

SIFCO INDUSTRIES INC  
Form 10-Q  
May 10, 2012

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

**WASHINGTON, D.C. 20549**

**FORM 10-Q**

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

**For the quarterly period ended March 31, 2012**

**or**

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

**For the transition period from            to**

**Commission file number 1-5978**

**SIFCO Industries, Inc.**

**(Exact name of registrant as specified in its charter)**

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|   |  |
|---|--|
| <b>Ohio</b><br>(State or other jurisdiction of<br>incorporation or organization)        | <b>34-0553950</b><br>(I.R.S. Employer<br>Identification No.) |
| <b>970 East 64th Street, Cleveland Ohio</b><br>(Address of principal executive offices) | <b>44103</b><br>(Zip Code)                                   |
| <b>(216) 881-8600</b><br>(Registrant's telephone number, including area code)           |  |

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

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

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

|  |   |
|--|---|
| Large accelerated filer <input type="checkbox"/> | Accelerated filer <input type="checkbox"/>                    |
| Non-accelerated filer <input type="checkbox"/>   | Smaller reporting company <input checked="" type="checkbox"/> |

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

The number of the Registrant's Common Shares outstanding at March 31, 2012 was 5,323,416.

**Part I. Financial Information****Item 1. Financial Statements****SIFCO Industries, Inc. and Subsidiaries****Consolidated Condensed Statements of Operations****(Unaudited)****(Amounts in thousands, except per share data)**

|  | <b>Three Months Ended<br/>March 31,</b> |             | <b>Six Months Ended<br/>March 31,</b> |             |
|--|---|-------------|---------------------------------------|-------------|
|  | <b>2012</b>                             | <b>2011</b> | <b>2012</b>                           | <b>2011</b> |
| Net sales  | <b>\$ 34,079</b>                        | \$ 26,804   | <b>\$ 62,589</b>                      | \$ 48,200   |
| Operating expenses:                                |   |             |                                       |             |
| Cost of goods sold                                 | <b>26,601</b>                           | 19,878      | <b>48,646</b>                         | 36,299      |
| Selling, general and administrative expenses       | <b>4,104</b>                            | 3,318       | <b>8,073</b>                          | 6,494       |
| Amortization of intangible assets                  | <b>662</b>                              | 685         | <b>1,477</b>                          | 742         |
| Total operating expenses                           | <b>31,367</b>                           | 23,881      | <b>58,196</b>                         | 43,535      |
| Operating income                                   | <b>2,712</b>                            | 2,923       | <b>4,393</b>                          | 4,665       |
| Interest income                                    | <b>(3)</b>                              | (11)        | <b>(10)</b>                           | (33)        |
| Interest expense                                   | <b>134</b>                              | 44          | <b>228</b>                            | 64          |
| Foreign currency exchange (gain) loss, net         | <b>3</b>                                | 5           | <b>(19)</b>                           | 9           |
| Other income, net                                  | <b>(118)</b>                            | (117)       | <b>(235)</b>                          | (234)       |
| Income before income tax provision                 | <b>2,696</b>                            | 3,002       | <b>4,429</b>                          | 4,859       |
| Income tax provision                               | <b>972</b>                              | 1,007       | <b>1,519</b>                          | 1,658       |
| Net income   | <b>\$ 1,724</b>                         | \$ 1,995    | <b>\$ 2,910</b>                       | \$ 3,201    |
| Net income per share                               |   |             |                                       |             |
| Basic  | <b>\$ 0.32</b>                          | \$ 0.38     | <b>\$ 0.55</b>                        | \$ 0.61     |
| Diluted  | <b>\$ 0.32</b>                          | \$ 0.38     | <b>\$ 0.55</b>                        | \$ 0.60     |
| Weighted-average number of common shares (basic)   | <b>5,315</b>                            | 5,267       | <b>5,303</b>                          | 5,263       |
| Weighted-average number of common shares (diluted) | <b>5,336</b>                            | 5,313       | <b>5,326</b>                          | 5,302       |

See notes to unaudited consolidated condensed financial statements.

## SIFCO Industries, Inc. and Subsidiaries

## Consolidated Condensed Balance Sheets

(Amounts in thousands, except per share data)

|   | March 31,<br>2012<br>(unaudited) | September 30,<br>2011 |
|---|----------------------------------|-----------------------|
| <b>ASSETS</b>   |                                  |                       |
| Current assets:   |                                  |                       |
| Cash and cash equivalents   | \$ 7,009                         | \$ 6,431              |
| Receivables, net  | 23,735                           | 20,739                |
| Inventories, net  | 18,244                           | 10,239                |
| Refundable income taxes   | 38                               | 281                   |
| Deferred income taxes   | 1,386                            | 1,500                 |
| Prepaid expenses and other current assets   | 1,075                            | 468                   |
| Total current assets  | 51,487                           | 39,658                |
| Property, plant and equipment, net  | 32,033                           | 27,558                |
| Intangible assets, net  | 15,829                           | 8,506                 |
| Goodwill  | 7,026                            | 3,493                 |
| Other assets  | 1,020                            | 796                   |
| Total assets  | \$ 107,395                       | \$ 80,011             |
| <b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>   |                                  |                       |
| Current liabilities:  |                                  |                       |
| Current maturities of long-term debt  | \$ 2,002                         | \$ 30                 |
| Accounts payable  | 11,171                           | 9,778                 |
| Accrued liabilities   | 3,797                            | 4,626                 |
| Total current liabilities   | 16,970                           | 14,434                |
| Long-term debt, net of current maturities   | 22,711                           | 1,186                 |
| Deferred income taxes   | 2,120                            | 2,233                 |
| Other long-term liabilities   | 8,365                            | 8,749                 |
| Shareholders' equity:   |                                  |                       |
| Serial preferred shares, no par value, authorized 1,000 shares  | 0                                | 0                     |
| Common shares, par value \$1 per share, authorized 10,000 shares; issued shares 5,350 at March 31, 2012 and 5,335 at September 30, 2011; outstanding shares 5,350 at March 31, 2012 and 5,299 at September 30, 2011 | 5,350                            | 5,335                 |
| Additional paid-in capital  | 7,138                            | 7,032                 |
| Retained earnings   | 57,032                           | 54,122                |
| Accumulated other comprehensive loss  | (12,291)                         | (12,702)              |
| Common shares held in treasury at cost, no shares at March 31, 2012 and 36 shares at September 30, 2011   | 0                                | (378)                 |
| Total shareholders' equity  | 57,229                           | 53,409                |
| Total liabilities and shareholders' equity  | \$ 107,395                       | \$ 80,011             |

See notes to unaudited consolidated condensed financial statements.



