CYTEC INDUSTRIES INC/DE/
Form 10-Q
October 28, 2010
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE

SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended September 30, 2010

Commission file number 1-12372

CYTEC INDUSTRIES INC.

(Exact name of registrant as specified in its charter)

Delaware	**22-3268660**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No).**
Five Garret Mountain Plaza Woodland Park, New Jersey	**07424**
(Address of principal executive offices)	**(Zip Code)**

Registrant s telephone number, including area code (973) 357-3100

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 þ 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 þ No ¨.

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

Large accelerated filer þ Accelerated filer ¨ Non-accelerated filer ¨ Small 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 þ

There were 49,384,678 shares of common stock outstanding at October 18, 2010.

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CYTEC INDUSTRIES INC. AND SUBSIDIARIES

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PART I FINANCIAL INFORMATION

Item 1. CONSOLIDATED FINANCIAL STATEMENTS

CYTEC INDUSTRIES INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF INCOME

(Unaudited)

(Dollars in millions, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net sales	$ 837.1	$ 740.2	$ 2,497.8	$ 2,037.5
Manufacturing cost of sales	658.2	605.4	1,948.1	1,706.2
Selling and technical services	51.5	48.6	150.6	148.6
Research and process development	18.0	17.2	54.1	56.1
Administrative and general	32.8	29.6	95.0	90.1
Amortization of acquisition intangibles	9.1	9.7	27.6	28.3
Net gain on sale of assets	0.0	0.0	0.0	0.2
Earnings from operations	67.5	29.7	222.4	8.4
Other (expense)/income, net	(2.0)	6.9	(3.9)	3.6
Net loss on early extinguishment of debt	0.1	8.6	0.8	8.6
Equity in earnings of associated companies	0.4	0.2	0.7	0.7
Interest expense, net	7.8	7.6	23.9	18.3
Earnings/(loss) before income taxes	58.0	20.6	194.5	(14.2)
Income tax provision/(benefit)	19.8	7.6	68.2	(2.8)
Net earnings/(loss)	38.2	13.0	126.3	(11.4)
Less: Net earnings attributable to noncontrolling interests	(0.5)	(0.5)	(2.0)	(1.0)
Net earnings/(loss) attributable to Cytec Industries Inc.	$ 37.7	$ 12.5	$ 124.3	$ (12.4)
Earnings/(loss) per share attributable to Cytec Industries Inc.				
Basic earnings/(loss) per common share	$ 0.76	$ 0.26	$ 2.52	$ (0.26)
Diluted earnings/(loss) per common share	$ 0.75	$ 0.26	$ 2.50	$ (0.26)
Dividends per common share	$ 0.0125	$ 0.0125	$ 0.0375	$ 0.15

See accompanying Notes to Consolidated Financial Statements

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CYTEC INDUSTRIES INC. AND SUBSIDIARIES

CONSOLIDATED BALANCE SHEETS

(Unaudited)

(Dollars in millions, except per share amounts)

	September 30, 2010	December 31, 2009
Assets		
Current assets		
Cash and cash equivalents	$ 357.1	$ 261.7
Trade accounts receivable, less allowance for doubtful accounts of $5.1 and $6.6 in 2010 and 2009, respectively	451.0	374.2
Other accounts receivable	60.4	58.4
Inventories	420.4	351.9
Deferred income taxes	39.5	41.3
Currency swap receivable	19.5	34.4
Other current assets	26.8	19.0
Total current assets	1,374.7	1,140.9
Investment in associated companies	19.9	21.5
Plants, equipment and facilities, at cost	2,330.0	2,310.0
Less: accumulated depreciation	(1,162.1)	(1,133.8)
Net plant investment	1,167.9	1,176.2
Acquisition intangibles, net of accumulated amortization of $238.2 and $214.8 in 2010 and 2009, respectively	360.0	399.5
Goodwill	689.7	701.9
Deferred income taxes	15.8	11.9
Other assets	101.9	107.5
Total assets	$ 3,729.9	$ 3,559.4
Liabilities		
Current liabilities		
Accounts payable	$ 354.4	$ 276.4
Short-term borrowings	8.6	10.4
Current maturities of long-term debt	15.4	16.7
Accrued expenses	229.6	202.2
Income taxes payable	22.4	19.2
Currency swap payable	33.4	45.3
Deferred income taxes	2.5	5.2
Total current liabilities	666.3	575.4
Long-term debt	642.0	658.4
Pension and other postretirement benefit liabilities	333.3	388.8

Other noncurrent liabilities	284.2	309.7
Deferred income taxes	85.4	64.0
Stockholders equity		
Preferred stock, 20,000,000 shares authorized; none issued and outstanding	0.0	0.0
Common stock, $.01 par value per share, 150,000,000 shares authorized; issued 49,357,136 and 49,316,913 in 2010 and 2009, respectively	0.5	0.5
Additional paid-in capital	448.0	451.0
Retained earnings	1,245.7	1,123.2
Accumulated other comprehensive income	19.1	16.0
Treasury stock, at cost, 767 shares in 2010 and 594,134 shares in 2009	0.0	(31.8)
Total Cytec Industries Inc. stockholders equity	1,713.3	1,558.9
Noncontrolling interests	5.4	4.2
Total equity	1,718.7	1,563.1
Total liabilities and stockholders equity	$ 3,729.9	$ 3,559.4

See accompanying Notes to Consolidated Financial Statements

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CYTEC INDUSTRIES INC. AND SUBSIDIARIES

CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(Dollars in millions)

	Nine Months Ended September 30,	
	2010	**2009**
Cash flows provided by (used in) operating activities		
Net earnings/(loss)	$ 126.3	$ (11.4)
Noncash items included in net earnings/(loss):		
Depreciation	78.8	88.8
Amortization	33.3	33.1
Share-based compensation	8.0	6.2
Deferred income taxes	21.6	(29.6)
Net gain on sale of assets	(2.3)	(0.2)
Non-cash gain on transfer of land	0.0	(8.9)
Net loss on early extinguishment of debt	0.8	8.6
Unrealized gain on derivative instruments	(8.0)	(11.3)
Other	0.6	0.2
Changes in operating assets and liabilities:		
Trade accounts receivable	(78.7)	45.9
Other receivables	(1.5)	31.9
Inventories	(68.5)	193.3
Other assets	3.7	(3.1)
Accounts payable	84.4	39.1
Accrued expenses	29.7	27.2
Income taxes payable	8.2	4.4
Other liabilities	(54.0)	(18.0)
Net cash provided by operating activities	182.4	396.2
Cash flows (used in) provided by investing activities		
Additions to plants, equipment and facilities	(85.5)	(159.4)
Net proceeds received on sale of assets	1.7	7.0
Net cash used in investing activities	(83.8)	(152.4)
Cash flows provided by (used in) financing activities		
Proceeds from long-term debt	0.0	390.2
Payments on long-term debt	(18.4)	(517.5)
Change in short-term borrowings, net	(2.4)	(25.4)
Cash dividends	(3.2)	(8.6)
Proceeds from the exercise of stock options	17.7	1.6
Excess tax benefits from share-based payment arrangements	2.9	0.0
Net cash used in financing activities	(3.4)	(159.7)

Effect of currency rate changes on cash and cash equivalents	0.2	4.0
Increase in cash and cash equivalents	95.4	88.1
Cash and cash equivalents, beginning of period	261.7	55.3
Cash and cash equivalents, end of period	$ 357.1	$ 143.4

See accompanying Notes to Consolidated Financial Statements

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CYTEC INDUSTRIES INC. AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

(Currencies in millions, except per share amounts, unless otherwise indicated)

1. BASIS OF PRESENTATION

The accompanying unaudited consolidated financial statements included herein have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission for reporting on Form 10-Q and accounting principles generally accepted in the United States of America (U.S. GAAP) for interim reporting. Certain information and footnote disclosures normally included in our annual financial statements have been condensed or omitted pursuant to such rules and regulations. Financial statements prepared in accordance with U.S. GAAP require management to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses and other disclosures. In the opinion of management, these financial statements include all normal and recurring adjustments necessary for a fair presentation of the financial position and the results of our operations and cash flows for the interim periods presented. The results of operations for any interim period are not necessarily indicative of the results of operations for the full year. The financial statements should be read in conjunction with the Consolidated Financial Statements and Notes to the Consolidated Financial Statements contained in the Company s 2009 Annual Report on Form 10-K. Unless indicated otherwise, the terms Company, Cytec, we, us, and our each refer collectively to Cytec Industries Inc. and its subsidia

2. DIVESTITURES

In the first quarter of 2009, we sold certain of our European polyurethane product line assets for cash proceeds totaling $5.7 and recognized a pre-tax gain on sale of $1.6 ($1.0 after-tax). The gain is recorded in net gain on sale of assets in the accompanying statements of income.

Also in the first quarter of 2009, we decided to pursue strategic alternatives for our polyurethane product line assets in Asia. Accordingly, we revised the estimated remaining useful life of the assets to reflect the period we expected to continue to use the assets and recognized incremental depreciation expense in the first quarter of 2009 of $1.2 which is recorded in manufacturing cost of sales. We also recorded a charge of $0.4 during the first quarter of 2009 for additional costs that were incurred as a result of this decision, which are recorded in selling and technical services. In the second quarter of 2009, we sold our polyurethane product line assets in Asia for $1.8 of which $1.2 was received in cash and $0.6 represents a promissory note from the purchaser. The net loss of $1.4 resulting from this sale is recorded in net gain on sale of assets in the accompanying statements of income.

3. RESTRUCTURING OF OPERATIONS

In accordance with our policy, restructuring costs are included in our corporate unallocated operating results for segment reporting purposes consistent with management s view of its businesses.

Aggregate pre-tax restructuring charges/(credits) included in the statements of income were recorded by line item as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Manufacturing cost of sales	$ 3.5	$ 21.0	$ 8.3	$ 47.0
Selling and technical services	0.0	0.0	(0.1)	4.5
Research and process development	0.0	0.2	0.0	3.8
Administrative and General	(0.3)	0.9	(0.8)	4.2
Other expense, net	0.0	0.0	0.3	0.0
Total	$ 3.2	$ 22.1	$ 7.7	$ 59.5

Details of our 2010 restructuring initiatives are as follows:

In September 2010, we approved plans to consolidate manufacturing activities at one of our European sites. These plans resulted in a restructuring charge of $3.4 in the third quarter of 2010, of which $1.2 relates to the severance of nine positions, and $2.2 relates to the write-down of certain manufacturing assets. We expect the aforementioned plan to be completed by the end of the year.

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In May 2010, we approved plans to exit the production of certain phosphorus derivative products at our Mt. Pleasant, Tennessee facility. These plans resulted in a restructuring charge of $5.1 in the second quarter of 2010, of which $0.4 relates to the severance of 11 positions, $1.2 relates to asset write-offs, and $3.5 relates to decommissioning activities. For the three and nine months ended September 30, 2010, we recorded net restructuring charges of $0.3 and $5.4, respectively. The remaining reserve of $4.4 at September 30, 2010 for our 2010 restructuring initiatives is expected to be paid through 2011.

Details of our 2009 restructuring initiatives are as follows:

In 2009, we initiated restructuring actions across all segments and corporate functions. These actions were taken in response to the downturn in the global economy, which especially impacted the automotive, construction and general industrial markets that we serve, and led to a significant reduction in our sales and operating profitability. The following summarizes the details of the restructuring initiatives launched in 2009, which resulted in $91.9 of restructuring charges for the year ended December 31, 2009.

We launched restructuring initiatives at several of our Specialty Chemical manufacturing locations, which resulted in restructuring charges totaling $70.4 of which $40.4 is associated with severance and other employee benefits and $30.0 is associated with asset write-downs and accelerated depreciation. The manufacturing locations impacted by these initiatives are as follows:

- Closure of our manufacturing facility in La Llagosta, Spain and transfer of the manufacturing of most of the liquid coating resins products produced at the site to our facility in Werndorf, Austria.

- Transfer the manufacturing of our powder coating resins product line from Drogenbos, Belgium to our manufacturing facility in Bassano, Italy and consolidate or eliminate supply chain, sales, marketing and administrative functions at the site.

- Transfer the manufacturing of certain liquid coating resins products from our Hamburg, Germany site to our facility in Werndorf, Austria and consolidate or eliminate certain manufacturing, supply chain, and administrative functions at the site.

- Conversion of our manufacturing facility in Antofagasta, Chile into a blending and distribution facility to support the Mining business and eliminate manufacturing functions at the site.

- Closure of our manufacturing facility in Bogota, Colombia.

The above manufacturing restructuring initiatives include the elimination of 366 positions.

We launched restructuring initiatives across our Engineered Materials segment in response to inventory destocking by parts manufacturers that supply large commercial aircraft manufacturers as well as a sharper than expected decline in business and regional jet production rates. These initiatives resulted in $4.4 of restructuring expenses for severance and employee benefits related to the elimination of 239 positions.

We launched several initiatives throughout 2009 in our Specialty Chemical segments and corporate functions across sales, marketing, manufacturing, supply chain, research and development, and administrative functions, including our initiative to establish a shared services center. These initiatives resulted in $17.1 of charges related to severance and employee benefits associated with the elimination of 393 positions.

For the three and nine months ended September 30, 2010, we recorded net favorable adjustments of $0.5 and $1.1, respectively, related to our 2009 restructuring initiatives. All of the aforementioned initiatives were substantially complete as of December 31, 2009, with the exception of the shared services initiative, which is expected to be completed in waves throughout 2010 and 2011.

The remaining reserve at September 30, 2010 of $15.3 relating to 2009 restructuring initiatives is expected to be paid through 2012.

Details of our 2008 restructuring initiatives are as follows:

In 2008, as a cost reduction initiative and to align our cost structure to the declining demand environment at that time, we decided to restructure certain activities of our Coating Resins segment. These initiatives resulted in restructuring charges of $11.1 for the twelve months ended December 31, 2008, which primarily related to severance for 93 eliminated positions. These initiatives were completed in 2008. In 2009, the remaining balance of $0.9 was reversed as a result of actual costs being less than our forecast. All costs were paid in full as of December 31, 2009.

Details of our 2007 restructuring initiatives are as follows:

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In 2007, we initiated restructuring actions across our Specialty Chemicals segments to exit several mature product lines manufactured at our Willow Island, West Virginia and Wallingford, Connecticut facilities. As a result, we recorded total restructuring charges of $7.0 in 2007 and 2008. These initiatives were completed in 2008. In 2009, the remaining balance of $0.6 was reversed as a result of actual costs being less than our forecast. All costs were paid in full as of December 31, 2009.

