on HR&A's conclusion regarding estimating future claim liabilities, Leslie requested that HR&A update its analysis annually to determine whether such additional data warranted any change to HR&A's analyses and conclusions regarding future estimation. As a result, during the fourth quarter of 2008, HR&A updated its analysis and reaffirmed its conclusion, at that time, that a forecast of the number and value of any future asbestos claims was unwarranted and highly uncertain from a statistical perspective. However, when again updating its analysis at management's request during the fourth quarter of 2009, HR&A concluded that Leslie now had claims experience sufficient to provide a reasonable estimate of the liability associated not only with Leslie's open asbestos claims but also with respect to future claims. As a result, during the fourth quarter of 2009, Leslie recorded an additional \$39.8 million to its asbestos liability accrual for the estimated indemnity costs associated with future claims anticipated to be filed during the next five years. Asbestos related defense costs continued to be expensed as incurred and were not included in any future claim reserves.

During the second quarter of 2010, as a result of Leslie's Bankruptcy Filing and Reorganization Plan, we accrued liabilities based on the terms of the Reorganization Plan. As of December 31, 2010, we therefore recorded net Leslie asbestos and bankruptcy liabilities for resolution of pending and future claims of \$79.8 million (all classified as a current liability). As of April 3, 2011 these balances remained virtually unchanged. A summary of Leslie's accrued liabilities, including contributions to the Trust under the Reorganization Plan for existing and future asbestos claims as well as incurred but unpaid asbestos defense cost liabilities and the related insurance recoveries, is provided below.

<b>In Thousands</b>	<b>\$79,793 April 3, 2011</b>	<b>\$79,793 December 31, 2010</b>
Existing claim indemnity liability	\$ 34	\$ 64
Amounts payable to 524(g) trust	77,625	77,625
Incurred defense cost liability	2,142	2,142
Insurance recoveries receivable	(38)	(38)
<b>Net Leslie asbestos and bankruptcy liability</b>	<b>\$ 79,763</b>	<b>\$ 79,793</b>

*First Quarter 2011 Experience and Financial Statement Impact*

The following table provides information regarding the ongoing pre-tax costs associated with Leslie's asbestos litigation through the three months ended April 3, 2011 as well as additional charges incurred. The \$1.0 million bankruptcy related charges for the period ending April 3, 2011 is comprised solely of bankruptcy related professional fees.

<b>(In Thousands)</b>	<b>\$79,79300 Three Months Ended April 3, 2011</b>	<b>\$79,79300 April 4, 2010</b>
Indemnity costs accrued (filed cases)	\$ 0	\$ 699
Adverse verdict interest costs (verdict appealed)	0	65
Defense cost incurred	0	3,731
Insurance recoveries adjustment	0	(3,652)
Insurance recoveries accrued	0	(1,491)
Bankruptcy related costs	1,001	0
<b>Net pre-tax Leslie asbestos and bankruptcy charges (recoveries)</b>	<b>\$ 1,001</b>	<b>\$ (648)</b>

*Insurance*

## Edgar Filing: CIRCOR INTERNATIONAL INC - Form 10-Q

As of April 3, 2011, we believed that the aggregate amount of indemnity (on a cash basis) remaining on Leslie's primary layer of insurance was approximately \$1.8 million. From a financial statement perspective, however, after giving effect to our accrual for the estimated indemnity cost of resolving pending claims, Leslie had recorded the maximum amount of available primary layer insurance as of September 2008. As a result, asbestos related indemnity costs from that point forward were no longer partially offset by a corresponding insurance recovery. However, defense costs, which were recognized as incurred, continued to be and, but for the Bankruptcy Filing, would have continued to be partially offset by a 36% contribution from Leslie's remaining primary layer insurance.



## **Table of Contents**

carrier until such time as the aggregate amount of indemnity claims paid out (on a cash basis) by the remaining primary layer insurance carrier exceeded policy limits.

In addition to its primary layer of insurance, Leslie does have some available excess insurance coverage. However, some of this excess insurance lies above layers of excess insurance written by insolvent insurers which could affect when Leslie may be able to recover this excess insurance. Moreover, unlike primary policies under which defense costs do not erode policy limits, the terms of excess policies typically provide that covered defense costs do erode policy limits. Because the probability and amount of any recovery from excess carriers was uncertain, however, Leslie had not accrued an insurance receivable for such recovery as of the Filing Date. As discussed previously, under the Reorganization Plan, all remaining insurance proceeds are contributed to the Trust.