## SIFCO Industries, Inc. and Subsidiaries

## Consolidated Condensed Statements of Cash Flows

(Unaudited)

(Amounts in thousands)

|   | Six Months Ended<br>March 31, |          |
|---|-------------------------------|----------|
|   | 2012                          | 2011     |
| Cash flows from operating activities:   |                               |          |
| Net income  | \$ 2,910                      | \$ 3,201 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                               |          |
| Depreciation and amortization   | 3,255                         | 2,005    |
| LIFO provision  | 428                           | 225      |
| Share transactions under employee stock plans                                     | 498                           | 47       |
| Other   | 50                            | 7        |
| Changes in operating assets and liabilities:                                      |                               |          |
| Receivables   | 705                           | 1,078    |
| Inventories   | (4,442)                       | (2,015)  |
| Refundable income taxes   | 243                           | 692      |
| Prepaid expenses and other current assets   | (452)                         | 71       |
| Accounts payable  | 1,040                         | 2,120    |
| Accrued liabilities   | 149                           | (68)     |
| Other   | (266)                         | 44       |
| Net cash provided by operating activities   | 4,118                         | 7,407    |
| Cash flows from investing activities:   |                               |          |
| Acquisition of business   | (24,721)                      | (22,566) |
| Maturity of short-term investments  | 0                             | 3,000    |
| Capital expenditures  | (1,262)                       | (1,642)  |
| Net cash used for investing activities  | (25,983)                      | (21,208) |
| Cash flows from financing activities:   |                               |          |
| Proceeds from term note   | 10,000                        | 0        |
| Repayments of term note   | (1,000)                       | 0        |
| Proceeds from revolving credit agreement  | 37,016                        | 12,914   |
| Repayments of revolving credit agreement  | (24,812)                      | (9,540)  |
| Proceeds from other debt  | 2,302                         | 0        |
| Dividends paid  | (1,060)                       | (789)    |
| Other   | (28)                          | (56)     |
| Net cash provided by financing activities   | 22,418                        | 2,529    |
| Increase (decrease) in cash and cash equivalents                                  | 553                           | (11,272) |
| Cash and cash equivalents at the beginning of the period                          | 6,431                         | 18,671   |
| Effect of exchange rate changes on cash and cash equivalents                      | 25                            | (58)     |
| Cash and cash equivalents at the end of the period                                | \$ 7,009                      | \$ 7,457 |

Supplemental disclosure of cash flow information of continuing operations:

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|   |          |         |
|---|----------|---------|
| Cash paid for interest  | \$ (201) | \$ (19) |
| Cash paid for income taxes, net                                     | (1,159)  | (813)   |
| See notes to unaudited consolidated condensed financial statements. |          |         |

## SIFCO Industries, Inc. and Subsidiaries

## Notes to Unaudited Consolidated Condensed Financial Statements

(Dollars in thousands, except share and per share data)

**1. Summary of Significant Accounting Policies****A. Principles of Consolidation**

The accompanying unaudited consolidated condensed financial statements include the accounts of SIFCO Industries, Inc. and its wholly-owned subsidiaries (the Company). All significant intercompany accounts and transactions have been eliminated.

The U.S. dollar is the functional currency for all of the Company's U.S. operations and its Irish subsidiary. For these operations, all gains and losses from completed currency transactions are included in income currently. For the Company's other non-U.S. subsidiaries, the functional currency is the local currency. Assets and liabilities are translated into U.S. dollars at the rates of exchange at the end of the period, and revenues and expenses are translated using average rates of exchange. Foreign currency translation adjustments are reported as a component of accumulated other comprehensive loss in the unaudited consolidated condensed financial statements.

These unaudited consolidated condensed financial statements should be read in conjunction with the consolidated financial statements and related notes included in the Company's fiscal 2011 Annual Report on Form 10-K. The results of operations for any interim period are not necessarily indicative of the results to be expected for other interim periods or the full year. Certain prior period amounts may have been reclassified in order to conform to current period classifications.

**B. Net Income Per Share**

The Company's net income per basic share has been computed based on the weighted-average number of common shares outstanding. Net income per diluted share reflects the effect of the Company's outstanding stock options, restricted shares and performance shares under the treasury stock method. The dilutive effect of the Company's stock options, restricted shares and performance shares were as follows:

|   |         | Six Months Ended March 31, 2012 |                                      |                     |
|---|---------|---------------------------------|--------------------------------------|---------------------|
|   |         | Net Income                      | Weighted-average<br>common<br>shares | Per-share<br>Amount |
| (Amounts in thousands, except per share data) |         |                                 |                                      |                     |
| Net income per share                          | basic   | \$ 2,910                        | 5,303                                | \$ 0.55             |
| Effect of dilutive securities:                |         |                                 |                                      |                     |
| Stock options                                 |         | 0                               | 22                                   |                     |
| Restricted shares                             |         | 0                               | 1                                    |                     |
| Performance shares                            |         | 0                               | 0                                    |                     |
| Net income per share                          | diluted | \$ 2,910                        | 5,326                                | \$ 0.55             |

During periods when operating losses may occur, outstanding stock options, restricted shares and performance shares would not be included in the calculation of net loss per diluted share because such inclusion would be anti-dilutive.

**C. Derivative Financial Instruments**

The Company uses an interest rate swap agreement to reduce risk related to variable-rate debt, which is subject to changes in market rates of interest. The interest rate swap is designated as a cash flow hedge. At March 31, 2012, the Company held an interest rate swap agreement with a notional amount of \$9,000. Cash flows related to the interest rate swap agreement are included in interest expense. The Company's interest rate swap agreement and its variable-rate term debt are based upon LIBOR. During the first six months of fiscal year 2012, the Company's interest rate swap agreement qualified as a fully effective cash flow hedge against the Company's variable-rate term note interest risk. The following table reports the effects of the mark-to-market valuation of the Company's interest rate swap agreement for the six months ended March 31,



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2012:

|  |         |
|--|---------|
| Interest rate swap agreement market adjustment               | \$ (83) |
| Tax effect of interest rate swap agreement market adjustment | 31      |
| Net interest rate swap agreement market adjustment           | \$ (52) |

**2. Inventories**

Inventories consist of:

|                            | March 31,<br>2012 | September 30,<br>2011 |
|----------------------------|-------------------|-----------------------|
| Raw materials and supplies | \$ 6,667          | \$ 4,216              |
| Work-in-process            | 6,521             | 3,194                 |
| Finished goods             | 5,056             | 2,829                 |
| Total inventories          | \$ 18,244         | \$ 10,239             |

Inventories are stated at the lower of cost or market. Cost is determined using the last-in, first-out ( LIFO ) method for 48% and 54% of the Company's inventories at March 31, 2012 and September 30, 2011, respectively. The first-in, first-out ( FIFO ) method is used for the remainder of the inventories. If the FIFO method had been used for the inventories for which cost is determined using the LIFO method, inventories would have been \$8,402 and \$7,974 higher than reported at March 31, 2012 and September 30, 2011, respectively.

**3. Goodwill and Intangible Assets**

The Company's intangible assets by major asset class subject to amortization consist of:

| March 31, 2012                | Estimated<br>Useful Life | Original<br>Cost | Accumulated<br>Amortization | Net<br>Book<br>Value |
|-------------------------------|--------------------------|------------------|-----------------------------|----------------------|
| Intangible assets:            |                          |                  |                             |                      |
| Trade name                    | 10 years                 | \$ 1,900         | \$ 159                      | \$ 1,741             |
| Non-compete agreement         | 5 years                  | 1,300            | 197                         | 1,103                |
| Below market lease            | 5 years                  | 900              | 235                         | 665                  |
| Customer relationships        | 10 years                 | 13,000           | 1,146                       | 11,854               |
| Order backlog                 | 1 year                   | 2,100            | 1,634                       | 466                  |
| Transition services agreement | < 1 year                 | 23               | 23                          | 0                    |
| Total intangible assets       |                          | \$ 19,223        | \$ 3,394                    | \$ 15,829            |

| September 30, 2011            | Estimated<br>Useful Life | Original<br>Cost | Accumulated<br>Amortization | Net Book<br>Value |
|-------------------------------|--------------------------|------------------|-----------------------------|-------------------|
| Intangible assets:            |                          |                  |                             |                   |
| Trade name                    | 10 years                 | \$ 900           | \$ 73                       | \$ 827            |
| Non-compete agreement         | 5 years                  | 500              | 81                          | 419               |
| Below market lease            | 5 years                  | 900              | 145                         | 755               |
| Customer relationships        | 10 years                 | 6,800            | 548                         | 6,252             |
| Order backlog                 | 1 year                   | 1,300            | 1,047                       | 253               |
| Transition services agreement | < 1 year                 | 23               | 23                          | 0                 |
| Total intangible assets       |                          | \$ 10,423        | \$ 1,917                    | \$ 8,506          |