	2007 Restructuring Initiatives	2008 Restructuring Initiatives	2009 Restructuring Initiatives		2010 Restructuring Initiatives		Total
Balance December 31, 2008	**$ 2.0**	**$ 4.3**	**$ 0.0**		**$ 0.0**		**$ 6.3**
2009 charges/(credits)	(0.6)	(0.9)	91.9		0.0		90.4
Non-cash items	0.0	0.0	(30.6)	(1)	0.0		(30.6)
Cash payments	(1.4)	(3.3)	(31.0)		0.0		(35.7)
Currency translation adjustments	0.0	(0.1)	1.3		0.0		1.2
Other adjustments	0.0	0.0	(0.8)	(2)	0.0		(0.8)
Balance December 31, 2009	**$ 0.0**	**$ 0.0**	**$ 30.8**		**$ 0.0**		**$ 30.8**
1st quarter charges/(credits)	0.0	0.0	(0.4)		0.0		(0.4)
Cash payments	0.0	0.0	(10.9)		0.0		(10.9)
Currency translation adjustments	0.0	0.0	(0.9)		0.0		(0.9)
Balance March 31, 2010	**$ 0.0**	**$ 0.0**	**$ 18.6**		**$**		**$ 18.6**
2nd quarter charges/(credits)	0.0	0.0	(0.3)		5.1		4.8
Non-cash items	0.0	0.0	0.0		(1.2)	(3)	(1.2)
Cash payments	0.0	0.0	(2.2)		(0.2)		(2.4)
Currency translation adjustments	0.0	0.0	(1.5)		0.0		(1.5)
Balance June 30, 2010	**$ 0.0**	**$ 0.0**	**$ 14.6**		**$ 3.7**		**$ 18.3**
3rd quarter charges/(credits)	0.0	0.0	(0.5)		3.7		3.2
Non-cash items	0.0	0.0	0.0		(2.2)	(4)	(2.2)
Cash payments	0.0	0.0	(0.2)		(1.0)		(1.2)
Currency translation adjustments	0.0	0.0	1.4		0.2		1.6
Balance September 30, 2010	**$ 0.0**	**$ 0.0**	**$ 15.3**		**$ 4.4**		**$ 19.7**

(1) Represents accelerated depreciation of plant assets and impairment of the land at our facility in La Llagosta, Spain.
(2) Represents a reclassification of an environmental related restructuring accrual to environmental liabilities.
(3) Represents write-offs of inventories and construction in progress at our Mt. Pleasant, Tennessee facility.
(4) Represents write-off of plant assets at a certain European facility.

4. SHARE-BASED COMPENSATION

The fair value of each option or stock-settled share appreciation right (stock-settled SARS) award is estimated on the date of grant using a binomial-lattice option valuation model. Stock-settled SARS are economically valued the same as stock options. The binomial-lattice model takes into account variables such as volatility, dividend yield, and risk-free interest rate. In addition, the binomial-lattice model considers the contractual term of the option, the probability that the option will be exercised prior to the end of its contractual life, and the probability of termination or retirement of the option holder in computing the value of the option. The assumptions for the nine months ended September 30, 2010 and 2009 are noted in the following table:

	2010	2009
Expected life (years)	6.1	6.7
Expected volatility	43.3%	48.2%
Expected dividend yield	0.19%	2.23%
Risk-free interest rate	3.75%	2.7%
Weighted-average fair value per option	$ 16.73	$ 8.58

The expected life of options granted represents the period of time that options granted are expected to be outstanding. Expected volatilities are based on the combination of implied market volatility and our historical volatility. The risk-free rate for periods within the contractual life of the option is based on the U.S. Treasury yield curve in effect at the time of grant. As share-based compensation recognized in the consolidated statement of income is based on awards ultimately expected to vest, we incorporate the probability of pre-vesting forfeiture in determining the number of expected vested options. The forfeiture rate is based on the historical forfeiture experience and prospective analysis.

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Stock Award and Incentive Plan:

The 1993 Stock Award and Incentive Plan (the 1993 Plan) provides for grants of a variety of awards, such as stock options (including incentive stock options and nonqualified stock options), non-vested stock (including performance stock), SARS (including those settled with common shares) and deferred stock awards and dividend equivalents. At September 30, 2010, there were approximately 1,700,000 shares reserved for issuance under the 1993 Plan, and 4,000,000 shares underlying all outstanding share-based compensation grants.

We have utilized the stock option component of the 1993 Plan to provide for the granting of nonqualified stock options and stock-settled SARS with an exercise price at 100% of the market price on the date of the grant. Options and stock-settled SARS are generally exercisable in installments of one-third per year commencing one year after the date of grant and annually thereafter, with contract lives of generally 10 years from the date of grant.

A summary of stock options and stock-settled SARS activity for the nine months ended September 30, 2010 is presented below.

Options and Stock-Settled SARS Activity:	Number of Units	Average Exercise Price Per Unit	Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value
Outstanding at January 1, 2010	3,822,502	$ 39.67		
Granted	457,990	37.71		
Exercised	(622,769)	31.82		
Forfeited	(124,091)	41.99		
Outstanding at September 30, 2010	3,533,632	$ 40.72	5.9	$ 56.2
Exercisable at September 30, 2010	2,549,775	$ 43.32	4.9	$ 34.2

During the nine months ended September 30, 2010, we granted 457,990 stock options. The weighted-average grant-date fair value of the stock-settled SARS and stock options granted during the nine months ended September 30, 2010 and 2009 was $16.73 and $8.58 per share, respectively. Total pre-tax compensation cost related to stock option and stock-settled SARS was $1.8 and $1.8 during the three months ended September 30, 2010 and 2009, respectively, and $5.8 and $5.3 during the nine months ended September 30, 2010 and 2009, respectively. The total intrinsic value of stock options and stock-settled SARS exercised during the nine months ended September 30, 2010 and 2009 was $10.5 and $0.1, respectively. Treasury shares and newly issued shares have been utilized for stock option and stock-settled SARS exercises. The total fair value of stock options and stock-settled SARS vested during the nine months ended September 30, 2010 and 2009 was $7.6 and $9.7, respectively.

As of September 30, 2010, there was $6.8 of total unrecognized compensation cost related to stock options and stock-settled SARS. That cost is expected to be recognized over a weighted-average period of 1.4 years as the majority of our awards vest over three years.

Cash received (for stock options only) and the tax benefit realized from stock options and stock settled SARS exercised and deferred shares issued were $17.7 and $3.9 for the nine months ended September 30, 2010, and $1.7 and $0.0 for the nine months ended September 30, 2009, respectively. Cash used to settle cash-settled SARS exercises for the nine months ended September 30, 2010 was $0.1. There were no cash-settled SARS exercises for the nine months ended September 30, 2009. The liability related to our cash-settled SARS was $3.4 at September 30, 2010 and $1.7 at December 31, 2009.

As provided under the 1993 Plan, we have also issued non-vested stock, non-vested stock units, and performance stock. Non-vested stock and stock units are subject to certain restrictions on ownership and transferability that lapse upon vesting. Performance share payouts are based on the attainment of certain financial performance objectives and may vary depending on the degree to which the performance objectives are met. We currently do not expect any outstanding performance stock awards to vest. A summary of non-vested stock and non-vested stock units for the nine months ended September 30, 2010 is presented below.

Non-vested stock and stock units	Number of Units	Weighted Average Grant Date Fair Value Per Unit
Nonvested at January 1, 2010	57,824	$ 31.27
Granted	74,915	$ 39.71
Vested	(4,860)	$ 56.61
Forfeited	(3,139)	$ 37.59
Nonvested at September 30, 2010	124,740	$ 35.19

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During the nine months ended September 30, 2010, we granted 60,525 non-vested stock units and 14,390 shares of non-vested stock. The total amount of share-based compensation expense recognized for non-vested shares and non-vested stock units for three months ended September 30, 2010 and 2009 was $0.5 and $0.2, respectively, and for nine months ended September 30, 2010 and 2009 was $1.4 and $0.6, respectively. As of September 30, 2010, there was $2.2 of total unrecognized compensation cost related to non-vested stock and stock units. That cost is expected to be recognized over a weighted-average period of 2.2 years.

Compensation cost related to all share-based compensation arrangements capitalized in inventory as of September 30, 2010 and December 31, 2009 was approximately $0.4 and $0.2, respectively.

As of September 30, 2010 and December 31, 2009, our additional paid-in capital pool (APIC Pool) which represents excess tax benefits available to absorb potential future tax deficiencies was $70.1 and $69.9, respectively.

5. EARNINGS PER SHARE (EPS)

Basic earnings/(loss) per common share excludes dilution and is computed by dividing net earnings/(loss) available to common stockholders by the weighted-average number of common shares outstanding (which includes shares outstanding, less performance and non-vested shares for which vesting criteria have not been met) plus deferred stock awards, weighted for the period outstanding. Diluted earnings per common share is computed by dividing net earnings available to common stockholders by the sum of the weighted-average number of common shares outstanding for the period adjusted (i.e., increased) for all additional common shares that would have been outstanding if potentially dilutive common shares had been issued and any proceeds of the issuance had been used to repurchase common stock at the average market price during the period. Under this method, an increase in the fair market value of the Company s stock can result in a greater dilutive effect from potentially dilutive common shares. The proceeds are assumed to be the sum of the amount to be paid to the Company upon exercise of options, the amount of compensation cost attributed to future services and not yet recognized, and the amount of income taxes that would be credited to or deducted from capital upon exercise.

The following table sets forth the computation of basic and diluted earnings/(loss) per common share for the three and nine months ended September 30 (in thousands, except net earnings/(loss) in millions and per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Numerator:				
Net earnings/(loss) attributable to Cytec Industries Inc.	$ 37.7	$ 12.5	$ 124.3	$ (12.4)
Denominator:				
Weighted average shares outstanding	49,422	48,724	49,243	48,125
Effect of dilutive shares:				
Options and stock-settled SARS	521	54	447	0
Non-vested shares and units	59	24	49	0
Diluted average shares outstanding	50,002	48,802	49,739	48,125
Basic earnings/(loss) per common share	$ 0.76	$ 0.26	$ 2.52	$ (0.26)
Diluted earnings/(loss) per common share	$ 0.75	$ 0.26	$ 2.50	$ (0.26)

Since the results for the nine months ended September 30, 2009 were a loss, all per share calculations are performed using the same denominator, as the loss available to common stockholders renders all potential common shares anti-dilutive.

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The following table sets forth the anti-dilutive shares/units excluded from the above calculation because their inclusion would have had an anti-dilutive effect on earnings per share (in thousands):

	Nine Months Ended September 30,	
	2010	2009
Options	291	1,863
Stock-Settled SARS	1,354	1,453
Non-vested shares/units	0	0
Total	**1,645**	**3,316**

6. INVENTORIES

Inventories consisted of the following:

	September 30, 2010	December 31, 2009
Finished goods	$ 286.1	$ 234.8
Work in progress	31.4	33.6
Raw materials and supplies	102.9	83.5
Total inventories	**$ 420.4**	**$ 351.9**

7. DEBT

Long-term debt, including the current portion, consisted of the following:

	September 30, 2010		December 31, 2009	
	Face	Carrying Value	Face	Carrying Value
Five-Year Revolving Credit Line Due June 2012	$ 0.0	$ 0.0	$ 0.0	$ 0.0
5.5% Notes Due October 1, 2010	15.4	15.4	15.4	15.4
4.6% Notes Due July 1, 2013	141.1	141.5	157.2	157.8
6.0% Notes Due October 1, 2015	250.0	249.7	250.0	249.6
8.95% Notes Due July 1, 2017	250.0	249.4	250.0	249.4
Other	1.4	1.4	2.9	2.9
	$ 657.9	$ 657.4	$ 675.5	$ 675.1
Less: Current maturities	(15.4)	(15.4)	(16.7)	(16.7)
Long-term Debt	$ 642.5	$ 642.0	$ 658.8	$ 658.4

All of the outstanding notes are unsecured and may be repaid in whole or in part, at our option at any time subject to a prepayment adjustment.

During the first quarter of 2010, we repurchased portions of our 4.6% notes due July 1, 2013 with a total carrying value of $14.5 for a total purchase price of $15.2 including accrued interest, resulting in a loss of $0.7. Net loss from our debt repurchases is included in net loss on early

extinguishment of debt in the accompanying statement of income.

During the second quarter of 2010, we repurchased a portion of our 4.6% notes due July 1, 2013 with a total carrying value of $0.3 for a total purchase price of $0.3 including accrued interest, resulting in a loss of less than $0.1.

During the third quarter of 2010, we repurchased a portion of our 4.6% notes due July 1, 2013 with a total carrying value of $1.4 for a total purchase price of $1.5 including accrued interest, resulting in a loss of less than $0.1.

On July 6, 2009, we sold $250.0 aggregate principal amount of 8.95% senior unsecured notes due July 1, 2017, which resulted in $247.7 in net proceeds after original issue discount and underwriting fees. In addition, on June 30, 2009, we commenced

offers to purchase our 5.5% notes due October 1, 2010 and our 4.6% notes due July 1, 2013. In July 2009, we applied the net proceeds from the issuance of the 8.95% notes and corporate cash to repurchase $234.6 principal amount of our 5.5% notes due October 1, 2010 for a purchase price of $242.8 plus accrued interest of $3.7 and $15.4 principal amount of our 4.6 % notes due July 1, 2013 for a purchase price of $14.6 plus accrued interest of $0.1. On October 1, 2010 we paid down the remaining $15.4 principal of the 5.5% notes, according to its terms.

There were no borrowings outstanding under the $400.0 unsecured five-year revolving credit facility at September 30, 2010. This facility contains covenants that are customary for such facilities including two financial covenants: the ratio of consolidated total debt to consolidated earnings before interest, taxes, depreciation and amortization (EBITDA) and the ratio of consolidated EBITDA to consolidated interest expense. We are in compliance with these covenants and expect to be in compliance for the remainder of the current facility which matures in June 2012.

At September 30, 2010 and December 31, 2009, the fair value of our long-term debt, including the current portion, was $762.3 and $746.1, respectively. The fair value is based on a discounted cash flow analysis which incorporates the contractual terms of the notes and observable market-based inputs that include time value, interest rate curves, and credit spreads.

The weighted-average interest rate on all of our debt was 6.80% and 6.47% as of September 30, 2010 and 2009, respectively. The weighted-average interest rate on short-term borrowings outstanding as of September 30, 2010 and 2009 was 1.11% and 1.08%, respectively.

8. ENVIRONMENTAL, CONTINGENCIES AND COMMITMENTS

Environmental Matters

We are subject to substantial costs arising out of environmental laws and regulations, which include obligations to remove or limit the effects on the environment of the disposal or release of certain wastes or substances at various sites or to pay compensation to others for doing so.