### *Other Matters*

Smaller numbers of asbestos-related claims have also been filed against two of our other subsidiaries Spence, the stock of which we acquired in 1984; and Hoke, the stock of which we acquired in 1998. Due to the nature of the products supplied by these entities, the markets they serve and our historical experience in resolving these claims, we do not believe that asbestos-related claims will have a material adverse effect on the financial condition, results of operations or liquidity of Spence or Hoke, or the financial condition, consolidated results of operations or liquidity of the Company.

### **ITEM 1A. RISK FACTORS.**

We have not identified any material changes from the risk factors as previously disclosed in Item 1A. to Part I of our Annual Report on Form 10-K for the year ended December 31, 2010.

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

#### **Working Capital Restrictions and Limitations upon Payment of Dividends**

Certain of our loan agreements contain covenants that require, among other items, maintenance of certain financial ratios and also limit our ability to: enter into secured and unsecured borrowing arrangements; issue dividends to shareholders; acquire and dispose of businesses; invest in capital equipment; transfer assets among domestic and international entities; participate in certain higher yielding long-term investment vehicles; and issue additional shares of our stock. The two primary financial covenants are leverage ratio and interest coverage ratio. We were in compliance with all covenants related to our existing debt obligations at April 3, 2011 and December 31, 2010 and we believe it is reasonably likely that we will continue to meet such covenants in the near future.

### **ITEM 3. DEFAULTS UPON SENIOR SECURITIES.**

None.

### **ITEM 4. (REMOVED AND RESERVED).**

### **ITEM 5. OTHER INFORMATION.**

None.

## **Table of Contents**

### **ITEM 6. EXHIBITS.**

<b>Exhibit No.</b>	<b>Description and Location</b>
2	Plan of Acquisition, Reorganization, Arrangement, Liquidation or Succession:
2.1	Distribution Agreement by and between Watts Industries, Inc. and CIRCOR International, Inc., dated as of October 1, 1999, is incorporated herein by reference to Exhibit 2.1 to Amendment No. 2 to CIRCOR International, Inc.'s Registration Statement on Form 10-12B, File No. 000-26961, filed with the Securities and Exchange Commission on October 6, 1999.
3	Articles of Incorporation and By-Laws:
3.1	Amended and Restated Certificate of Incorporation of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 3.1 to CIRCOR International, Inc.'s Form 10-Q, File No. 001-14962, filed with the Securities and Exchange Commission on October 29, 2009.
3.2	Amended and Restated By-Laws of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 3.2 to CIRCOR International, Inc.'s Form 10-K, File No. 001-14962, filed with the Securities and Exchange Commission on February 26, 2009.
3.3	Certificate of Amendment to the Amended and Restated Bylaws of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 3.3 to CIRCOR International, Inc.'s Form 10-K, File No. 001-14962, filed with the Securities and Exchange Commission on February 26, 2009.
3.4	Amended and Restated Certificate of Designations of Series A Junior Participating Cumulative Preferred Stock of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 3.4 to CIRCOR International, Inc.'s Form 10-Q, File No. 001-14962, filed with the Securities and Exchange Commission on October 29, 2009.
4	Instruments Defining the Rights of Security Holders, Including Indentures:
4.1	Shareholder Rights Agreement, dated as of September 23, 2009, between CIRCOR International, Inc. and American Stock Transfer & Trust Company LLC, is incorporated herein by reference to Exhibit 4.1 to CIRCOR International, Inc.'s Form 8-A, File No. 001-14962, filed with the Securities and Exchange Commission on September 28, 2009.
4.2	Specimen certificate representing the Common Stock of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 4.1 to Amendment No. 1 to CIRCOR International, Inc.'s Registration Statement on Form 10-12B, File No. 000-26961, filed with the Securities and Exchange Commission on September 22, 1999.
10	Material Contracts:
10.1*	Credit Agreement, dated May 2, 2011, among CIRCOR International, Inc., as borrower, certain subsidiaries of CIRCOR International, Inc., as guarantors, the lenders from time to time party thereto and SunTrust Bank, as administrative agent, swing line lender and a letter of credit issuer.
31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32**	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

\* Filed with this report.

\*\* Furnished with this report.

§ Indicates management contract or compensatory plan or arrangement.

**Table of Contents**

**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.

**CIRCOR INTERNATIONAL, INC.**

**Date: May 5, 2011**

**/s/ A. WILLIAM HIGGINS**  
**A. William Higgins**  
**President and Chief Executive Officer**  
*Principal Executive Officer*

**Date: May 5, 2011**

**/s/ FREDERIC M. BURDITT**  
**Frederic M. Burditt**  
**Vice President, Chief Financial Officer and Treasurer**  
*Principal Financial Officer*

**Date: May 5, 2011**

**/s/ JOHN F. KOBER**  
**John F. Kober**  
**Vice President, Corporate Controller**  
*Principal Accounting Officer*