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Included in the intangible assets at March 31, 2012 are intangible assets acquired in connection with the purchase of the forging business and substantially all related operating assets from GEL Industries, Inc. (DBA Quality Aluminum Forge, Inc.) on October 28, 2011, as discussed more fully in Note 11. These acquired intangible assets consist of:

|                             | Estimated<br>Useful Life | Original<br>Cost |
|-----------------------------|--------------------------|------------------|
| Intangible assets:          |                          |                  |
| Trade name                  | 10 years                 | \$ 1,000         |
| Non-compete agreement       | 5 years                  | 800              |
| Customer relationships      | 10 years                 | 6,200            |
| Order backlog               | 1 year                   | 800              |
| <br>Total intangible assets |                          | <br>\$ 8,800     |

The amortization expense on identifiable intangible assets for the six months ended March 31, 2012 and 2011 was \$1,477 and \$742, respectively. Amortization expense associated with the identified intangible assets, all of which relates to the Forged Components Group, is expected to be as follows:

|                  | Amortization<br>Expense |
|------------------|-------------------------|
| Fiscal year 2012 | \$ 2,952                |
| Fiscal year 2013 | 2,025                   |
| Fiscal year 2014 | 1,950                   |
| Fiscal year 2015 | 1,950                   |
| Fiscal year 2016 | 1,724                   |

The Company's goodwill is not being amortized, but is subject to impairment tests. All of the goodwill is expected to be deductible for tax purposes. Changes in the net carrying amount of goodwill were as follows:

|                                   |              |
|-----------------------------------|--------------|
| Balance at September 30, 2011     | \$ 3,493     |
| Goodwill acquired during the year | 3,533        |
| <br>Balance at March 31, 2012     | <br>\$ 7,026 |

#### 4. Comprehensive Income and Accumulated Other Comprehensive Loss

Total comprehensive income is as follows:

|  | Three Months Ended<br>March 31, |              | Six Months Ended<br>March 31, |              |
|--|---------------------------------|--------------|-------------------------------|--------------|
|  | 2012                            | 2011         | 2012                          | 2011         |
| Net income   | \$ 1,724                        | \$ 1,995     | \$ 2,910                      | \$ 3,201     |
| Foreign currency translation adjustment, net of tax  | 83                              | 104          | 38                            | 79           |
| Interest rate swap agreement adjustment, net of tax  | (7)                             | 0            | (52)                          | 0            |
| Net retirement plan liability adjustment, net of tax | 223                             | 204          | 425                           | 408          |
| <br>Total comprehensive income                       | <br>\$ 2,023                    | <br>\$ 2,303 | <br>\$ 3,321                  | <br>\$ 3,688 |



The components of accumulated other comprehensive loss are as follows:

|  | March 31,<br>2012 | September 30,<br>2011 |
|--|-------------------|-----------------------|
| Foreign currency translation adjustment, net of tax  | \$ (5,732)        | \$ (5,770)            |
| Net retirement plan liability adjustment, net of tax | (6,507)           | (6,932)               |
| Interest rate swap agreement adjustment, net of tax  | (52)              | 0                     |
| Total accumulated other comprehensive loss           | \$ (12,291)       | \$ (12,702)           |

## 5. Long-Term Debt

Long-term debt consists of:

|                            | March 31,<br>2012 | September 30,<br>2011 |
|----------------------------|-------------------|-----------------------|
| Revolving credit agreement | \$ 13,388         | \$ 1,184              |
| Term loan                  | 9,000             | 0                     |
| Promissory Note            | 2,322             | 0                     |
| Capital lease obligations  | 0                 | 28                    |
| Other                      | 3                 | 4                     |
|                            | 24,713            | 1,216                 |
| Less current maturities    | 2,002             | 30                    |
| Total long-term debt       | \$ 22,711         | \$ 1,186              |

In October 2011, the Company entered into an amendment to its existing credit agreement (the Credit Agreement Amendment) with its bank increasing the maximum borrowing amount from \$30.0 million to \$40.0 million, of which \$10.0 million is a five (5) year term loan and \$30.0 million is a five (5) year revolving loan, secured by substantially all the assets of the Company and its U.S. subsidiaries and a pledge of 65% of the stock of its non-U.S. subsidiaries. The term loan is repayable in quarterly installments of \$0.5 million starting December 1, 2011.

The term loan has a Libor-based variable interest rate that was 2.3% at March 31, 2012 and which becomes an effective fixed rate of 2.9% after giving effect to an interest rate swap agreement. Borrowing under the revolving loan bears interest at a rate equal to Libor plus 0.75% to 1.75%, which percentage fluctuates based on the Company's leverage ratio of outstanding indebtedness to EBITDA. The loans are subject to certain customary financial covenants including, without limitation, covenants that require the Company to not exceed a maximum leverage ratio and to maintain a minimum fixed charge coverage ratio. There is also a commitment fee ranging from 0.10% to 0.25% to be incurred on the unused balance. The Company was in compliance with all applicable loan covenants as of March 31, 2012.

In connection with the acquisition of the QAF business, as discussed more fully in Note 11, the Company issued a \$2.4 million non-interest bearing promissory note to the seller, which note is payable by the Company in November, 2013. The imputed interest rate used to discount the note was 2% per annum.

## 6. Government Grants

In the past, the Company received grants from certain government entities as an incentive to invest in facilities, research and employees. Remaining grants, principally capital in nature, are amortized into income over the estimated useful lives of the related assets. The unamortized portion of deferred grant revenue recorded in other long-term liabilities at March 31, 2012 and September 30, 2011 was \$360 and \$375, respectively. The Company's grants are denominated primarily in Euros. The Company adjusts its deferred grant revenue balance in response to currency exchange rate fluctuations for as long as such grants are treated as obligations.



## 7. Income Taxes

For each interim reporting period, the Company makes an estimate of the effective tax rate it expects to be applicable for the full fiscal year. This estimated effective rate is used in providing for income taxes on a year-to-date basis. The Company's effective tax rate through the first six months of both fiscal 2012 and 2011 is 34%, and differs from the U.S. federal statutory rate due primarily to (i) the impact of U.S. state and local income taxes, (ii) a domestic production activities deduction, (iii) application of tax credits and (iv) the recognition of U.S. federal income taxes on undistributed earnings of non-U.S. subsidiaries. The income tax provision consists of the following:

|  | Three Months Ended<br>March 31, |          | Six Months Ended<br>March 31, |          |
|--|---------------------------------|----------|-------------------------------|----------|
|  | 2012                            | 2011     | 2012                          | 2011     |
| Current income tax provision:            |                                 |          |                               |          |
| U.S. federal                             | \$ 673                          | \$ 802   | \$ 1,100                      | \$ 1,340 |
| U.S. state and local                     | 125                             | 122      | 199                           | 197      |
| Non-U.S.                                 | 122                             | 72       | 190                           | 114      |
| Total current tax provision              | 920                             | 996      | 1,489                         | 1,651    |
| Deferred income tax provision (benefit): |                                 |          |                               |          |
| U.S. federal                             | 52                              | 12       | 36                            | 9        |
| Non-U.S.                                 | 0                               | (1)      | (6)                           | (2)      |
| Total deferred tax provision             | 52                              | 11       | 30                            | 7        |
| Income tax provision                     | \$ 972                          | \$ 1,007 | \$ 1,519                      | \$ 1,658 |

The Company is subject to income taxes in the U.S. federal jurisdiction, and various state, local and non-U.S. jurisdictions. The Company is no longer subject to U.S. federal, state and local, or non-U.S. income tax examinations by tax authorities for fiscal years prior to 2006.