As of September 30, 2010 and December 31, 2009, the aggregate environmental related accruals were $102.0 and $105.4, respectively. As of September 30, 2010 and December 31, 2009, $5.5 of the above amounts was included in accrued expenses, with the remainder included in other noncurrent liabilities. Environmental remediation spending for the three months ended September 30, 2010 and 2009 was $1.1 and $1.2, respectively, and for the nine months ended September 30, 2010 and 2009 was $3.2 and $2.8, respectively.

Our process is to review our environmental remediation accruals quarterly and based on new information, may from time to time adjust our environmental related accruals. During the nine months ended September 30, 2010, based on additional information generated by site evaluations, we increased our environmental related accruals by $2.7, primarily related to operating sites in the U.S and Europe.

Our environmental related accruals can change substantially due to such factors as additional information on the nature or extent of contamination, methods of remediation required, changes in the apportionment of costs among responsible parties and other actions by governmental agencies or private parties or if we are named in a new matter and determine that an accrual needs to be provided or if we determine that we are not liable and no longer require an accrual.

A further discussion of environmental matters can be found in Note 11 of the Notes to the Consolidated Financial Statements contained in our 2009 Annual Report on Form 10-K.

Other Contingencies

We are the subject of numerous lawsuits and claims incidental to the conduct of our or certain of our predecessors businesses, including lawsuits and claims relating to product liability, personal injury including asbestos, environmental, contractual, employment and intellectual property matters.

As of September 30, 2010 and December 31, 2009, the aggregate self-insured and insured contingent liability was $59.6 and $60.8, respectively, and the related insurance recovery receivable for the liability as well as claims for past payments was $24.7 at September 30, 2010 and $28.0 at December 31, 2009. The asbestos liability included in the above amounts at September 30, 2010 and December 31, 2009 was $44.5 and $45.0, respectively, and the insurance receivable related to the liability as well as claims for past payments was $23.7 at September 30, 2010 and $26.5 at December 31, 2009. We anticipate receiving a net tax benefit for payment of those claims for which full insurance recovery is not realized.

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Asbestos

We, like many other industrial companies, have been named as one of hundreds of defendants in a number of lawsuits filed in the U.S. by persons alleging bodily injury from asbestos. The claimants allege exposure to asbestos at facilities that we own or formerly owned or from products that we formerly manufactured for specialized applications. Most of these cases involve numerous defendants, sometimes as many as several hundred. Historically, most of the closed asbestos claims against us have been dismissed without any indemnity payment by us; however, we can make no assurances that this pattern will continue.

The following table presents information about the number of claimants involved in asbestos claims with us:

	Nine Months Ended September 30, 2010	Year Ended December 31, 2009
Number of claimants at beginning of period	8,000	8,100
Number of claimants associated with claims closed during period	(100)	(200)
Number of claimants associated with claims opened during period	0	100
Number of claimants at end of period	7,900	8,000

Numbers in the foregoing table are rounded to the nearest hundred and are based on information as received by us which may lag actual court filing dates by several months or more. Claims are recorded as closed when a claimant is dismissed or severed from a case. Claims are opened whenever a new claim is brought, including from a claimant previously dismissed or severed from another case.

During the third quarter of 2009, we completed an actuarial study of our asbestos related contingent liabilities and related insurance receivables. This study which updated our last study prepared in the third quarter of 2006, is based on, among other things, the incidence and nature of historical claims data through September 30, 2009, the incidence of malignancy claims, the severity of indemnity payments for malignancy and non-malignancy claims, dismissal rates by claim type, estimated future claim frequency, settlement values and reserves, and expected average insurance recovery rates by claim type.

As a result of our findings, we recorded a decrease of $5.0 to our self insured and insured contingent liabilities for indemnity costs for pending and anticipated probable future claims and recorded a decrease of $4.9 related to receivables for probable insurance recoveries for these pending and future claims. The reserve decrease is attributable to significantly lower projected claim filings offset by more severe malignancy rates and settlement value projections. The decrease in the receivable is a result of the lower gross liability and a shift in the types of future claims expected. Overall, we expect to recover approximately 48% of our future indemnity costs. We have completed coverage in place agreements with most of our larger insurance carriers.

It should be noted that the ultimate liability and related insurance recovery for all pending and anticipated future claims cannot be determined with certainty due to the difficulty of forecasting the numerous variables that can affect the amount of the liability and insurance recovery. These variables include but are not limited to: (i) significant changes in the number of future claims; (ii) significant changes in the average cost of resolving claims; (iii) changes in the nature of claims received; (iv) changes in the laws applicable to these claims; and (v) financial viability of co-defendants and insurers.

Lead Pigment

Over the past 15 years we have been named as defendants in more than fifty cases in the U.S. in which plaintiffs assert claims for personal injury, property damage, and other claims for relief relating to one or more kinds of lead pigment that were used as an ingredient decades ago in paint for use in buildings. Seven cases remain outstanding. The different suits were brought by government entities and/or individual plaintiffs, on behalf of themselves and others. The suits variously sought compensatory and punitive damages and/or injunctive relief, including funds for the cost of monitoring, detecting and removing lead based paint from buildings and for medical monitoring; for personal injuries allegedly caused by ingestion of lead based paint; and plaintiffs attorneys fees. We settled one of these cases in 2005 for an immaterial amount in order to avoid litigation costs. In all of the other cases, we prevailed in court or were dismissed as a defendant. We believe that the seven remaining suits

against us are without merit, and we are vigorously defending them.

Six of the remaining lead suits are for personal injury claims and have been filed against us in Wisconsin. In July 2005, the Supreme Court of Wisconsin held in a case in which we were one of several defendants that Wisconsin s risk contribution doctrine applies to bodily injury cases against manufacturers of white lead pigment. Under this doctrine, manufacturers of white lead pigment may be liable for injuries caused by white lead pigment based on their past market shares unless they can prove they are not responsible for the white lead pigment which caused the injury in question. Seven other courts have previously rejected the applicability of this and similar doctrines to white lead pigment. The trial court s dismissal of the plaintiff s strict liability and negligent design defect causes of action for white lead carbonate in the case styled *Ruben Godoy et al v. E.I DuPont de Nemours et al*., one of the Wisconsin lead cases, was affirmed by the Wisconsin Court of Appeals in October 2007 and by the Wisconsin Supreme Court in July 2009. The decision in this case together with our non-existent or diminutive market share reinforces our belief that we have no liability in any of the Wisconsin cases, and accordingly, we have not recorded a loss contingency.

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We have access to a substantial amount of primary and excess general liability insurance for certain lead pigment related claims and believe these policies are available to cover a significant portion of both our defense costs and indemnity costs, if any, for certain lead pigment related claims. We currently have agreements with two of our insurers which provide that they will pay for approximately fifty percent (50%) of our defense costs associated with certain lead pigment related claims.

Other

Periodically, we enter into settlement discussions for lawsuits or claims for which we have meritorious defenses and for which an unfavorable outcome against us is not probable. In such instances, no loss contingency is recorded since a loss is not probable and it is our policy to expense defense costs as incurred. Typically, we consider these types of settlements in fairly limited circumstances usually related to the avoidance of future defense costs and/or the elimination of any risk of an unfavorable outcome. Such settlements, if any, are recorded when it is probable a liability has been incurred, typically upon entering into a settlement agreement.

While it is not feasible to predict the outcome of all pending environmental matters, lawsuits and claims, it is reasonably possible that there will be a necessity for future provisions for costs for environmental matters and for other contingent liabilities that we believe, will not have a material adverse effect on our consolidated financial position, but could be material to our consolidated results of operations or cash flows in any one accounting period. We cannot estimate any additional amount of loss or range of loss in excess of the recorded amounts. Moreover, many of these liabilities are paid over an extended period, and the timing of such payments cannot be predicted with any certainty.

From time to time, we are also included in legal proceedings as a plaintiff involving tax, contract, patent protection, environmental and other legal matters. Gain contingencies related to these matters, if any, are recorded when they are realized.

A further discussion of other contingencies can be found in Note 11 of the Notes to the Consolidated Financial Statements contained in our 2009 Annual Report on Form 10-K.

Commitments

We frequently enter into long-term contracts with customers with terms that vary depending on specific industry practices. Our business is not substantially dependent on any single contract or any series of related contracts. Descriptions of our significant sales contracts at December 31, 2009 are set forth in Note 11 of the Notes to Consolidated Financial Statements contained in our 2009 Annual Report on Form 10-K.

9. COMPREHENSIVE INCOME

The components of comprehensive income, which represents the change in equity from non-owner sources, for the three and nine months ended September 30, 2010 and 2009 are as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Net earnings/(loss)	$ 38.2	$ 13.0	126.3	(11.4)
Other comprehensive income (loss):				
Accumulated pension liability, net of tax	(1.4)	(4.9)	8.9	(3.4)
Unrealized (losses)/gains on cash flow hedges, net of tax	(7.6)	0.1	(7.2)	(10.0)
Foreign currency translation adjustments	91.7	41.4	1.9	66.3
Comprehensive income	$ 120.9	$ 49.6	$ 129.9	$ 41.5
Comprehensive income attributable to noncontrolling interest	0.8	0.7	2.5	1.0
Comprehensive income attributable to Cytec Industries Inc.	$ 120.1	$ 48.9	$ 127.4	$ 40.5

10. INCOME TAXES

The effective income tax rate for the three and nine months ended September 30, 2010 was a tax provision of 34.1% ($19.8) and 35.1% ($68.2), respectively, compared to a tax provision of 36.9% ($7.6) and a tax benefit of 19.7% ($2.8) for the three

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and nine months ended September 30, 2009. The 2010 effective tax rate for the year-to-date period was unfavorably impacted by a shift in earnings to higher tax jurisdictions and an $8.3 charge to tax expense related to the enactment of U.S. health care legislation (as further discussed below). The rate was favorably impacted by a $3.2 tax benefit primarily attributable to the remeasurement of the future utilization of deferred tax assets in a European tax jurisdiction. The underlying estimated annual income tax rate for the nine months ended September 30, 2010 was 32.3% (excluding accrued interest on unrecognized tax benefits) with an underlying tax rate of 32.6% including such interest.

For the first nine months ended September 30, 2009, the rate was unfavorably impacted by the lack of a tax benefit given to restructuring costs related to our decision to exit our polyurethane product line operations in Asia. The effective income tax rate for the first nine months of 2009 also includes a limited tax benefit for other restructuring charges.

The *Medicare Prescription Drug, Improvement and Modernization Act of 2003* established a U.S. Medicare prescription drug benefit and a tax-free federal subsidy to companies that sponsored retiree health care plans. Pursuant to *The Patient Protection and Affordable Care Act*, as signed into law on March 23, 2010, as amended by the *Health Care and Education Reconciliation Act of 2010* on March 30, 2010, the U.S. tax deductible prescription drug costs will now be reduced by the aforementioned federal subsidy. The impact of this legislation will reduce the future tax deductions with respect to the Company s prescription drug costs. Accordingly, we recorded an $8.3 charge to tax expense from continuing operations in the first quarter 2010 to reflect the reduction in the related deferred tax asset.

As of September 30, 2010, the amount of unrecognized tax benefits is $40.3 (gross) of which $21.2 would impact our effective tax rate, if recognized. The amount of unrecognized tax benefits at December 31, 2009 was $37.9 (gross) of which $19.8 would impact our effective tax rate, if recognized.

We recognize interest and penalties related to unrecognized tax benefits in income tax expense in the consolidated statements of income. We had recorded a liability for the payment of interest (gross), of approximately $6.9 as of December 31, 2009, which decreased $0.1 due to current year tax activity and the impact of foreign exchange, thus resulting in a liability for the payment of interest of $6.8 (gross) as of September 30, 2010.

11. OTHER FINANCIAL INFORMATION

On July 20, 2010, our Board of Directors declared a $0.0125 per common share cash dividend, payable on August 25, 2010 to shareholders of record as of August 10, 2010. Cash dividends paid in the third quarter of 2010 and 2009 were $0.7 and $2.1, respectively, and for the nine months ended September 30, 2010 and 2009 were $3.2 and $8.6, respectively. Dividends paid in the first nine months of 2010 include $1.3 paid by a majority owned subsidiary to its minority shareholder. Dividends paid in the nine months ended September 30, 2009 include $1.5 paid by a majority owned subsidiary to its minority shareholder. On October 21, 2010 the Board of Directors declared a $0.0125 per common share cash dividend, payable on November 26, 2010 to shareholders of record as of November 10, 2010.

Income taxes paid for the nine months ended September 30, 2010 and 2009 were $44.5 and $26.6, respectively. Interest paid for the nine months ended September 30, 2010 and 2009 was $30.3 and $25.4, respectively. Interest income for the nine months ended September 30, 2010 and 2009 was $5.1 and $5.1, respectively.

During the first quarter of 2010, we sold our real estate at an inactive site for $2.5 of which $0.5 was received in cash and $2.0 represents a promissory note from the purchaser. The net gain of $2.3 from this sale is recorded in other (expense)/income, net in the accompanying statements of income.

On September 28, 2009, we transferred title to land previously leased to a third party to such third party. The transfer of title was triggered by the third party exercising their right to purchase the property pursuant to the terms of the original lease. The transfer of title resulted in the recognition of a gain of $8.9, which represents the unamortized balance of the consideration we received at the inception of the lease as of the date of the exercise of the option to purchase. The gain is recorded in other (expense)/ income, net in the consolidated statement of income.

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12. SEGMENT INFORMATION

Summarized segment information for our five segments for the three and nine months ended September 30 is as follows:

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Net Sales:				
Coating Resins	$ 363.8	$ 336.3	$ 1,074.2	$ 878.3
Additive Technologies				
Sales to external customers	66.4	64.9	194.8	178.7
Intersegment sales	0.1	0.3	0.6	0.4
In Process Separation	75.2	71.2	211.0	185.1
Engineered Materials	194.7	169.2	568.7	539.1
Building Block Chemicals				
Sales to external customers	137.0	98.6	449.1	256.3
Intersegment sales	6.2	6.4	19.2	14.6
Net sales from segments	843.4	746.9	2,517.6	2,052.5
Elimination of intersegment revenue	(6.3)	(6.7)	(19.8)	(15.0)
Total consolidated net sales	$ 837.1	$ 740.2	$ 2,497.8	$ 2,037.5

	Three Months Ended September 30,				Nine Months Ended September 30,			
	2010	% of Sales	2009	% of Sales	2010	% of Sales	2009	% of Sales
Earnings/(loss) from operations:								
Coating Resins	$ 19.5	5%	$ 18.5	6%	$ 64.3	6%	$ (21.0)	-2%
Additive Technologies	9.1	14%	3.1	5%	28.1	14%	6.8	4%
In Process Separation	12.8	17%	12.5	18%	42.0	20%	19.4	10%
Engineered Materials	27.9	14%	18.3	11%	87.5	15%	73.5	14%
Building Block Chemicals	9.7	7%	4.8	5%	28.7	6%	9.9	4%
Earnings from segments	79.0	9%	57.2	8%	250.6	10%	88.6	4%
Corporate and Unallocated, net (1)	(11.5)		(27.5)		(28.2)		(80.2)	
Total earnings from operations	$ 67.5	8%	$ 29.7	4%	$ 222.4	9%	$ 8.4	0%

(1) For the three and nine months ended September 30, 2010, Corporate and Unallocated includes pre-tax charges of $3.2 and $7.4, respectively, related to the exit of certain phosphorus derivative products in Mt. Pleasant, TN, and for additional restructuring costs primarily associated with consolidating manufacturing operations in Europe during the third quarter. For the three and nine months ended September 30, 2009, Corporate and Unallocated includes pre-tax charges of $22.1 and $59.5, respectively, for various manufacturing and organizational restructuring initiatives across our Specialty Chemical and Engineered Materials segments and organizational restructuring activities within corporate operations. Corporate and Unallocated for the nine months ended September 30, 2009 also includes a net loss of $1.4 related to the exit of our polyurethane product line in Europe and Asia.