At March 31, 2012 and September 30, 2011, the Company recorded liabilities of \$77 and \$96, respectively, for uncertain tax positions and any related interest and penalties. The Company classifies any interest and penalties related to uncertain tax positions in income tax expense. A summary of activity related to the Company's uncertain tax positions is as follows:

|  |       |
|--|-------|
| Balance at September 30, 2011                      | \$ 96 |
| Lapse of statute of limitations                    | (21)  |
| Increase due to tax positions taken in prior years | 2     |
| Balance at March 31, 2012                          | \$ 77 |

## 8. Retirement Benefit Plans

The Company and certain of its subsidiaries sponsor defined benefit pension plans covering most of its employees. The components of net periodic benefit cost of the Company's defined benefit plans are as follows:

|               | Three Months Ended<br>March 31, |       | Six Months Ended<br>March 31, |        |
|---------------|---------------------------------|-------|-------------------------------|--------|
|               | 2012                            | 2011  | 2012                          | 2011   |
| Service cost  | \$ 71                           | \$ 70 | \$ 142                        | \$ 151 |
| Interest cost | 247                             | 261   | 494                           | 524    |



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|                                    |       |       |       |       |
|------------------------------------|-------|-------|-------|-------|
| Expected return on plan assets     | (351) | (369) | (702) | (716) |
| Amortization of prior service cost | 12    | 29    | 24    | 58    |
| Amortization of net loss           | 210   | 175   | 420   | 350   |

|                           |        |        |        |        |
|---------------------------|--------|--------|--------|--------|
| Net periodic benefit cost | \$ 189 | \$ 166 | \$ 378 | \$ 367 |
|---------------------------|--------|--------|--------|--------|

Through March 31, 2012, the Company has made contributions in the amount of \$420 to its defined benefit pension plans. The Company anticipates making \$618 of additional contributions to fund its defined benefit pension plans during the balance of fiscal 2012.

#### 9. Stock-Based Compensation

In previous periods, the Company has awarded stock options under its shareholder approved 1995 Stock Option Plan ( 1995 Plan ) and 1998 Long-term Incentive Plan ( 1998 Plan ). No further options may be awarded under either the 1995 Plan or the 1998 Plan. Option exercise price is not less than fair market value on date of grant and options are exercisable no later than ten years from date of grant. All options awarded under both plans are fully vested as of March 31, 2012.

Aggregate option activity is as follows:

|                    | Number<br>of<br>Share<br>Options | Weighted-<br>Average<br>Exercise<br>Price | Weighted-<br>Average<br>Remaining<br>Contractual<br>Term (Years) | Aggregate<br>Intrinsic<br>Value |
|--------------------|----------------------------------|---|--|---------------------------------|
| September 30, 2011 | 43,000                           | \$ 3.86                                   |  |                                 |
| Options exercised  | (23,000)                         | \$ 3.86                                   |  |                                 |
| March 31, 2012     | 20,000                           | \$ 3.86                                   | 3.2  | \$ 300                          |

Vested and exercisable at March 31, 2012 20,000 \$ 3.86 3.2 \$ 300

As of March 31, 2012, there was no unrecognized compensation cost related to the stock options granted under either the 1995 or 1998 Plans.

The Company has awarded performance and restricted shares under its shareholder approved 2007 Long-Term Incentive Plan ( 2007 Plan ). The aggregate number of shares that may be awarded under the 2007 Plan is 600,000 less any shares previously awarded and subject to an adjustment for the forfeiture of any unissued shares. In addition, shares that may be awarded are subject to individual recipient award limitations. The shares awarded under the 2007 Plan may be made in multiple forms including stock options, stock appreciation rights, restricted or unrestricted stock, and performance related shares. Any such awards are exercisable no later than ten years from date of grant.

The performance shares that have been awarded under the 2007 Plan generally provide for the issuance of the Company's common shares upon the Company achieving certain defined financial performance objectives during a period up to three years following the making of such award. The ultimate number of common shares of the Company that may be earned pursuant to an award ranges from a minimum of no shares to a maximum of 150% of the initial target number of performance shares awarded, depending on the level of the Company's achievement of its financial performance objectives.

With respect to such performance shares, compensation expense is being accrued at (i) 100% of the target levels for recipients of the performance shares awarded during fiscal 2012, (ii) 100% of the target levels for recipients of the performance shares awarded during fiscal 2011 and (iii) approximately 130% of the target levels for recipients of the performance shares awarded during fiscal 2010. During each future reporting period, such expense may be subject to adjustment based upon the Company's subsequent estimate of the number of common shares that it expects to issue upon the completion of the performance period. The performance shares were valued at the closing market price of the Company's common shares on the date of grant, and such value was recorded as unearned compensation. The vesting of such shares is determined at the end of the performance period.

During fiscal 2012, the Company awarded restricted shares to certain of its directors. The restricted shares were valued at the closing market price of the Company's common shares on the date of grant, and such value was recorded as unearned compensation. The unearned compensation is being amortized ratably over the restricted stock vesting period of one (1) to three (3) years.

If all outstanding share awards are ultimately earned and issued at the target number of shares, then at March 31, 2012 there are approximately 396,200 shares that remain available for award. If any of the outstanding share awards are ultimately earned and issued at greater than the target number of shares, up to a maximum of 150% of such target, then a fewer number of shares would be available for award.



Compensation expense related to all performance and restricted shares awarded under the 2007 Plan was \$567 and \$177 during the first six months of fiscal 2012 and 2011, respectively. As of March 31, 2012, there was \$1,983 of total unrecognized compensation cost related to the performance and restricted shares awarded under the 2007 Plan. The Company expects to recognize this cost over the next 2.5 years.

The following is a summary of activity related to the target number of shares awarded and the actual number of shares earned under the 2007 Plan:

|   | Number of<br>Shares | Weighted<br>Average Fair<br>Value<br>at Date<br>of Grant |
|---|---------------------|--|
| Outstanding at September 30, 2011             | 135,480             | \$ 13.25   |
| Restricted shares awarded (2012 award)        | 26,560              | 22.00  |
| Restricted shares earned (2011 award)         | (10,680)            | 16.30  |
| Performance shares awarded (2012 award)       | 58,925              | 19.56  |
| Performance shares forfeited (various awards) | (13,350)            | 16.65  |
| Performance shares earned (2009 award)        | (8,938)             | 5.99   |
| Performance shares not earned (2009 award)    | (29,062)            | 5.99   |
| Outstanding at March 31, 2012                 | 158,935             | \$ 18.30   |

Company issued common shares from treasury during the first six months of fiscal 2012 to satisfy obligations under its various equity compensation plans.

#### 10. Business Segments

The Company identifies reportable segments based upon distinct products manufactured and services performed. The Forged Components Group ( Forge Group ) consists of the production, heat-treatment, surface-treatment, non-destructive testing and some machining of both conventional and precision forged components in various steel, titanium and aluminum alloys utilizing a variety of processes for application principally in the aerospace and power generation industries. The Turbine Component Services and Repair Group ( Repair Group ) consists primarily of the repair and remanufacture of small aerospace and industrial turbine engine components, and is also involved in providing precision component machining and industrial coating of turbine engine components. The Applied Surface Concepts Group ( ASC Group ) is a provider of specialized selective plating processes and services used to apply metal coatings to a selective area of a component. The Company's reportable segments are separately managed.