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13. GOODWILL AND OTHER ACQUISITION INTANGIBLES

The following is the activity in the goodwill balances for each segment.

	Coating Resins	Additive Technologies	In Process Separation	Engineered Materials	Total
Balance, December 31, 2009:					
Goodwill	762.2	19.6	53.2	256.8	1,091.8
Accumulated impairment charges	(389.9)	0.0	0.0	0.0	(389.9)
	$ 372.3	**$ 19.6**	**$ 53.2**	**$ 256.8**	**$ 701.9**
Currency exchange:					
Goodwill	(24.0)	0.0	0.8	(1.7)	(24.9)
Accumulated impairment charges	12.7	0.0	0.0	0.0	12.7
	(11.3)		0.8	(1.7)	(12.2)
Balance, September 30, 2010:					
Goodwill	738.2	19.6	54.0	255.1	1,066.9
Accumulated impairment charges	(377.2)				(377.2)
	$ 361.0	**$ 19.6**	**$ 54.0**	**$ 255.1**	**$ 689.7**

Other acquisition intangibles consisted of the following major classes:

	Weighted Average Useful Life (years)	Gross Carrying Value		Accumulated Amortization		Net Carrying Value	
	2010	September 30, 2010	December 31, 2009	September 30, 2010	December 31, 2009	September 30, 2010	December 31, 2009
Technology-based	16.2	$ 55.5	$ 55.9	$ (34.9)	$ (32.3)	$ 20.6	$ 23.6
Marketing-related	< 2.0	2.0	2.1	(2.0)	(2.1)	0.0	0.0
Marketing-related	15.5	63.9	65.0	(28.2)	(25.6)	35.7	39.4
Marketing-related	40.0	45.3	47.5	(4.8)	(4.2)	40.5	43.3
Customer-related	15.0	431.5	443.8	(168.3)	(150.6)	263.2	293.2
Total		$ 598.2	$ 614.3	$ (238.2)	$ (214.8)	$ 360.0	$ 399.5

Amortization of acquisition intangibles for the three months ended September 30, 2010 and 2009 was $9.1 and $9.7, respectively, and for the nine months ended September 30, 2010 and 2009 was $27.6 and $28.3, respectively.

Assuming no change in the gross carrying amount of acquisition intangibles and the 2010 average currency exchange rates remain constant, the estimated future amortization expense for the next five years are as follows:

	2010	2011	2012	2013	2014	2015
Intangibles Amortization Expense	$ 36.9	$ 36.9	$ 36.8	$ 36.2	$ 35.8	$ 35.7

14. DERIVATIVE FINANCIAL INSTRUMENTS AND COMMODITY HEDGING ACTIVITIES

Foreign Currency Derivative and Hedging Activities

Currency Forward Contracts

We periodically enter into currency forward contracts primarily to hedge currency fluctuations of transactions denominated in currencies other than the functional currency of the respective entity. At September 30, 2010, the principal transactions hedged involved accounts receivable, accounts payable and intercompany loans. When hedging currency exposures, our practice is to economically hedge such exposures with forward contracts denominated in the same currency and with similar critical terms as the underlying exposure, and therefore, the instruments are effective at generating offsetting changes in the fair value, cash flows or future earnings of the hedged item or transaction. The fair values of forward contracts are calculated each period.

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These forward contracts are not defined as hedging instruments; therefore, all changes in fair values are reported in other (expense)/income, net.

At September 30, 2010, net contractual amounts of forward contracts outstanding translated into U. S. dollars (USD) amount to $159.0. Of this total, $141.9 was attributed to the exposure in forward selling/purchase of USD. The remaining $17.1 was attributable to the exposure in forward selling/purchase of Euros, translated into USD equivalent amounts. The net favorable fair values of currency contracts, based on forward exchange rates at September 30, 2010 and December 31, 2009 were $6.9 and $0.5, respectively.

Cross Currency Swaps

We used cross currency swaps to hedge the changes in the cash flows of certain Euro denominated intercompany loans receivable (Euro loans) held by U.S. entities and to hedge a portion of our net investment in Cytec Surface Specialties SA/NV (our largest Euro functional currency subsidiary). Since the loans and underlying investment are denominated in Euros, we have foreign exchange exposure to the Euro/USD exchange rate changes. We originally hedged these foreign exchange exposures by entering into two cross currency swaps each with notional amounts of 207.9 ($250.0) that settle on October 1, 2010 (five year swaps) and October 1, 2015 (ten year swaps), respectively. At the initial principal exchange, we paid $500.0 and received 415.8 from counterparties. At the final exchanges on each of October 1, 2010 and October 1, 2015, we will pay 207.9 and receive $250.0. The swaps have fixed interest rates on both legs. On the five year swaps, we pay 3.78% interest per annum on the Euro notional amount and we receive 5.5% interest per annum on the USD notional amount. On the ten year swaps, we pay 4.52% interest per annum on the Euro notional amount and we receive 6.0% interest per annum on the USD notional amount. The interest payment dates (April 1 and October 1) and Euro rates coincide with the Euro loans.

Certain five and ten year swaps fix the USD equivalent cash flows of the Euro loans and eliminate foreign exchange variability, since the notional amounts of the swaps equal that of the loans, and all cash flow dates and interest rates coincide between the swaps and the loans; therefore no ineffectiveness is expected. Certain currency swaps were originally designated as cash flow hedges of the changes in value of the future Euro interest and principal receipts that results from changes in the USD to Euro exchange rates on certain Euro denominated intercompany loans receivable we have with one of our subsidiaries. In November 2008, the five year swaps were de-designated as cash flow hedges and we executed new off-setting cross currency swaps (two year swaps) to lock-in the Euro forward exchange rate for the principal exchange on the five year swaps due on October 1, 2010.

The two year swaps cover an identical notional amount of 207.9 and also call for a semi-annual exchange of fixed Euro interest receipts for fixed USD interest payments. With respect to the two year swaps, we will receive 3.78% per annum on the Euro notional amount and will pay 3.69% per annum on the USD notional amount on each April 1 and October 1, through the maturity date of the two year swaps, which is also on October 1, 2010. The two year swaps are not designated as cash flow hedges, therefore all changes in fair value are reported in interest expense, net, and other (expense)/income, net.

In September 2010, we de-designated our ten year swaps as hedging instruments due to the early settlement of a 41.6 portion of these swaps by one of our counterparties effective October 1, 2010. As a result of this termination, we executed a new cross currency swap effective October 1, 2010 to maintain the total notional amount of the ten year swaps at 207.9. With respect to this replacement swap, we will pay 4.52% per annum on the Euro notional amount and will receive 5.80% per annum on the USD notional amount on each April 1 and October 1, through the maturity date of the swap, which is also on October 1, 2015. We concurrently designated all the ten year swaps as a net investment hedge of the value of one of our U.S. subsidiaries net investment in our Belgium-based subsidiary, Cytec Surface Specialties SA/NV, against the risk of adverse foreign exchange movements in the USD value of the Euro. Since the critical terms of the ten year swaps match the critical terms of the net investment in Cytec Surface Specialties SA/NV, the ten year swaps are highly effective in offsetting the changes in the value of the net investment attributable to the change in USD value of the Euro.

All cross currency swaps are recorded at fair value as either assets or liabilities. We accrue the periodic net swap interest payments due each period in the consolidated income statement for the cash flow hedges. Each period we record the change in the fair value of the ten year swaps in accumulated other comprehensive income. For the ten year swaps, prior to its de-designation as cash flow hedges in September 2010, we reclassified an amount out of accumulated other comprehensive income to the income statement to offset the foreign currency gain or loss on the remeasurement to USD of the Euro intercompany loans. The amount of such reclassification depended on changes in the USD/Euro exchange rate occurred during the period. We also accounted for the five year swaps in this manner until de-designation as cash flow hedges in November 2008.

For cross currency swaps designated as a hedge of our net investment in Cytec Surface Specialties SA/NV, the fair value of the ten year swaps is calculated each period with changes in fair value reported in foreign currency translation adjustments within accumulated other comprehensive income (loss), net of tax. Such amounts reclassified to a translation adjustment will remain in other comprehensive income/(loss) until the complete or substantially complete liquidation of our investment in Cytec Surface Specialties SA/NV. The fair values of the two year swaps and, since its de-designation, the five year swaps, are calculated each period with changes in fair value reported in interest expense, net, and other (expense)/income, net. We monitor the counterparty credit risk and the continued probability of the hedged cash flows as to amount and timing.

At September 30, 2010, the favorable/(unfavorable) fair values of the two, five, and ten year swaps were $19.9, $(31.9), and $(20.1), respectively, and at December 31, 2009, the favorable/(unfavorable) fair values of the two, five, and ten year swaps were $34.8, $(44.7), and $(41.6), respectively. The two and five year swaps were settled according to their terms on October 1, 2010.

Commodity Derivative and Hedging Activities

We purchase natural gas for utility consumption at our manufacturing facilities and therefore, our overall profitability and operating cash flows are exposed to the variability in the market price. To partially eliminate this variability, we use natural gas forward purchase contracts to hedge a portion of our utility requirements at certain of our North American manufacturing facilities. These forward contracts, which are highly effective at achieving offsetting cash flows of the underlying natural gas purchases, have been designated as cash flow hedges of our forecasted natural gas purchases and are reported on the consolidated balance sheets at fair value in other assets/liabilities, with the effective portion of the fair value of the forward contract included in accumulated other comprehensive income/(loss) on an after-tax basis. Any ineffectiveness, which represents the amount by which the cumulative change in the cash flows of the forward contract is not completely offset by the cumulative change in the cash flows of the hedged transaction is recognized in other (expense)/income, net in the current period. During the nine months ended September 30, 2010 and September 30, 2009 there were no significant gains or losses reported in earnings for ineffectiveness. Gains and losses are reclassified into earnings, as a component of manufacturing cost of sales, in the period the hedged natural gas purchases affect earnings. If the derivative is no longer highly effective in achieving offsetting cash flows, subsequent changes in fair value are recorded in other expense, net. If the hedging relationship is terminated and the originally hedged transaction remains probable of occurring, the unrealized gain or loss associated with forward contracts remains in accumulated other comprehensive income and is recognized in earnings as a component of cost of sales in the period the originally hedged natural gas purchase affects earnings. If the forecasted transaction is no longer probable of occurring we recognize the related gain or loss in other expense, net in that period.

Generally, short-term (one to three months) natural gas usage requirements are hedged up to 90% with a gradual decrease to 10% for the natural gas requirements extending out to twelve months. At September 30, 2010, we held natural gas forwards to purchase approximately 2,000,000 MMBtu of gas with an unfavorable fair value of $2.2 included in accrued expenses, which will be reclassified into Manufacturing Cost of Sales through June 2011 as the hedged natural gas purchases affect earnings.

At September 30, 2010, we did not have derivative instruments that contained credit-related-risk contingent features or provisions that would trigger immediate settlement or require us to post collateral to our counterparties. Also as of September 30, 2010, we did not have any significant concentration of credit risk arising from our derivative instruments.

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The following tables summarize the impact of derivative instruments on our consolidated balance sheets and statements of income:

	Asset Derivatives				Liability Derivatives			
	September 30, 2010		December 31, 2009		September 30, 2010		December 31, 2009	
	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value	Balance Sheet Location	Fair Value
Derivatives designated as hedging instruments:								
Natural Gas Forwards			Other current assets	$ 0.3	Accrued expenses	$ 2.2		
Cross currency swaps (1)	Other current assets	$ 1.1	Other current assets	0.4	Other noncurrent liabilities	21.2	Other noncurrent liabilities	$ 42.0
Total derivatives designated as hedging instruments:		**$ 1.1**		**$ 0.7**		**$ 23.4**		**$ 42.0**
Derivatives not designated as hedging instruments:								
Cross currency swaps (2)	Currency Swap receivable	$ 19.5	Currency Swap receivable	$ 34.4	Currency Swap payable	$ 33.4	Currency Swap payable	$ 45.3
	Other current assets	1.9	Other current assets	1.0				
Foreign currency forwards	Other current assets	7.2	Other current assets	2.4	Accrued expenses	0.3	Accrued expenses	1.9
Total derivatives not designated as hedging instruments:		**$ 28.6**		**$ 37.8**		**$ 33.7**		**$ 47.2**
Total derivatives		**$ 29.7**		**$ 38.5**		**$ 57.1**		$ (3,329)
Changes for pre-existing warranty liabilities		**(803)**	(345)					
Warranty reserve end of year		**$ 755**	$ 1,363					

NOTE F - LONG-TERM DEBT AND CREDIT ARRANGEMENTS

	2009	2008
Senior indebtedness:		
Credit line borrowings	**$ 25,278**	$ 42,789
Term loans	**12,830**	14,336
Equipment financing	**6,908**	10,075
Capital lease obligations	**1,806**	3,199
Mortgage note payable	**6,022**	6,288
Note payable	**277**	---
Total senior indebtedness	**53,121**	76,687
Convertible subordinated debentures	**14,662**	17,162
Total long-term debt	**67,783**	93,849
Less: current portion of long-term debt	**(7,335)**	(7,439)
Less: current portion of capital lease obligations	**(1,099)**	(1,393)
Total long-term debt, less current portion	**$ 59,349**	$ 85,017

In October 2008, the Company amended and restated its senior loan and security agreement to extend the agreement's maturity date from May 11, 2010 to May 11, 2013, decrease the monthly term loan principal installments and increase interest rates applicable to borrowings under the agreement to more current market interest rates. Effective January 1, 2009, the amended and restated senior loan and security agreement was further amended to modify certain interest rate definitions to change the relative relationship between base rates and LIBOR rates as used in the agreement and to reduce the applicable credit spreads for base rate loans by 0.50%. Effective July 31, 2009, the Company reduced its revolving credit facility from $70,000 to $55,000 to better align the size of the revolving credit facility with the Company's anticipated levels of accounts receivable and inventory. The Company's amended and restated senior loan and security agreement provides $67,830 of credit, consisting of $55,000 of revolving credit and a $12,830 term loan. The term loan is payable in monthly principal installments of $126 and is due May 11, 2013.

Interest rates available under the amended and restated senior loan and security agreement may be selected from a number of options that effectively allow the Company to borrow at rates ranging from the lender's prime rate plus

1.00% to the lender's prime rate plus 2.25% for base rate loans, or at rates ranging from LIBOR plus 2.00% to LIBOR plus 3.25% for LIBOR loans. The weighted-average interest rate on borrowings outstanding under this agreement was 6.92% at December 26, 2009 and 5.68% at December 27, 2008. Commitment fees ranging from 0.25% to 0.375% per annum are payable on the average daily unused balance of the revolving credit facility. The interest rate on a portion of borrowings under the amended and restated senior loan and security agreement are fixed by an interest rate swap arrangement that effectively fixes the interest rate on $30,000 of such borrowings at 4.79% plus the applicable credit spreads. The levels of the Company's accounts receivable and inventory limit borrowing availability under the revolving credit facility. The facility is secured by a first priority lien on substantially all of the Company's assets.

The Company's amended and restated senior loan and security agreement does not contain ongoing financial covenants and permits payment of dividends and repurchases of the Company's Common Stock in an aggregate annual amount of up to $3,000 and distributions in excess of $3,000 under conditions specified in the agreement. The agreement also contains covenants that could limit future acquisitions. Unused borrowing capacity under the amended and restated senior loan and security agreement on December 26, 2009 was $10,444.

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The Company's equipment financing notes have terms ranging from five to seven years, are secured by the specific equipment financed, bear interest ranging from 5.55% to 6.94% and are due in monthly installments of principal and interest of $311 through February 2010 and monthly installments of principal and interest ranging from $263 to $38 from March 2010 through May 2014. The notes do not contain financial covenants.

The Company's capitalized lease obligations have terms ranging from four to seven years, are secured by the specific equipment leased, bear interest ranging from 6.65% to 7.27% and are due in monthly installments of principal and interest of $131 through June 2010 and monthly installments of principal and interest ranging from $32 to $8 from July 2010 through November 2015.

The Company's $6,022 mortgage is secured by real property, is payable in monthly principal installments ranging from $20 to $28 during the remaining term and matures on March 2013. The mortgage bears interest at LIBOR plus 2.0% and the interest rate is fixed at 6.54% through March 13, 2013 by an interest rate swap.

The Company's convertible subordinated debentures bear interest at 7% payable semi-annually, are due in 2012, and are convertible by their holders into shares of the Company's Common Stock at an effective conversion price of $32.20 per share, subject to adjustment under certain circumstances. Mandatory sinking fund payments, which commenced May 15, 1998, retire $2,500 principal amount of the debentures annually and approximately 86% of the debentures prior to maturity. The convertible debentures are subordinated in right of payment to all of the Company's other indebtedness.

Interest payments for continuing operations were $5,379 in 2009, $6,093 in 2008, and $6,469 in 2007. Interest capitalized by the Company was $0 in 2009, $367 in 2008, and $457 in 2007.

Maturities of long-term debt for periods following December 26, 2009 are as follows:

	Long-Term Debt	Capital Leases (See Note	Total

			M)			
2010	$	7,335	$	1,099	$	8,434
2011		6,387		259		6,646
2012		12,909		160		13,069
2013		39,161		84		39,245
2014		185		90		275
Thereafter		---		114		114
Total	$	65,977	$	1,806	$	67,783

NOTE G - FAIR VALUE MEASUREMENTS AND FINANCIAL INSTRUMENTS

Fair value is defined as the exchange value of an asset or a liability in an orderly transaction between market participants. The fair value guidance outlines a valuation framework and establishes a fair value hierarchy in order to increase the consistency and comparability of fair value measurements and disclosures. The hierarchy consists of three levels as follows:

Level 1 - Quoted market prices in active markets for identical assets or liabilities as of the reported date;

Level 2 - Other than quoted market prices in active markets for identical assets or liabilities, quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, and other than quoted prices for assets or liabilities and prices that are derived principally from or corroborated by market data by correlation or other means; and

Level 3 - Measurements using management's best estimate of fair value, where the determination of fair value requires significant management judgment or estimation.

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The Company's interest rate swaps are measured under the fair value standard. The following table summarizes the hierarchy level the Company used to determine fair value of its financial assets and liabilities as of December 26, 2009:

		Fair Value Hierarchy Level		
	Balance at December 26, 2009	Level 1	Level 2	Level 3
Liabilities:				
Interest rate swaps	$ 1,031	$ ---	$ 1,031	$ ---

The fair value of the interest rate swaps was obtained from external sources and was determined through the use of models that consider various assumptions and relevant economic factors.

Available-for-sale securities, if any, are reflected on the Company's consolidated condensed balance sheets in other current assets and related gains and losses are deferred in accumulated other comprehensive income (loss) ("AOCIL"). During 2009, the Company sold its remaining available-for-sale securities and realized gains from the sale of such securities of $292, or $181 net of tax.

The Company's financial instruments are not held or issued for trading purposes. The carrying amounts and estimated fair values of the Company's financial instruments are summarized as follows:

	2009		2008	
	Carrying Amount	**Fair Value**	Carrying Amount	Fair Value
Financial assets:				
Cash and cash equivalents	**$ 56**	**$ 56**	$ 113	$ 113
Notes receivable, including current portion	**419**	**419**	425	425

Available-for-sale securities	**---**	**---**	235	235
Financial Liabilities:				
Long-term debt and capital leases, including current portion	**67,783**	**70,882**	93,849	92,486
Interest rate swaps	**1,031**	**1,031**	2,248	2,248

The fair values of the Company's long-term debt and capital leases were estimated using market rates the Company believes are available for similar types of financial instruments. The fair values of cash and cash equivalents and notes receivable approximate their carrying amounts.

The Company's earnings, cash flows and financial position are exposed to market risks relating to interest rates. It is the Company's policy to minimize its exposure to adverse changes in interest rates and manage interest rate risks inherent in funding the Company with debt. The Company addresses this financial exposure through a risk management program that includes maintaining a mix of fixed and floating rate debt and the use of interest rate swaps, to minimize interest rate volatility. The Company does not hold speculative financial instruments, nor does it hold or issue financial instruments for trading purposes.

Derivatives designated as cash flow hedges are linked to specific liabilities on the Company's balance sheet. The Company assesses, both at inception and on an ongoing basis, whether the derivatives that are used in the hedging transaction are highly effective in offsetting changes in cash flows of the hedged items. When it is determined that a derivative is not highly effective or the derivative expires, is sold, terminated, or exercised, the Company discontinues hedge accounting for that specific hedge instrument. The Company recognizes all derivatives on its consolidated balance sheet at fair value. Changes in the fair value of effective cash flow hedges are deferred in AOCIL. Changes in the fair value of derivatives that are not effective hedges are recognized in income.

The Company is a party to an interest rate swap agreement with a notional amount of $30,000 through May 11, 2010. Under this interest rate swap agreement, the Company pays a fixed rate of interest of 4.79% times the notional amount and receives in return a specified variable rate of interest times the same notional amount. The interest rate swap agreement is linked to the Company's variable rate debt and is considered a highly effective hedge.

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The Company is also a party to an interest rate swap agreement through March 2013, which is linked to a mortgage and considered a highly effective hedge. Under the interest rate swap agreement, the Company pays a fixed rate of interest times a notional amount equal to the outstanding balance of the mortgage, and receives in return an amount equal to a specified variable rate of interest times the same notional amount. At December 26, 2009, the notional amount of the interest rate swap agreement was $6,022. Under the terms of the interest rate swap agreement, the Company pays a fixed rate of interest through March 2013, which effectively fixes the interest rate on the mortgage at 6.54%.

The following table summarizes the fair values of derivative instruments included in the Company's consolidated balance sheets:

	Liability Derivatives	
	2009	2008
Cash flow hedges - interest rate swaps:		
Accrued expenses	**$ 590**	$ ---
Other long-term liabilities	**441**	2,248
Total	**$ 1,031**	$ 2,248

The following table summarizes the pre-tax impact of derivative instruments on the Company's financial statements:

	Amount of Gain or (Loss) Recognized in AOCIL on Derivative (effective portion)		
	2009	2008	2007
Cash flow hedges - interest rate	**$ (345)**	$ (1,968)	$ (1,001)

swaps

The following table summarizes the pre-tax impact of derivative instruments on the Company's financial statements:

	Amount of Gain or (Loss) Reclassified from AOCIL into Income (effective portion) (1) (2)		
	2009	2008	2007
Cash flow hedges - interest rate swaps	**$ (1,586)**	$ (671)	$ 206

(1) The amount of loss reclassified from AOCIL is included in interest expense on the Company's consolidated condensed statements of operations.

(2) The amount of loss expected to be reclassified from AOCIL into earnings during the next 12 months is $769.

NOTE H - EMPLOYEE BENEFIT PLANS

The Company sponsors two 401(k) defined contribution plans covering substantially all associates. The Company generally matches participants' contributions, on a sliding scale, up to a maximum of 5% of the participant's earnings. The Company will not match participants' contributions for one of the two 401(k) plans for the 2009 plan year; accordingly, matching contributions for the 401(k) plans were $95 in 2009, $1,076 in 2008 and $1,025 in 2007. The 401(k) contribution plans provide that the Company may make additional contributions to the plan if the Company attains certain performance targets.

The Company sponsors a non-qualified retirement savings plan that allows eligible associates to defer a specified percentage of their compensation. The obligations owed to participants under this plan were $10,595 at December 26, 2009 and $9,197 at December 27, 2008 and are included in other long-term liabilities in the Company's consolidated balance sheets. The obligations are unsecured general obligations of the Company and the participants have no right, interest or claim in the assets of the Company, except as unsecured general creditors. The Company utilizes a Rabbi Trust to hold, invest and reinvest deferrals and contributions under the plan. Amounts invested in company-owned life insurance in the Rabbi Trust were $10,690 at December 26, 2009 and $8,931 at December 27, 2008 and are included in other long-term assets in the Company's consolidated balance sheets.

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On December 29, 2007, the Company merged its only remaining defined benefit pension plan into a multi-employer pension plan. As a result of the merger, the Company ceased to be a plan sponsor and became a contributing employer in the multi-employer pension plan. Expenses related to the merger in 2007 were $1,518, or $1,023 net of tax, and the Company contributed $205 in January 2008 to complete its funding obligation for the defined benefit pension plan. Substantially all of the expenses were non-cash and principally consisted of previously unrecognized actuarial losses. The Company's expense related to the multi-employer pension plan during 2009 was $222 and $186 during 2008. Based upon current employment and benefit levels, the Company's contributions to the multi-employer pension plan are expected to be approximately $232 for 2010.

The Company sponsors a legacy postretirement benefit plan that provides life insurance to a limited number of associates as a result of a prior acquisition. The Company also sponsors a postretirement benefit plan that provides medical and life insurance for a limited number of associates who retired prior to January 1, 2003.

Information about the benefit obligation and funded status of the Company's postretirement benefit plans is summarized as follows:

	2009	2008
Change in benefit obligation:		
Benefit obligation at beginning of year	$ **853**	$ 842
Service cost	**4**	4
Interest cost	**46**	46
Participant contributions	**26**	25
Actuarial gain	**(61)**	(52)
Benefits paid	**(30)**	(26)
Medicare Part D subsidy	**7**	14
Benefit obligation at end of year	**845**	853
Change in plan assets:		
Fair value of plan assets at beginning of year	**---**	---
Employer contributions	**(2)**	(13)
Participant contributions	**26**	25
Benefits paid	**(31)**	(26)
Medicare Part D subsidy	**7**	14

Fair value of plan assets at end of year	**---**	---
Funded status	$ **(845)**	$ (853)

The balance sheet classification of the Company's liability for postretirement benefit plans is summarized as follows:

	2009	2008
Accrued expenses	**$ 25**	$ 33
Other long-term liabilities	**820**	820
Total liability	**$ 845**	$ 853

Benefits expected to be paid on behalf of associates for postretirement benefit plans during the period 2010 through 2019 are summarized as follows:

Years	Postretirement Plans
2010	$ 25
2011	24
2012	24
2013	24
2014	24
2015 - 2019	119

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Assumptions used to determine benefit obligations of the Company's postretirement benefit plans are summarized as follows:

	2009	2008
Weighted-average assumptions as of year-end:		
Discount rate (benefit obligations)	**4.90%**	5.68%

Assumptions used and related effects of health care cost are summarized as follows:

	2009	2008
Health care cost trend assumed for next year	**10.00%**	10.00%
Rate to which the cost trend is assumed to decline	**5.00%**	5.00%
Year that the rate reaches the ultimate trend rate	**2016**	2016

The effect of a 1% change in the health care cost trend on the Company's postretirement benefit plans is summarized as follows:

	2009		2008	
	1% Increase	**1% Decrease**	1% Increase	1% Decrease
Accumulated postretirement benefit obligation	**$ 9**	**$ (8)**	$ 3	$ (4)

Components of net periodic benefit costs for all retirement plans are summarized as follows:

	2009	2008	2007
Defined benefit plans:			
Service cost	**$ ---**	$ ---	$ 169
Interest cost	**---**	---	164
Expected return on plan assets	**---**	---	(200)
Amortization of prior service costs	**---**	---	6
Recognized net actuarial loss	**---**	---	78
Settlement loss	**---**	---	221

Total - Defined pension plans	**---**	---	438
Defined contribution plan	**95**	1,076	1,025
Net periodic benefit cost	**$ 95**	$ 1,076	$ 1,463

Costs charged for all postretirement plans are summarized as follows:

	2009	2008	2007
Defined benefit plans:			
Service cost	**$ 4**	$ 4	$ 5
Interest cost	**46**	47	46
Amortization of prior service credits	**(88)**	(88)	(88)
Recognized net actuarial gain	**(92)**	(61)	(53)
Settlement gain	**(60)**	(32)	(68)
Net periodic benefit credit	**$ (190)**	$ (130)	$ (158)

Pre-tax amounts included in AOCIL for the Company's postretirement benefit plans at December 26, 2009 are summarized as follows:

	Postretirement Benefit Plans	
	Balance at 2009	2010 Expected Amortization
Prior service credits	**$ (541)**	$ (88)
Unrecognized actuarial gains	**(419)**	(51)
Totals	**$ (960)**	$ (139)

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NOTE I - INCOME TAXES

The Company accounts for uncertainty in income tax positions according to FASB guidance relating to uncertain tax positions. Unrecognized tax benefits were $52 at December 26, 2009 and $332 at December 27, 2008. Due to the Company's valuation allowances, such benefits, if recognized, would not affect the Company's effective tax rate. No interest or penalties have been accrued as of December 26, 2009 or December 27, 2008. The Company does not expect its unrecognized tax benefits to change significantly during the next twelve months. The Company recognizes interest and penalties related to uncertain tax positions, if any, in income tax expense.