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The following table summarizes certain information regarding segments of the Company:

|  | Three Months Ended<br>March 31, |                       | Six Months Ended<br>March 31, |           |
|--|---------------------------------|-----------------------|-------------------------------|-----------|
|  | 2012                            | 2011                  | 2012                          | 2011      |
| Net sales:   |                                 |                       |                               |           |
| Forged Components Group                            | \$ 28,162                       | \$ 20,620             | \$ 50,850                     | \$ 36,311 |
| Turbine Component Services and Repair Group        | 1,981                           | 2,570                 | 4,019                         | 4,970     |
| Applied Surface Concepts Group                     | 3,936                           | 3,614                 | 7,720                         | 6,919     |
| Consolidated net sales                             | \$ 34,079                       | \$ 26,804             | \$ 62,589                     | \$ 48,200 |
| Operating income (loss):                           |                                 |                       |                               |           |
| Forged Components Group                            | \$ 3,607                        | \$ 3,161              | \$ 5,794                      | \$ 5,233  |
| Turbine Component Services and Repair Group        | (328)                           | 124                   | (461)                         | 185       |
| Applied Surface Concepts Group                     | 358                             | 348                   | 708                           | 567       |
| Corporate unallocated expenses                     | (925)                           | (710)                 | (1,648)                       | (1,320)   |
| Consolidated operating income                      | 2,712                           | 2,923                 | 4,393                         | 4,665     |
| Interest expense, net                              | 131                             | 33                    | 218                           | 31        |
| Foreign currency exchange (gain) loss, net         | 3                               | 5                     | (19)                          | 9         |
| Other income, net                                  | (118)                           | (117)                 | (235)                         | (234)     |
| Consolidated income before income tax provision    | \$ 2,696                        | \$ 3,002              | \$ 4,429                      | \$ 4,859  |
| Depreciation and amortization expense:             |                                 |                       |                               |           |
| Forged Components Group                            | \$ 1,363                        | \$ 1,160              | \$ 2,792                      | \$ 1,545  |
| Turbine Component Services and Repair Group        | 87                              | 75                    | 164                           | 149       |
| Applied Surface Concepts Group                     | 71                              | 88                    | 151                           | 172       |
| Corporate unallocated expenses                     | 74                              | 62                    | 148                           | 139       |
| Consolidated depreciation and amortization expense | \$ 1,595                        | \$ 1,385              | \$ 3,255                      | \$ 2,005  |
| LIFO expense for the Forged Components Group       | \$ 269                          | \$ 183                | \$ 428                        | \$ 225    |
|  | March 31,<br>2012               | September<br>30, 2011 |                               |           |
| Identifiable assets                                |                                 |                       |                               |           |
| Forged Components Group                            | \$ 85,316                       | \$ 58,361             |                               |           |
| Turbine Component Services and Repair Group        | 3,746                           | 3,758                 |                               |           |
| Applied Surface Concepts Group                     | 6,544                           | 6,217                 |                               |           |
| Corporate  | 11,789                          | 11,675                |                               |           |
| Consolidated total assets                          | \$ 107,395                      | \$ 80,011             |                               |           |

## 11. Business Acquisition

On October 28, 2011, through its wholly-owned subsidiary, Forge Acquisition, LLC – now known as Quality Aluminum Forge, LLC ( QAF ), the Company completed the purchase of the forging business and substantially all related operating assets from GEL Industries, Inc. (DBA Quality Aluminum Forge). The forging business is operated in QAF's Orange and Long Beach, California facilities, all of which are leased. The purchase price for the forging business and related operating assets was approximately \$24.8 million payable in cash, subject to certain adjustments related principally to the delivered working capital level and/or indemnification holdback provisions under the purchase agreement. In addition, the Company has assumed certain current operating liabilities of the forging business.

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The QAF purchase transaction is accounted for under the purchase method of accounting. The Company has not yet completed the purchase accounting related to the QAF acquisition. The final purchase price allocation will be allocated to the assets acquired and liabilities assumed based upon their fair values when appraisals, other studies and additional information become available.

The preliminary allocation of the purchase price and the estimated goodwill and intangible assets, all of which belong to the Forge Group, are as follows:

|  | October 28,<br>2011 (As<br>Initially<br>Reported) | Measurement<br>Period<br>Adjustments | As Adjusted      |
|--|---|--------------------------------------|------------------|
| <b>Assets acquired:</b>                  |   |                                      |                  |
| Accounts receivable                      | \$ 3,801  | \$ (98)                              | \$ 3,703         |
| Inventory                                | 3,823   | 161                                  | 3,984            |
| Property and equipment                   | 4,965   | 0                                    | 4,965            |
| Intangible assets                        | 9,100   | (300)                                | 8,800            |
| Goodwill                                 | 3,337   | 196                                  | 3,533            |
| Other assets                             | 200   | (47)                                 | 153              |
|  | 25,226  | (88)                                 | 25,138           |
| <b>Liabilities assumed:</b>              |   |                                      |                  |
| Accounts payable and accrued liabilities | 417   | 0                                    | 417              |
| <b>Total purchase price</b>              | <b>\$ 24,809</b>                                  | <b>\$ (88)</b>                       | <b>\$ 24,721</b> |

On December 10, 2010, through its wholly-owned subsidiary, TWF Acquisition, LLC now known as T&W Forge, LLC ( TWF ), the Company completed the purchase of the forging business and substantially all related operating assets from T&W Forge, Inc. ( T&W Forge ). TWF operates in T&W Forge's Alliance, Ohio facility under a long-term lease arrangement, with an option to purchase the facility at a nominal price. The TWF purchase transaction is accounted for under the purchase method of accounting.

The results of operation of QAF and TWF from their respective dates of acquisition are included in the Company's unaudited consolidated condensed statements of operations and are reported in the Forge Group. The following unaudited pro forma information presents a summary of the results of operations for the Company including QAF and TWF as if the acquisitions had occurred on October 1, 2010 and 2009, respectively:

|                                | <b>Three Months</b>       |                         |                           |
|--------------------------------|---------------------------|-------------------------|---------------------------|
|                                | <b>Ended</b>              | <b>Six Months Ended</b> |                           |
|                                | <b>March 31,<br/>2011</b> | <b>2012</b>             | <b>March 31,<br/>2011</b> |
| Net sales                      | \$ 31,599                 | \$ 64,102               | \$ 60,305                 |
| Net income                     | 2,500                     | 3,644                   | 3,990                     |
| Net income per share (basic)   | 0.47                      | 0.69                    | 0.76                      |
| Net income per share (diluted) | 0.47                      | 0.68                    | 0.75                      |

## Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Management's Discussion and Analysis of Financial Condition and Results of Operations may contain various forward-looking statements and includes assumptions concerning the Company's operations, future results and prospects. These forward-looking statements are based on current expectations and are subject to risk and uncertainties. In connection with the safe harbor provisions of the Private Securities Litigation Reform Act of 1995, the Company provides this cautionary statement identifying important economic, political and technological factors, among others, the absence or effect of which could cause the actual results or events to differ materially from those set forth in or implied by the forward-looking statements and related assumptions. Such factors include the following: (1) the impact on business conditions in general, and on the demand for product in the aerospace and power generation industries in particular, of the global economic outlook, including the availability of capital and liquidity from banks and other providers of credit; (2) future business environment, including capital and consumer spending; (3) competitive factors, including the ability to replace business which may be lost; (4) successful development of turbine component repair processes and/or procurement of new repair process licenses from turbine engine manufacturers and/or the Federal Aviation Administration;

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(5) metals and commodities price increases and the Company's ability to recover such price increases; (6) successful development and market introduction of new products and



services (7) continued reliance on consumer acceptance of regional and business aircraft powered by more fuel efficient turboprop engines; (8) continued reliance on military spending, in general, and/or several major customers, in particular, for revenues; (9) the impact on future contributions to the Company's defined benefit pension plans due to changes in actuarial assumptions, government regulations and the market value of plan assets; (10) stable governments, business conditions, laws, regulations and taxes in economies where business is conducted and (11) the ability to successfully integrate businesses that may be acquired into the Company's operations.

The Company and its subsidiaries engage in the production and sale of a variety of metalworking processes, services and products produced primarily to the specific design requirements of its customers. The processes and services include both conventional and precision forging, heat-treating, coating, welding, precision component machining and selective plating. The products include conventional and precision forged components, machined forged components, other machined metal components, remanufactured component parts for turbine engines, and selective plating solutions and equipment. The Company's operations are conducted in three business segments: (1) Forged Components Group, (2) Turbine Component Services and Repair Group, and (3) Applied Surface Concepts Group.

The Company endeavors to plan and evaluate its businesses' operations while taking into consideration certain factors including the following (i) the projected build rate for commercial, business and military aircraft as well as the engines that power such aircraft, (ii) the projected build rate for industrial gas turbine engines, (iii) the projected maintenance, repair and overhaul schedules for commercial, business and military aircraft as well as the engines that power such aircraft, and (iv) anticipated exploration and production activities relative to oil and gas products, etc.

The primary factor that impacts the operating income of all three of the Company's business segments, in a similar manner, is net sales and related production volumes. This is due to the fact that each of the Company's segments operates within a cost structure that includes a significant fixed component. Therefore, higher net sales volumes are expected to result in greater operating income because such higher volumes allow the business segments' operations to better leverage the fixed component of their respective cost structures. Conversely, the opposite effect is expected to occur at lower net sales and related production volumes.

## **A. Results of Operations**

### ***Non-GAAP Financial Measures***

Presented below is certain financial information based on our EBITDA and Adjusted EBITDA. References to EBITDA mean earnings before interest, taxes, depreciation and amortization, and references to Adjusted EBITDA mean EBITDA plus, as applicable for each relevant period, certain adjustments as set forth in the reconciliations of net income to EBITDA and Adjusted EBITDA.

Neither EBITDA nor Adjusted EBITDA is a measurement of financial performance under accounting principles generally accepted in the United States of America (GAAP). The Company presents EBITDA and Adjusted EBITDA because (i) it believes they are useful indicators for evaluating operating performance and liquidity, including the Company's ability to incur and service debt and (ii) it uses EBITDA to evaluate prospective acquisitions. Although the Company uses EBITDA and Adjusted EBITDA for the reasons noted, the use of these non-GAAP financial measures as analytical tools has limitations and, therefore, reviewers of the Company's financial information should not consider them in isolation, or as a substitute for analysis of its results of operations as reported in accordance with GAAP. Some of these limitations are:

Neither EBITDA nor Adjusted EBITDA reflects the interest expense, or the cash requirements necessary to service interest payments, on indebtedness;

Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and neither EBITDA nor Adjusted EBITDA reflects any cash requirements for such replacements;

The omission of the substantial amortization expense associated with the Company's intangible assets further limits the usefulness of EBITDA and Adjusted EBITDA;

Neither EBITDA nor Adjusted EBITDA includes the payment of taxes, which is a necessary element of operations; and

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Adjusted EBITDA excludes the cash expense the Company has incurred to acquire businesses. Because of these limitations, EBITDA and Adjusted EBITDA should not be considered as measures of discretionary cash available to the Company to invest in the growth of its businesses. Management compensates for these limitations by not viewing EBITDA or Adjusted EBITDA in isolation and specifically by using other GAAP measures, such as net income, net sales and operating profit, to measure operating performance. Neither EBITDA nor Adjusted EBITDA is a measurement of financial performance under GAAP, and neither should be considered as an alternative to net income or cash flow from operations determined in accordance with GAAP. The Company's calculation of EBITDA and Adjusted EBITDA may not be comparable to the calculation of similarly titled measures reported by other companies.

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The following table sets forth a reconciliation of net income to EBITDA and Adjusted EBITDA:

(Dollars in thousands)

|   | Three Months Ended<br>March 31, |          | Six Months Ended<br>March 31, |          |
|---|---------------------------------|----------|-------------------------------|----------|
|   | 2012                            | 2011     | 2012                          | 2011     |
| Net income                                    | \$ 1,724                        | \$ 1,995 | 2,910                         | \$ 3,201 |
| Adjustments:                                  |                                 |          |                               |          |
| Depreciation and amortization expense         | 1,595                           | 1,385    | 3,255                         | 2,005    |
| Interest expense, net                         | 131                             | 33       | 218                           | 31       |
| Income tax provision                          | 972                             | 1,007    | 1,519                         | 1,658    |
| EBITDA  | 4,422                           | 4,420    | 7,902                         | 6,895    |
| Adjustments:                                  |                                 |          |                               |          |
| Inventory purchase accounting adjustments (1) | 216                             | 110      | 441                           | 202      |
| Acquisition transaction-related expenses (2)  | 105                             | 25       | 229                           | 173      |
| Equity compensation expense (3)               | 329                             | 123      | 567                           | 177      |
| LIFO provision (4)                            | 269                             | 183      | 428                           | 225      |
| Adjusted EBITDA                               | \$ 5,341                        | \$ 4,861 | 9,567                         | \$ 7,672 |

- (1) Represents accounting adjustments to inventory associated with acquisitions of businesses that were charged to cost of sales when the inventory was sold.
- (2) Represents transaction-related costs comprising legal, financial and tax due diligence expenses; and valuation services costs that are required to be expensed as incurred.
- (3) Represents the equity based compensation expense recognized by the Company under its 2007 Long-term Incentive Plan.
- (4) Represents the increase in the reserve for inventories for which cost is determined using the last in, first out ( LIFO ) method.

## Six Months Ended March 31, 2012 compared with Six Months Ended March 31, 2011

Net sales in the first six months of fiscal 2012 increased 29.9% to \$62.6 million, compared with \$48.2 million in the comparable period in fiscal 2011. Net income in the first six months of fiscal 2012 was \$2.9 million, compared with \$3.2 million in the comparable period in fiscal 2011. EBITDA in the first six months of fiscal 2012 was \$7.9 million, or 12.6% of net sales, compared with \$6.9 million, or 14.3% of net sales, in the comparable period in fiscal 2011. Adjusted EBITDA in the first six months of fiscal 2012 was \$9.6 million, or 15.3% of net sales, compared with \$7.7 million, or 15.9% of net sales, in the comparable period in fiscal 2011. See **Non-GAAP Financial Measures** above for certain information regarding EBITDA and Adjusted EBITDA, including reconciliations of EBITDA and Adjusted EBITDA to net income. As discussed more fully in Note 11 to the unaudited consolidated condensed financial statements, the Company completed the purchase of the forging business and substantially all related operating assets of Quality Aluminum Forge ( QAF ) and T&W Forge ( TWF ) on October 28, 2011 and December 10, 2010, respectively.