The following is a summary of the change in the Company's unrecognized tax benefits:

	2009	2008	2007
Balance at beginning of year	**$ 332**	$ 419	$ 432
Additions based on tax positions taken during a prior period	**---**	37	59
Reductions related to settlement of tax matters	**(216)**	(15)	(51)
Reductions related to a lapse of applicable statute of limitations	**(64)**	(109)	(21)
Balance at end of year	**$ 52**	$ 332	$ 419

The Company and its subsidiaries are subject to United States federal income taxes, as well as income taxes in a number of state jurisdictions. The tax years subsequent to 2003 remain open to examination for U.S. federal income taxes and most state jurisdictions. The majority of state jurisdictions remain open for years subsequent to 2005. A few state jurisdictions remain open to examination for tax years subsequent to 2004.

The provision (benefit) for income taxes on income (loss) from continuing operations consists of the following:

	2009	2008	2007
Current			
Federal	**$ (11,472)**	$ (4,740)	$ 4,079
State	**139**	(194)	308
Total current	**(11,333)**	(4,934)	4,387

Deferred			
Federal	**2,468**	1,223	(645)
State	**20**	804	(49)
Total deferred	**2,488**	2,027	(694)
Income tax provision (benefit)	**$ (8,845)**	$ (2,907)	$ 3,693

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and the tax basis of those assets and liabilities.

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Significant components of the Company's deferred tax liabilities and assets are as follows:

	2009	2008
Deferred tax liabilities:		
Property, plant and equipment	**$ 13,937**	$ 14,363
Intangible assets	**---**	161
Other	**313**	3,340
Total deferred tax liabilities	**14,250**	17,864
Deferred tax assets:		
Inventories	**1,339**	1,446
Retirement benefits	**3,757**	4,050
Other employee benefits	**614**	858
Exit cost reserve	**603**	---
State net operating losses	**3,153**	1,956
Federal/State tax credit carryforwards	**2,179**	2,194
Allowances for bad debts, claims and discounts	**1,814**	2,276
Other	**2,686**	1,512
Total deferred tax assets	**16,145**	14,292
Valuation allowance	**(5,143)**	(3,640)

Net deferred tax asset	**11,002**	10,652
Net deferred tax liabilities	**$ 3,248**	$ 7,212

At December 26, 2009, $3,153 of deferred tax assets related to approximately $71,734 of state tax net operating loss carryforwards and $2,179 state tax credit carryforwards were available to the Company that will expire in five to twenty years. A valuation allowance of $5,143 is recorded to reflect the estimated amount of deferred tax assets that may not be realized during the carryforward periods.

Differences between the provision (benefit) for income taxes and the amount computed by applying the statutory federal income tax rate to income (loss) from continuing operations are summarized as follows:

	2009	2008	2007
Federal statutory rate	**35%**	34%	34%
Statutory rate applied to income (loss) from continuing operations	**$ (17,732)**	$ (11,572)	$ 3,560
Plus state income taxes net of federal tax effect	**103**	581	269
Total statutory provision (benefit)	**(17,629)**	(10,991)	3,829
Increase (decrease) attributable to:			
Impairment of goodwill	**8,000**	7,861	---
Tax contingency reserve	**---**	(71)	33
Refunds from utilization of tax credits	**(89)**	(93)	(114)
APIC charge	**204**	---	---
Change in valuation allowance	**391**	440	116
Other items	**278**	(53)	(171)

Total tax provision (benefit)	**$ (8,845)**	$ (2,907)	$ 3,693

During first quarter of 2009, the Company recognized a $31,406 impairment of goodwill. The Company's 2009 income tax benefit includes a $2,992 benefit from the tax deductible component of the goodwill impairment. The Company's effective tax benefit rate was 17.5% for 2009, principally as a result of the goodwill impairment.

During the fourth quarter of 2008, the Company recognized a non-deductible loss of $23,121 from the impairment of goodwill. The Company's effective tax benefit rate was 8.5% for 2008, principally as a result of the goodwill impairment.

Income tax refunds received, net of income tax payments for continuing and discontinued operations were $4,895 in 2009. Income tax payments, net of income tax refunds received were $1,368 in 2008 and $3,080 in 2007.

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NOTE J - COMMON STOCK AND EARNINGS PER SHARE

Common & Preferred Stock

The Company's Charter authorizes 80,000,000 shares of Common Stock with a $3 par value per share and 16,000,000 shares of Class B Common Stock with a $3 par value per share. Holders of Class B Common Stock have the right to twenty votes per share on matters that are submitted to Shareholders for approval and to dividends in an amount not greater than dividends declared and paid on Common Stock. Class B Common Stock is restricted as to transferability and may be converted into Common Stock on a one share for one share basis. The Company's Charter also authorizes 200,000,000 shares of Class C Common Stock, $3 par value per share, and 16,000,000 shares of Preferred Stock. No shares of Class C Common Stock or Preferred Stock have been issued.

Earnings Per Share

In the first quarter of 2009, the Company adopted newly issued guidance, which requires the Company to include all unvested stock awards which contain non-forfeitable rights to dividends or dividend equivalents (participating securities), whether paid or unpaid, in the number of shares outstanding in basic and diluted EPS calculations when the inclusion of these shares would be dilutive. As a result, the Company has included all of its unvested restricted stock awards in the calculation of basic and dilutive EPS for 2007. For 2009 and 2008, these participating securities were not included in the determination of EPS because to do so would be anti-dilutive.

This accounting guidance also requires additional disclosure of EPS for common stock and unvested share-based payment awards, separately disclosing distributed and undistributed earnings. Distributed earnings represent common stock dividends and dividends earned on unvested share-based payment awards. Undistributed earnings represent earnings that were available for distribution but were not distributed. Common stock and unvested share-based payment awards earn dividends equally. All earnings were undistributed in all periods presented.

The following table sets forth the computation of basic and diluted earnings (loss) per share from continuing operations:

2009	2008	2007
$ (41,818)	$ (31,128)	$ 6,778

Income (loss) from continuing operations (1)						
Weighted-average shares outstanding (2)		**12,331**		12,449		12,788
Participating securities - unvested restricted stock (3)		**---**		---		254
Shares for basic earnings (loss) per share (2)		**12,331**		12,449		13,042
Effect of dilutive securities:						
Stock options (3)		**---**		---		148
Directors' stock performance units (3)		**---**		---		25
Shares for diluted earnings per share (2)(3)		**12,331**		12,449		13,215
Earnings (loss) per share:						
Basic	**$**	**(3.39)**	**$**	(2.50)	$	0.52
Diluted		**(3.39)**		(2.50)		0.51

(1) No adjustments needed in the numerator for diluted calculations.

(2) Includes Common and Class B Common shares in thousands, less shares held in treasury, in thousands.

(3)

Because their effects are anti-dilutive, shares issuable under stock option plans where the exercise price is greater than the average market price of the Company's Common Stock at the end of the relevant period, unvested restricted stock deemed to be participating securities, directors' stock performance units, and shares issuable on conversion of subordinated debentures into shares of Common Stock have been excluded. Aggregate shares excluded were 1,658 shares in 2009, 1,531 shares in 2008, and 1,236 shares in 2007.

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THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

(Continued)

NOTE K - STOCK COMPENSATION EXPENSE AND STOCK PLANS

Stock Compensation Expense

The Company recognizes compensation expense relating to share-based payments based on the fair value of the equity or liability instrument issued.

The Company's stock compensation expense was $1,193 for 2009, $1,322 for 2008 and $1,179 for 2007.

Excess tax benefits of $115 were included in cash provided by financing activities for the year ended 2007.

2006 Stock Award Plan

On May 3, 2006, the Company's shareholders' approved and adopted the Company's 2006 Stock Award Plan (the "2006 Plan") which provides for the issuance of up to 800,000 shares of Common Stock and/or Class B Common Stock as stock-based or stock-denominated awards to directors of the Company and to salaried employees of the Company and its participating subsidiaries. The 2006 Plan superseded and replaced The Dixie Group, Inc. Stock Incentive Plan (the "2000 Plan"), which was terminated with respect to the granting of new awards. Awards previously granted under the 2000 Plan will continue to be governed by the terms of that plan and will not be affected by its termination.

Restricted Stock Awards

Each executive officer has the opportunity to earn a Primary Long-Term Incentive Award of restricted stock and receive an award of restricted stock denominated as Career Shares. The number of shares issued, if any, is based on

the market price of the Company s Common Stock at the time of grant of the award, subject, to a $5.00 per share minimum value. Primary Long-Term Incentive Awards vest over 3 years, and Career Shares vest when the participant becomes qualified to retire from the Company at 60 years of age and has retained the Career Shares for 24 months following the grant date. There were no new restricted stock awards granted during 2009.

During 2009, the Company amended and restated a 125,000 share Restricted Stock Award ("award) originally granted to its Chief Executive Officer on June 6, 2006 with a seven year term. The award is intended to retain and motivate the Company's Chief Executive Officer and to bring his total compensation package closer to median levels for Chief Executive Officers of comparable companies. The fair value on the date of the original award was $1,556, or $12.45 per share, equivalent to 92% of the market value of a share of the Company's Common Stock. Such value was determined using a binomial model and will be expensed over the term of the award. Vesting of the shares is contingent on a 35% increase in the market value of the Company's Common Stock (the "Market Condition") prior to five years from the date of the original grant. Additionally, vesting of shares requires the Chief Executive Officer to meet a continued service condition during the term of the award with a two year minimum vesting period. Shares subject to the award vest pro rata annually after the Market Condition and minimum vesting period are met on the anniversary date of the award. The award was amended to extend the term by one year to June 6, 2014, and to extend the time during which the award's market condition may be met by three years to June 6, 2014. The modification resulted in incremental stock compensation expense of $41 which will be amortized over the award's remaining vesting period.

During 2008, the Company granted 187,417 shares of restricted stock to officers of the Company. The grant-date fair value of the awards was $1,643, or $8.765 per share. The shares vest over terms ranging from 2 to 19 years from the date the awards were granted. Each award is subject to a continued service condition. The fair value of each share of restricted stock awarded was equal to the market value of a share of the Company's Common Stock on the grant date.

During 2007, the Company granted 109,620 shares of restricted stock to officers and other key employees. The grant-date fair value of the awards was $1,435, or $13.09 per share. The shares vest over terms ranging from 2 to 20 years from the date the awards were granted. Each award is subject to a continued service condition. The fair value of each share of restricted stock awarded was equal to the market value of a share of the Company's Common Stock on the grant date.

THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

(Continued)

During 2006, the Company also granted 24,000 shares of restricted stock to key employees. The grant-date fair value of the awards was $333, or $13.88 per share. Vesting of the share awards is subject to a continued service condition, with one-third to one-fifth of the awards vesting each year from the date the awards were granted. The fair value of each share of restricted stock awarded was equal to the market value of a share of the Company's Common Stock on the grant date.

Restricted stock activity for the three years ended December 26, 2009 is summarized as follows:

	Number of Shares	Weighted-Average Fair Value of Awards Granted During the Year
Outstanding at December 30, 2006	187,660	$ ---
Granted	109,620	13.09
Vested	(29,369)	---
Forfeited	(11,787)	---
Outstanding at December 29, 2007	256,124	---
Granted	187,417	8.77
Vested	(50,371)	---
Forfeited	---	---
Outstanding at December 27, 2008	393,170	---
Granted	---	---
Vested	(97,526)	---

Forfeited	(13,988)		---
Outstanding at December 26, 2009	281,656	$	---

As of December 26, 2009, unrecognized compensation cost related to unvested restricted stock was $1,591. That cost is expected to be recognized over a weighted-average period of 3.9 years. The total fair value of shares vested was approximately $146, $412 and $359 during the year 2009, 2008 and 2007, respectively.

Stock Performance Units

The Company's non-employee directors receive an annual retainer of $12 in cash and $12 in value of Performance Units (subject to a $5.00 minimum per unit) under the Director's Stock Plan. Since the share price on the date of grant was below $5.00 per share, the number of units issued was reduced resulting in a value of $5 to the directors for the 2009 Performance Units. Upon retirement, the Stock Performance Units vest and the Company issues a number of shares of Common Stock equivalent to the number of Stock Performance Units held by non-employee directors. As of December 26, 2009, 60,812 Stock Performance Units were outstanding under this plan.

Stock Purchase Plan

The Company has a stock purchase plan which authorizes 108,000 shares of Common Stock for purchase by supervisory associates at the market price prevailing at the time of purchase. At December 26, 2009, 27,480 shares remained available for issuance under the plan. Shares sold under this plan are held in escrow until paid for and are subject to repurchase agreements which give the Company a right of first refusal to purchase the shares if they are subsequently sold. No shares were sold under the plan in 2009, 2008 or 2007.

Stock Options

All unvested stock options issued under the Company's 2000 Plan are exercisable generally at a cumulative rate of 25% per year after the second year from the date the options are granted. Any options granted under the Company's 2006 Plan will be exercisable for periods determined at the time the awards are granted. Effective 2009, the Company established a $5.00 minimum exercise price on all options granted.

THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

(Continued)

The fair value of each option was estimated on the date of grant using the Black-Scholes model. Expected volatility was based on historical volatility of the Company's stock, calculated using the most recent period equal to the expected life of the options. The risk-free interest rate was based on the U.S. Treasury yield for a term equal to the expected life of the option at the time of grant. The Company uses historical exercise behavior data of similar employee groups to determine the expected life of options.

The following weighted-average assumptions were used to estimate the fair value of stock options granted during the year ended December 26, 2009:

	2009	2008 (1)	2007 (1)
Expected volatility	49.70%	---	---
Risk-free interest rate	2.36%	---	---
Dividend yield	0.00%	---	---
Expected life of options	5 years	---	---

(1) No options were granted during the years ended December 27, 2008 and December 29, 2007.

During 2009, the Company extended the life of 234,081 options held by 27 of the Company's employees by an additional three years. The modification increased stock compensation expense by $9.

During 2008, the Company modified 257,360 options by extending the life of certain options from 5 and 6 years to 10 years. The modification affected only 25 employees of the Company and resulted in an additional expense of approximately $21.