## Forged Components Group ( Forge Group )

The Forge Group consists of the production, heat-treatment, surface-treatment, non-destructive testing, and machining of both conventional and precision forged components in various steel, titanium and aluminum alloys utilizing a variety of processes for application principally in the aerospace and power generation industries. The Forge Group's results for the first six months of fiscal 2012 include the results of QAF from the date of its acquisition. The Forge Group's results for the first six months of fiscal 2011 include the results of TWF from the date of its acquisition.

Net sales in the first six months of fiscal 2012 increased 40.0% to \$50.9 million, compared with \$36.3 million in the comparable period of fiscal 2011. The Forge Group produces forged components for (i) turbine engines that power commercial, business and regional aircraft as well as various military aircraft and armored military vehicles; (ii) airframe applications for a variety of aircraft; (iii) industrial gas turbine engines for power generation units; and (iv) other commercial applications. Net sales comparative information for the first six months of fiscal 2012 and 2011, respectively, is as follows:

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(Dollars in millions)

| (Dollars in millions)                      | Six Months Ended |         |            |
|--|------------------|---------|------------|
|  | March 31,        |         | Increase   |
| Net Sales                                  | 2012             | 2011    | (Decrease) |
| Aerospace components for:                  |                  |         |            |
| Fixed wing aircraft                        | \$ 24.7          | \$ 16.3 | \$ 8.4     |
| Rotorcraft                                 | 14.3             | 12.4    | 1.9        |
| Components for power generation units      | 9.4              | 5.5     | 3.9        |
| Commercial product sales and other revenue | 2.5              | 2.1     | 0.4        |
|  |                  |         |            |
| Total                                      | \$ 50.9          | \$ 36.3 | \$ 14.6    |

The increase in net sales of forged components for fixed wing aircraft during the first six months of fiscal 2012, compared with the comparable period in fiscal 2011, is principally due to the impact of the acquisition of QAF during the first quarter of fiscal 2012. The increase in net sales of engine components for power generation units is due to the impact of the acquisition of TWF during the first six months of fiscal 2011. Net sales of aerospace components for rotorcraft increased in the first six months of fiscal 2012, compared with the same period in fiscal 2011, principally due to the negative impact on sales volumes during the first six months of fiscal 2011 resulting from a significant customer that was in the process of adjusting its inventory levels of certain components.

The Forge Group's aerospace components have both military and commercial applications. Net sales of such components that solely have military applications were \$16.5 million in the first six months of fiscal 2012, compared with \$15.4 million in the comparable period in fiscal 2011. Demand for additional military helicopters and related replacement components are the primary driver of the sales demand for components for military applications.

The Forge Group's cost of goods sold increased \$12.3 million to \$40.5 million, or 79.6% of net sales, during the first six months of fiscal 2012, compared with \$28.2 million, or 77.7% of net sales, in the comparable period in fiscal 2011. Cost of goods sold as a percentage of net sales reflected an increase in the first six months of fiscal 2012, compared to the comparable period in fiscal 2011, due to the net impact of the changes in the following components of manufacturing related expenditures:

The material component of manufacturing costs was approximately 36.3% of net sales during the first six months of fiscal 2012, compared with 37.5% of net sales in the comparable period in fiscal 2011, due primarily to the mix of product - a higher concentration of products, with lower material content, were sold during the first six months of fiscal 2012, compared with the comparable period in fiscal 2011.

All other manufacturing costs were approximately 43.3% of net sales during the first six months of fiscal 2012, compared with 40.2% of net sales in the comparable period in fiscal 2011. Labor costs were higher principally due to the mix of product - a higher concentration of products with higher labor content were sold during the first six months of fiscal 2012, compared with the comparable period in fiscal 2011. The Forge Group also experienced a reduction in its labor efficiency during the first six months of fiscal 2012, compared with the comparable period in fiscal 2011. The following changes in the components of the Forge Group's other manufacturing overhead expenditures during the first six months of fiscal 2012, a portion of which was due to the acquisitions of QAF and TWF, compared with the same period in fiscal 2011, also impacted cost of goods sold:

| (Dollars in millions)                      | Six Months Ended March 31,<br>2012 |                      | 2011         |                      | \$<br>Amount<br>Increase<br>(Decrease) |
|--|------------------------------------|----------------------|--------------|----------------------|--|
|  | \$<br>Amount                       | % of<br>Net<br>Sales | \$<br>Amount | % of<br>Net<br>Sales |  |
| <b>Manufacturing overhead expenditures</b> |                                    |                      |              |                      |  |
| Utilities                                  | 2.4                                | 4.8                  | 2.3          | 6.2                  | 0.1                                    |
| Repairs, maintenance and supplies          | 2.2                                | 4.4                  | 1.6          | 4.4                  | 0.6                                    |
| Depreciation                               | 1.3                                | 2.6                  | 0.8          | 2.2                  | 0.5                                    |
| Tooling                                    | 1.5                                | 3.0                  | 1.1          | 3.1                  | 0.4                                    |

Manufacturing costs in the first six months of fiscal 2012, compared with the same period in fiscal 2011, increased due to (i) an increase in manufacturing expenditures required to support the \$14.6 million of additional product sales volume and (ii) an increase in depreciation expense, both of which were primarily attributable to the acquisitions of TWF and QAF. These higher costs were partially offset by a decrease in the cost of natural gas in the first six months of fiscal 2012, compared with the same period in fiscal 2011.

The Forge Group's selling, general and administrative expenses increased \$1.7 million to \$4.6 million, or 9.0% of net sales, in the first six months of fiscal 2012, compared with \$2.9 million, or 7.9% of net sales, in the comparable period in fiscal 2011. The increase in selling, general and administrative expenses is principally due to (i) a \$0.7 million increase in amortization of intangible assets related to the acquisitions of TWF and QAF and (ii) the impact of the acquisitions of TWF and QAF on relative spending levels. The Forge Group's selling, general and administrative expenses in the first six months of fiscal 2012, before the impact of the \$0.7 million increase in amortization of intangible assets, was \$3.1 million, or 6.1% of net sales, compared with \$2.1 million, or 5.8% of net sales, in the comparable period in fiscal 2011.

The Forge Group's operating income increased \$0.6 million to \$5.8 million in the first six months of fiscal 2012, compared with \$5.2 million in the comparable period in fiscal 2011. The following is a comparison of operating income on both a LIFO and FIFO basis:

| (Dollars in millions)                 |                               |        |                        |
|---------------------------------------|-------------------------------|--------|------------------------|
|                                       | Six Months Ended<br>March 31, |        | Increase<br>(Decrease) |
| Operating Income                      | 2012                          | 2011   |                        |
| Operating income                      | \$ 5.8                        | \$ 5.2 | \$ 0.6                 |
| LIFO expense                          | 0.4                           | 0.2    | 0.2                    |
| Operating income without LIFO expense | \$ 6.2                        | \$ 5.4 | \$ 0.8                 |

The Forge Group's operating income in the first six months of fiscal 2012 was favorably impacted by the increase in gross profit that resulted from the \$13.3 million of additional product sales volumes that resulted from the acquisitions of TWF and QAF plus the net impact of the other cost of goods sold and selling, general and administrative expense factors noted above.