Option activity for the three years ended December 26, 2009 is summarized as follows:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Fair Value of Options Granted During the Year
Outstanding at December 30, 2006	1,029,597	$ 11.13	$ ---
Exercised	(103,106)	6.16	---
Forfeited	(8,625)	12.90	---
Outstanding at December 29, 2007	917,866	11.68	---
Exercised	(6,250)	3.95	---
Forfeited	(52,675)	13.50	---
Outstanding at December 27, 2008	858,941	11.62	---
Granted above market	139,000	5.00	0.90
Exercised	---	---	---
Forfeited	(80,663)	9.97	---
Outstanding at December 26, 2009	917,278	$ 10.76	$ ---
Options exercisable at:			
December 29, 2007	904,054	$ 11.71	---
December 27, 2008	854,691	11.62	---
December 26, 2009	778,278	11.79	---

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THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

(Continued)

The following table summarizes information about stock options at December 26, 2009:

	Options Outstanding			
Range of Exercise Prices	Number of Shares	Weighted-Average Remaining Contractual Life		Weighted-Average Exercise Price
$3.875 - $5.00	229,500	8.0 years	$	4.76
6.96 - 6.96	107,418	5.4 years		6.96
11.85 - 17.58	580,360	5.4 years		13.84
$3.875 - $17.58	917,278	6.0 years	$	10.76

	Options Exercisable			
Range of Exercise Prices	Number of Shares	Weighted-Average Remaining Contractual Life		Weighted-Average Exercise Price
$3.875 - $4.78	90,500	5.2 years	$	4.38
6.96 - 6.96	107,418	5.4 years		6.96
11.85 - 17.58	580,360	5.4 years		13.84
$3.875 - $17.58	778,278	5.4 years	$	11.79

At December 26, 2009, the market value of all outstanding stock options was less than their exercise price by $7,626 and the market value of exercisable stock options was less than their exercise price by $7,271. The market value of stock options exercised exceeded their exercise price during the year ended 2009, 2008 and 2007 by $0, $13 and $682, respectively.

At December 26, 2009, unrecognized compensation expense related to unvested stock options was $121 and is expected to be recognized over a weighted-average period of 4.9 years.

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THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

(Continued)

NOTE L - COMPREHENSIVE INCOME (LOSS)

	2009	2008	2007
Net income (loss)	**$ (42,098)**	$ (31,403)	$ 6,266
Other comprehensive income (loss):			
Unrealized loss on interest rate swap agreements:			
Before income taxes	**(345)**	(1,968)	(1,001)
Income taxes	**(131)**	(748)	(381)
Net of taxes	**(214)**	(1,220)	(620)
Reclassification into earnings on interest rate swap agreements:			
Before income taxes	**1,586**	671	(206)
Income taxes	**603**	255	(78)
Net of taxes	**983**	416	(128)
Unrealized gain on available-for-sale securities:			
Before income taxes	**58**	455	---
Income taxes	**22**	173	---
Net of taxes	**36**	282	---
Realized gain on sale of available-for-sale securities:			
Before income taxes	**(292)**	(222)	---
Income taxes	**(111)**	(85)	---
Net of taxes	**(181)**	(137)	---

Unrecognized net actuarial gain (loss) on pension and postretirement benefit plans:			
Before income taxes	**1**	20	(202)
Income taxes	**---**	8	(75)
Net of taxes	**1**	12	(127)
Recognition of net actuarial (gain) loss on pension and postretirement benefit plans:			
Before income taxes	**(92)**	(61)	1,806
Income taxes	**(35)**	(23)	685
Net of taxes	**(57)**	(38)	1,121
Amortization of prior service credits on pension and postretirement benefit plans:			
Before income taxes	**(88)**	(88)	(14)
Income taxes	**(33)**	(34)	(6)
Net of taxes	**(55)**	(54)	(8)
Comprehensive income (loss)	**$ (41,585)**	$ (32,142)	$ 6,504

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THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

(Continued)

Components of accumulated other comprehensive income (loss) are as follows:

	Interest Rate Swaps	Available-for-Sale Securities	Pension & Post-Retirement Liabilities	Total
Balance at December 30, 2006	$ 193	$ ---	$ (201)	$ (8)
Unrealized loss on interest rate swap agreements, net of tax of $381	(620)	---	---	(620)
Reclassification into earnings on interest rate swap agreements, net of tax of $78	(128)	---	---	(128)
Unrecognized net actuarial loss on pension and postretirement benefit plans, net of tax of $75	---	---	(127)	(127)
Recognition of net actuarial loss on pension and postretirement benefit plans, net of tax of $685	---	---	1,121	1,121

Amortization of prior service credits on pension and postretirement benefit plans, net of tax of $6	---	---	(8)	(8)
Balance at December 29, 2007	(555)	---	785	230
Unrealized loss on interest rate swap agreements, net of tax of $748	(1,220)	---	---	(1,220)
Reclassification into earnings on interest rate swap agreements, net of tax of $255	416	---	---	416
Unrealized gain on available-for-sale securities, net of tax of $173	---	282	---	282
Realized gain on sale of available-for-sale securities, net of tax of $85	---	(137)	---	(137)
Unrecognized net actuarial gain on postretirement benefit plans, net of tax of $8	---	---	12	12
Recognition of net actuarial gain on postretirement benefit plans, net of tax of $23	---	---	(38)	(38)

Amortization of prior service credits on postretirement benefit plans, net of tax of $34	---	---	(54)	(54)
Balance at December 27, 2008	(1,359)	145	705	(509)
Unrealized loss on interest rate swap agreements, net of tax of $131	(214)	---	---	(214)
Reclassification into earnings on interest rate swap agreements, net of tax of $603	983	---	---	983
Unrealized gain on available-for-sale securities, net of tax of $22	---	36	---	36
Realized gain on sale of available-for-sale securities, net of tax of $111	---	(181)	---	(181)
Unrecognized net actuarial gain on postretirement benefit plans, net of tax of $0	---	---	1	1
Recognition of net actuarial gain on postretirement benefit plans, net of tax of $35	---	---	(57)	(57)
Amortization of prior service credits on	---	---	(55)	(55)

postretirement benefit plans, net of tax of $33								
Balance at December 26, 2009	**$**	**(590)**	**$**	**---**	**$**	**594**	**$**	**4**

THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

(Continued)

NOTE M - COMMITMENTS

The Company had commitments of $70 at December 26, 2009, consisting primarily for purchases of machinery & equipment.

The Company leases certain equipment under capital leases and certain buildings, machinery and equipment under operating leases. The Company has outstanding letters of credit of $769 which collateralize certain equipment under an operating lease. Commitments for minimum rentals under non-cancelable leases, including any applicable rent escalation clauses, are as follows:

	Capital Leases	Operating Leases
2010	$ 1,181	$ 2,783
2011	298	2,517
2012	186	2,071
2013	102	1,227
2014	102	735
Total commitments	1,869	9,333
Less amounts representing interest	(177)	---
Total	$ 1,692	$ 9,333

Property, plant and equipment includes machinery and equipment under capital leases which have cost and accumulated depreciation of $9,680 and $7,424, respectively, at December 26, 2009, and $9,680 and $6,199, respectively, at December 27, 2008.

Rental expense was approximately $2,520, $2,641 and $2,422 during the years 2009, 2008 and 2007, respectively.

NOTE N - OTHER (INCOME) EXPENSE

Other income and expense is summarized as follows:

	2009	2008	2007
Other operating income:			
Gain on sale of other operating assets	**$ (188)**	$ (214)	$ (13)
Insurance proceeds	**(62)**	---	---
Miscellaneous income	**(392)**	(214)	(456)
Other operating income	**$ (642)**	$ (428)	$ (469)
Other operating expense:			
Loss on disposal of other operating assets	**$ 260**	$ 29	$ 27
Retirement expenses	**334**	546	392
Miscellaneous expense	**162**	370	254
Other operating expense	**$ 756**	$ 945	$ 673
Other income:			
Interest income	**$ (15)**	$ (20)	$ (20)
Sale of available-for-sale securities	**(292)**	(222)	---
Miscellaneous income	**(50)**	(137)	(143)
Other income	**$ (357)**	$ (379)	$ (163)
Other expense:			
Write-off deferred financing costs	**$ 133**	$ ---	$ ---
	43	53	69

Miscellaneous expense			
Other expense	**$ 176**	$ 53	$ 69

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THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

(Continued)

NOTE O - FACILITY CONSOLIDATION AND SEVERANCE EXPENSES

In response to the difficult economic conditions, the Company began consolidating its Eton, Georgia carpet tufting operation into its Atmore, Alabama tufting, dyeing and finishing facility beginning in the fourth quarter of 2008. This was substantially completed in the first quarter of 2009. The Company also made organizational and other changes designed to reduce staff and expenses throughout the Company. In addition, the Company consolidated its Santa Ana, California tufting plant, a leased facility, into its Santa Ana, California dyeing, finishing and distribution facility, a facility owned by the Company, which was completed during the fourth quarter of 2009. Also, in 2009, the leased facility was vacated and the Company recorded the estimated costs related to fulfillment of its contractual lease obligations and on-going facilities maintenance, net of an estimate of sub-lease expectations.

Costs related to the 2008 Facilities Consolidation Plan are summarized as follows:

					As of December 26, 2009	
	Accrued Balance at 2008	2009 Expenses To Date	Cash Payments	Accrued Balance at 2009	Total Costs Incurred To Date	Total Expected Costs
Equipment and inventory relocation	$ ---	$ 1,338	$ (1,338)	$ ---	$ 3,193	$ 3,193
Severance pay and employee relocation	281	633	(914)	---	1,095	1,095
Leased facilities - obligations	---	1,271	---	1,271	1,271	1,271
Totals	$ 281	$ 3,242	$ (2,252)	$ 1,271	$ 5,559	$ 5,559

In August 2009, the Company developed and began implementing a plan to realign its organizational structure in the third and fourth quarters of 2009. Under this plan, the Company combined its three residential carpet units into one

business with three distinct brands. As a result, the Company's residential business is organized much like its commercial carpet business and more like the rest of the industry. Costs related to the organization realignment include severance costs, associate relocation expenses and costs related to the migration of certain computer applications necessary to support the realignment. The Company estimates future additional costs under this initiative of approximately $120, primarily related to completion of the systems migration.

Costs related to the 2009 Organization Restructuring Plan are summarized as follows:

					As of December 26, 2009	
	Accrued Balance at 2008	2009 Expenses To Date	Cash Payments	Accrued Balance at 2009	Total Costs Incurred To Date	Total Expected Costs
Severance pay and employee relocation	$ ---	$ 684	$ (656)	$ 28	$ 684	$ 714
Computer systems conversion cost	---	166	(115)	51	166	256
Totals	$ ---	$ 850	$ (771)	$ 79	$ 850	$ 970

Expenses incurred under these plans are classified in "facility consolidation and severance expenses" in the Company's consolidated statements of operations.

Long-lived Assets

Long-lived assets are reviewed for impairment when circumstances indicate that the carrying value of an asset may not be fully recoverable. During the fourth quarter of 2008, as the Company began consolidating certain of its operations and facilities, certain assets were identified, primarily computer systems under development, that would not be utilized. As a result, the Company recorded a non-cash pre-tax charge of $4,478 to reflect the write-off of these assets. During 2009, the Company recorded a non-cash pre-tax charge of $1,459 for long-lived asset impairments primarily related to previously recorded leasehold improvement assets in the California leased facility that, subsequent to the exit of the

THE DIXIE GROUP, INC.

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(dollars in thousands, except per share data)

(Continued)

leased facility, will not provide future economic benefit to the Company, other manufacturing related assets that will no longer be used as a result of the California facilities consolidation and additional computer software taken out of service in the systems consolidation process. The charge is included in "Impairment of assets" in our Consolidated Statements of Operations for the years ended December 26, 2009 and December 27, 2008.

NOTE P - DISCONTINUED OPERATIONS

Results associated with operations that have been sold or discontinued are generally classified as discontinued operations for all periods presented.

Discontinued operations are summarized as follows:

	2009	2008	2007
Loss on discontinued operations:			
Before income taxes	**$ (431)**	$ (417)	$ (873)
Income tax benefit	**(151)**	(142)	(361)
Loss from discontinued operations, net of tax	**$ (280)**	$ (275)	$ (512)

Discontinued operating losses in 2009, 2008 and 2007 primarily consisted of expenses for workers' compensation and sales tax expenses related to businesses sold in 2003 and 2004.

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SCHEDULE II - VALUATION AND QUALIFYING ACCOUNTS

THE DIXIE GROUP, INC. AND SUBSIDIARIES

(dollars in thousands)

Description	Balance at Beginning of Year	Additions Charged to Costs and Expenses	Deductions	Balance at End of Year
Year ended December 26, 2009:				
Reserves deducted from asset accounts:				
Allowance for doubtful accounts	$ 961	$ 1,265	$ 1,489 (1)	$ 737
Reserves classified as liabilities:				
Provision for claims, allowances and warranties	3,131	3,477	4,495 (2)	2,113
Year ended December 27, 2008:				
Reserves deducted from asset accounts:				
Allowance for doubtful accounts	$ 676	$ 607	$ 322 (1)	$ 961
Reserves classified as liabilities:				
Provision for claims, allowances and warranties	3,382	6,080	6,331 (2)	3,131
Year ended December 29, 2007:				
Reserves deducted from asset accounts:				
Allowance for doubtful accounts	$ 651	$ 204	$ 179 (1)	$ 676

Reserves classified as liabilities:				
Provision for claims, allowances and warranties	3,089	6,981	6,688 (2)	3,382

(1)

Uncollectible accounts written off, net of recoveries.

(2)

Reserve reductions for claims and allowances settled.

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ANNUAL REPORT ON FORM 10-K
ITEM 15(c)
EXHIBITS

YEAR ENDED DECEMBER 26, 2009
THE DIXIE GROUP, INC.
CHATTANOOGA, TENNESSEE

Exhibit Index

EXHIBIT NO.	EXHIBIT DESCRIPTION	INCORPORATION BY REFERENCE
(3.1)	Text of Restated Charter of The Dixie Group, Inc. as Amended - Blackline Version.	Incorporated by reference to Exhibit (3.4) to Dixie's Annual Report on Form 10-K for the year ended December 27, 2003. *
(3.2)	Amended By-Laws of The Dixie Group, Inc. as of February 22, 2007.	Incorporated by reference to Exhibit 3.1 to Dixie's Current Report on Form 8-K dated February 26 2007.*
(4.1)	Form of Indenture, dated May 15, 1987 between Dixie Yarns, Inc. and Morgan Guaranty Trust Company of New York as Trustee.	Incorporated by reference to Exhibit 4.2 to Amendment No. 1 of Dixie's Registration Statement No. 33-14078 on Form S-3, dated May 19, 1987. *
(4.2)	Master Lease Agreement for Synthetic Lease, dated October 14, 2003, between the Company and General Electric Capital Corporation.	Incorporated by reference to Exhibit (10.28) to Dixie's Annual Report on Form 10-K for the year ended December 27, 2003. *
(4.3)	Amended and Restated Loan and Security Agreement dated April 14, 2004 by and among The Dixie Group, Inc. each of its subsidiaries as guarantors, and Fleet Capital Corporation.	Incorporated by reference to Exhibit (4.13) to Dixie's Current Report on Form 8-K dated April 14, 2004. *
(4.4)	First Amendment to Amended and Restated Loan and Security Agreement, dated November 10, 2004 by and among The Dixie Group, Inc. each of its subsidiaries as guarantors, and Fleet Capital Corporation.	Incorporated by reference to Exhibit (4.1) to Dixie's Current Report on Form 8-K dated November 8, 2004. *

(4.5)	Second Amendment, dated July 27, 2005, to Amended and Restated Loan and Security Agreement dated April 14, 2004 by and among The Dixie Group, Inc. each of its subsidiaries as guarantors, and Bank of America, N.A. (successor to Fleet Capital Corporation).	Incorporated by reference to Exhibit (10.1) to Dixie's Current Report on Form 8-K dated July 27, 2005. *
(4.6)	Third Amendment dated May 3, 2006, to Amended and Restated Loan and Security Agreement, by and among The Dixie Group, Inc., each of its subsidiaries as guarantors, Bank of America, N.A., in its capacity as collateral and administrative agent for the Lenders, and the Lenders (as such term is defined in the Loan Agreement).	Incorporated by reference to Exhibit (10.1) to Dixie's Current Report on Form 8-K dated May 4, 2006. *

(4.7)	Fourth Amendment dated October 25, 2006, to Amended and Restated Loan and Security Agreement, by and among The Dixie Group, Inc., each of its subsidiaries as guarantors, Bank of America, N.A., in its capacity as collateral and administrative agent for the Lenders, and the Lenders (as such term is defined in the Loan Agreement).	Incorporated by reference to Exhibit (10.1) to Dixie's Current Report on Form 8-K dated October 25, 2006. *
(4.8)	Letter Agreement dated July 16, 2007 to the Fourth Amendment dated October 25, 2006, to Amended and Restated Loan and Security Agreement, by and among The Dixie Group, Inc., each of its subsidiaries as guarantors, Bank of America, N.A., in its capacity as collateral and administrative agent for the Lenders, and the Lenders (as such term is defined in the Loan Agreement).	Incorporated by reference to Exhibit (10.1) to Dixie's Current Report on Form 8-K dated July 16, 2007.*
(4.9)	Fifth Amendment dated October 23, 2007, to Amended and Restated Loan and Security Agreement, by and among The Dixie Group, Inc., each of its subsidiaries as guarantors, Bank of America, N.A., in its capacity as collateral and administrative agent for the Lenders, and the Lenders (as such term is defined in the Loan Agreement).	Incorporated by reference to Exhibit (10.1) to Dixie's Current Report on Form 8-K dated October 23, 2007.*
(4.10)	Note and Security Agreement with Bank of America Leasing & Capital, LLC	Incorporated by reference to Exhibit (99.1) to Dixie's Current Report on Form 8-K dated November 9, 2007*
(4.12)	Second Amended and Restated Loan and Security Agreement dated October 24, 2008, by and among The Dixie Group, Inc., each of its subsidiaries as guarantors, Bank of America, N.A., in its capacity as collateral and administrative agent for the Lenders, and the Lenders (as such term is defined in the Loan Agreement)	Incorporated by reference to Exhibit 4.1 to Dixie's Current Report on Form 8-K dated October 24, 2008.
(4.13)	First Amendment to Second Amended and Restated Loan and Security Agreement dated October 24, 2008, by and among The Dixie Group, Inc. each of its subsidiaries as guarantors, and Bank of America, N.A. (successor to Fleet Capital Corporation), effective January 1, 2009.	Incorporated by reference to Exhibit (4.1) to Dixie's Current Report on Form 8-K dated December 23, 2008.
(10.1)	Dixie Yarns, Inc. Incentive Stock Plan as amended. **	Incorporated by reference to ANNEX A to Dixie's Proxy Statement dated March 27, 1998

	for its 1998 Annual Meeting of Shareholders. *
(10.2) The Dixie Group, Inc. Director's Stock Plan. **	Incorporated by reference to Exhibit (10y) to Dixie's Annual Report on Form 10-K for the year ended December 27, 1997. *

(10.3)	The Dixie Group, Inc. New Non-qualified Retirement Savings Plan effective August 1, 1999. **	Incorporated by reference to Exhibit (10.1) to Dixie's Quarterly Report on Form 10-Q for the quarter ended June 26, 1999. *
(10.4)	The Dixie Group, Inc. Deferred Compensation Plan Amended and Restated Master Trust Agreement effective as of August 1, 1999. **	Incorporated by reference to Exhibit (10.2) to Dixie's Quarterly Report on Form 10-Q for the quarter ended June 26, 1999. *
(10.5)	Stock Purchase Agreement dated as of July 1, 2000, by and among the Company and the stockholders of Fabrica International, Inc. named therein.	Incorporated by reference to Exhibit (2.1) to Dixie's Current Report on Form 8-K dated July 1, 2000. *
(10.6)	Stock Purchase Agreement dated as of July 1, 2000, by and among the Company and all of the stockholders of Chroma Technologies, Inc.	Incorporated by reference to Exhibit (2.2) to Dixie's Current Report on Form 8-K dated July 1, 2000. *
(10.7)	The Dixie Group, Inc. Stock Incentive Plan, as amended. **	Incorporated by reference to Annex A to Dixie's Proxy Statement dated April 5, 2002 for its 2002 Annual Meeting of Shareholders. *
(10.8)	Amended and restated stock purchase agreement by and among The Dixie Group, Inc., and Scott D. Guenther, Royce R. Renfroe, and the Albert A. Frink and Denise Frink Charitable Remainder Unitrust and the Albert A. Frink Loving Trust dated September 8, 2000.	Incorporated by reference to Exhibit (10.1) to Dixie's Quarterly Report on Form 10-Q for the quarter ended March 31, 2001. *
(10.9)	Form of Stock Option Agreement under The Dixie Group, Inc. Stock Incentive Plan. **	Incorporated by reference to Exhibit (10.23) to Dixie's Annual Report on Form 10-K for the year ended December 29, 2001. *

(10.10)	Form of Stock Rights and Restrictions Agreement for Restricted Stock Award under The Dixie Group, Inc. Stock Incentive Plan, as amended.**	Incorporated by reference to Exhibit (10.35) to Dixie's Annual Report on Form 10-K for the year ended December 25, 2004. *
(10.11)	Form of Stock Option Agreement under The Dixie Group, Inc. Stock Incentive Plan for Non-Qualified Options Granted December 20, 2005.**	Incorporated by reference to Exhibit (10.1) to Dixie's Current Report on Form 8-K dated December 20, 2005. *
(10.12)	Employment Agreement between The Dixie Group, Inc. and David E. Polley, dated November 20, 2002**	Incorporated by reference to Exhibit (10.1) to Dixie's Quarterly Report on Form 10-Q for the quarter ended March 29, 2003. *
(10.13)	First Amendment dated January 26, 2004 to Employment Agreement between The Dixie Group, Inc. and David E. Polley, dated November 20, 2002.**	Incorporated by reference to Exhibit (10.29) to Dixie's Annual Report on Form 10-K for the year ended December 27, 2003. *

(10.14)	Second Amendment, dated January 18, 2006, to Employment Agreement dated November 20, 2002 between The Dixie Group, Inc. and David E. Polley.**	Incorporated by reference to Exhibit (10.1) to Dixie's Current Report on Form 8-K dated January 18, 2006. *
(10.15)	Third Amendment, dated January 6, 2007, to Employment Agreement dated November 20, 2002 between The Dixie Group, Inc. and David E. Polley.**	Incorporated by reference to Exhibit (10.1) to Dixie's Current Report on Form 8-K dated January 16, 2007. *
(10.16)	Summary Description of the 2004 Annual Incentive Plan for The Dixie Group, Inc.**	Incorporated by reference to Exhibit (10.33) to Dixie's Annual Report on Form 10-K for the year ended December 25, 2004. *
(10.17)	Summary Description of the Director Compensation Arrangements for The Dixie Group, Inc.**	Incorporated by reference to Exhibit (10.34) to Dixie's Annual Report on Form 10-K for the year ended December 25, 2004. *
(10.18)	Severance Agreement and Release Between Fabrica International and Royce Renfroe effective as of May 12, 2005.**	Incorporated by reference to Exhibit (10.1) to Dixie's Current Report on Form 8-K dated May 12, 2005. *
(10.19)	The Dixie Group, Inc. 2006 Stock Awards Plan. **	Incorporated by reference to Annex A to the Company's Proxy Statement for its 2006 Annual Meeting of Shareholders, filed March 20, 2006. *
(10.20)	The 2006 Incentive Compensation Plan, approved February 23, 2006.**	Incorporated by reference to Current Report on Form 8-K dated March 1, 2006. *
(10.21)	Material terms of the performance goals for the period 2007-2011, pursuant to which incentive compensation awards may be made to certain key executives of the Company based on the results achieved by the Company during such years, approved March 14, 2006.**	Incorporated by reference to Current Report on Form 8-K dated March 20, 2006. *

(10.22)	Form of Award of Career Shares under the 2006 Incentive Compensation Plan for Participants holding only shares of the Company s Common Stock.**	Incorporated by reference to Exhibit (10.1) to Dixie's Current Report on Form 8-K dated June 6, 2006. *
(10.23)	Form of Award of Career Shares under the 2006 Incentive Compensation Plan for Participants holding shares of the Company s Class B Common Stock.**	Incorporated by reference to Exhibit (10.2) to Dixie's Current Report on Form 8-K dated June 6, 2006. *
(10.24)	Form of Award of Long Term Incentive Plan Shares under the 2006 Incentive Compensation Plan for Participants holding only shares of the Company s Common Stock.**	Incorporated by reference to Exhibit (10.3) to Dixie's Current Report on Form 8-K dated June 6, 2006. *

(10.25)	Form of Award of Long Term Incentive Plan Shares under the 2006 Incentive Compensation Plan for Participants holding shares of the Company s Class B Common Stock.**	Incorporated by reference to Exhibit (10.4) to Dixie's Current Report on Form 8-K dated June 6, 2006. *
(10.26)	Award of 125,000 shares of Restricted Stock under the 2006 Stock Awards Plan to Daniel K. Frierson.**	Incorporated by reference to Exhibit (10.1) to Dixie's Current Report on Form 8-K dated June 7, 2006. *
(10.27)	Summary description of The Dixie Group, Inc. 2007 Annual Compensation Plan.**	Incorporated by reference to Exhibit (10.1) to Dixie's Current Report on Form 8-K dated February 26, 2007.*
(10.28)	Rule 10b5-1 and 10b-18 Repurchase Agreement by and between The Dixie Group, Inc. and Raymond James & Associates, Inc. dated December 11, 2007*	Incorporated by reference to Exhibit (99.1) to Dixie's Current Report on Form 8-K dated December 11, 2007*
(10.29)	Merger agreement between The Dixie Group, Inc. and Unite Here National Retirement Fund regarding the Company's Masland Bargaining Unit Defined Benefit Pension Plan.**	Incorporated by reference to Exhibit (99.1) to Dixie's Current Report on Form 8-K dated December 28, 2007*
(10.30)	Summary description of The Dixie Group, Inc. 2008 Annual Incentive Plan.**	Incorporated by reference to Exhibit 10.1 to Dixie's Current Report on Form 8-K dated February 15, 2008*
(10.31)	Summary description of The Dixie Group, Inc. 2009 Annual Incentive Plan.**	Incorporated by reference to Exhibit 10.1 to Dixie's Current Report on Form 8-K dated March 26, 2009*
(10.32)	Amended and restated award of 125,000 shares of Restricted Stock under the 2006 Stock Awards Plan to Daniel K. Frierson.**	Incorporated by reference to Exhibit 10.1 to Dixie's Current Report on Form 8-K dated May 21, 2009.*
(10.33)	Consulting agreement and non-compete agreement between Gary A. Harmon and The Dixie Group, Inc.	Incorporated by reference to Exhibit 10.1 to Dixie's Current Report on Form 8-K dated July 30, 2009.*

(10.34)	Reduced revolving credit facility under its Second Amended and Restated Loan and Security Agreement dated October 24, 2008, by and among The Dixie Group, Inc., each of its subsidiaries as guarantors, Bank of America, N.A., in its capacity as collateral and administrative agent for the Lenders, and the Lenders (as such term is defined in the Loan Agreement).	Incorporated by reference to Exhibit (10.1) to Dixie's Current Report on Form 8-K dated July 30, 2009.

(10.35)	Agreement by and between Stifel, Nicolaus & Company, Inc. dated August 18, 2008, to repurchase shares of The Dixie Group, Inc.'s Common Stock	Incorporated by reference to Exhibit (99.1) to Dixie's Current Report on Form 8-K dated August 18, 2008.
(10.36)	Master Lease Agreement, Corporate Guaranty and Schedule to the Master Lease Agreement by and between General Electric Capital Corporation and Masland Carpets, LLC dated August 21, 2009.	Incorporated by reference to Exhibit (10.1, 10.2, 10.3) to Dixie's Current Report on Form 8-K dated August 25, 2009.
(10.37)	Agreement by and between Raymond James & Associates, Inc. dated November 6, 2008, to repurchase shares of The Dixie Group, Inc.'s Common Stock	Incorporated by reference to Exhibit (99.1) to Dixie's Current Report on Form 8-K dated November 6, 2008.
(14)	Code of Ethics, as amended and restated, February 15, 2010.	Filed herewith.
(21)	Subsidiaries of the Registrant.	Filed herewith.
(23)	Consent of Independent Registered Public Accounting Firm.	Filed herewith.
(31.1)	CEO Certification pursuant to Securities Exchange Act Rule 13a-14(a).	Filed herewith.
(31.2)	CFO Certification pursuant to Securities Exchange Act Rule 13a-14(a).	Filed herewith.
(32.1)	CEO Certification pursuant to Securities Exchange Act Rule 13a-14(b).	Filed herewith.
(32.2)	CFO Certification pursuant to Securities Exchange Act Rule 13a-14(b).	Filed herewith.

* Commission File No. 0-2585.

** Indicates a management contract or compensatory plan or arrangement.

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