The Forge Group's backlog as of March 31, 2012 was \$103.8 million, of which \$84.1 million was scheduled for delivery over the next twelve months, compared with \$92.2 million as of September 30, 2011, of which \$74.3 million was scheduled for delivery over the next twelve months. \$15.6 million of the Forge Group's backlog as of March 31, 2012 is attributable to the impact of the recently acquired QAF business. All orders are subject to modification or cancellation by the customer with limited charges. Delivery lead times for certain raw materials (e.g. aerospace grades of steel) have continued to lengthen due to increased demand and the Forge Group believes that such lead time increase may ultimately result in a fundamental shift in the ordering pattern of its customers. The Forge Group believes that a likely result of such a shift is that customers may place orders further in advance than they previously did, which may result in an increase, relative to comparable prior year periods, in the Forge Group's backlog. Accordingly, such backlog increase, to the extent it may occur, is not necessarily indicative of actual sales expected for any succeeding period.

#### *Turbine Component Services and Repair Group ( Repair Group )*

Net sales in the first six months of fiscal 2012, which consists principally of component repair services (including precision component machining and industrial coatings) for small aerospace turbine engines, decreased 19.1% to \$4.0 million, compared with \$5.0 million in the comparable fiscal 2011 period.

The Repair Group's cost of goods sold decreased \$0.3 million to \$3.8 million, or 94.1% of net sales, during the first six months of fiscal 2012, compared with \$4.1 million, or 81.7% of net sales, in the comparable period in fiscal 2011. Cost of goods sold as a percentage of net sales reflected an increase in the first six months of fiscal 2012, compared to the comparable period in fiscal 2011, due principally to the Repair Group maintaining a minimum/base cost structure that has a large fixed component that is determined necessary to sustain an operation with relevant capabilities.

During the first six months of fiscal 2012, the Repair Group's selling, general and administrative expenses were \$0.7 million, or 17.3% of net sales, compared with \$0.7 million, or 14.6% of net sales, in the comparable fiscal 2011 period.

The Repair Group's operating income decreased \$0.7 million to a loss of \$0.5 million in the first six months of fiscal 2012, compared with income of \$0.2 million in the comparable period in fiscal 2011. Operating income in the first six months of fiscal 2012 was negatively impacted by the significantly lower product sales volumes in relation to the large fixed component of the Repair Group's operating cost structure.

The Repair Group's backlog was \$1.3 million as of March 31, 2012, of which \$0.1 million was scheduled for delivery over the next twelve months, compared with \$1.2 million at September 30, 2011, of which \$0.4 million was scheduled for delivery over the next twelve months.



**Applied Surface Concepts Group ( ASC Group )**

Net sales in the first six months of fiscal 2012 increased 11.6% to \$7.7 million, compared with \$6.9 million in the comparable fiscal 2011 period. For purposes of the following discussion, (i) product net sales consist of selective plating equipment and solutions and (ii) contract service net sales consist of customized selective plating services. Net sales comparative information for the first six months of fiscal 2012 and 2011, respectively, is as follows:

| (Dollars in millions) |                  |        |            |
|-----------------------|------------------|--------|------------|
|                       | Six Months Ended |        |            |
|                       | March 31,        | 2011   | Increase   |
| Net Sales             | 2012             |        | (Decrease) |
| Product               | \$ 3.9           | \$ 3.6 | \$ 0.3     |
| Contract service      | 3.7              | 3.2    | 0.5        |
| Other                 | 0.1              | 0.1    | 0.0        |
| Total                 | \$ 7.7           | \$ 6.9 | \$ 0.8     |

The increase in product net sales in the first six months of fiscal 2012, compared with the same period in fiscal 2011, is attributed to an increase in net sales volumes of selective plating equipment as well as a general price increase implemented at the beginning of the second quarter of fiscal 2012. The increase in contract service net sales in the first six months of fiscal 2012, compared with the same period in fiscal 2011, is attributed to an increase in the volume of contract services provided to customers. A portion of the ASC Group's business is conducted in Europe and is denominated in local European currencies. Fluctuations in currency exchange rates during the first six months of fiscal 2012, compared with the same period in fiscal 2011, had a nominal impact on net sales.

The ASC Group's cost of goods sold increased \$0.3 million to \$4.4 million, or 56.5% of net sales, during the first six months of fiscal 2012, compared with \$4.0 million, or 58.1% of net sales, in the comparable period in fiscal 2011. Cost of goods sold as a percentage of net sales reflected a decrease in the first six months of fiscal 2012, compared to the first six months of fiscal 2011, due principally to the following:

The material component of cost of goods sold was approximately 20.3% of net sales during the first six months of fiscal 2012, compared with 18.5% of net sales in the comparable period in fiscal 2011, due principally to certain higher commodity prices and the mix of product - a higher concentration of products and contract services, with higher material content, were sold during the first six months of fiscal 2012, compared with the same period in fiscal 2011.

All other cost of goods sold were approximately 36.2% of net sales during the first six months of fiscal 2012, compared with 39.6% of net sales in the comparable period in fiscal 2011. The primary reason for the reduction of all other cost of goods sold as a percentage of net sales is the impact of higher sales volumes during the first six months of fiscal 2012, compared with the same period in fiscal 2011, which allowed the ASC Group to favorably leverage the fixed component of its operating cost structure. The ASC Group's selling, general and administrative expenses were \$2.6 million, or 34.3% of net sales, in the first six months of fiscal 2012, compared with \$2.3 million, or 33.7% of net sales in the comparable fiscal 2011 period. The \$0.3 million increase is due primarily to an increase in sales promotion efforts and the filling of an open sales position.

The ASC Group's operating income in the first six months of fiscal 2012 was \$0.7 million, compared with \$0.6 million in the same period in fiscal 2011. This improvement in operating income is due to the net impact of the reasons noted above.

The ASC Group's backlog as of March 31, 2012 was not material, which is consistent with the nature of its business.

**Corporate Unallocated Expenses**

Corporate unallocated expenses, consisting of corporate salaries and benefits, legal and professional and other expenses that are not related to and, therefore, not allocated to the business segments, were \$1.6 million in the first six months of fiscal 2012, compared with \$1.3 million in the same period in fiscal 2011. The \$0.3 million increase is due to a \$0.2 million increase in compensation and benefits expense principally related to the Company's long-term equity incentive plan and a \$0.1 million increase in legal and professional expense.



***Other/General***

Interest expense was \$0.2 million in the first six months of fiscal 2012, compared to \$0.1 million in the same period in fiscal 2011. In connection with the October 2011 acquisition of the QAF business, the Company borrowed \$12.4 million from its

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revolving credit agreement and \$10.0 million on a term note, and issued a \$2.4 million promissory note to the seller of the QAF business. The following table sets forth the weighted average interest rates and weighted average outstanding balances under the Company's debt agreement in the first six months of fiscal 2012 and 2011:

|                            | Weighted Average<br>Interest Rate |      | Weighted Average<br>Outstanding Balance |                |
|----------------------------|-----------------------------------|------|---|----------------|
|                            | Six Months Ended<br>March 31,     |      | Six Months Ended<br>March 31,           |                |
|                            | 2012                              | 2011 | 2012                                    | 2011           |
| Revolving credit agreement | 1.3%                              | 1.4% | \$ 11.6 million                         | \$ 5.8 million |
| Term note                  | 2.9%                              | N/A  | \$ 9.5 million                          | N/A            |
| Promissory note            | 2.0%                              | N/A  | \$ 2.3 million                          | N/A            |

Other income, net consists principally of \$0.2 million of rental income earned from the lease of the Cork, Ireland facility.

### Three Months Ended March 31, 2012 compared with Three Months Ended March 31, 2011

Net sales in the second quarter of fiscal 2012 increased 27.1% to \$34.1 million, compared with \$26.8 million in the comparable period in fiscal 2011. Net income in the second quarter of fiscal 2012 was \$1.7 million, compared with \$2.0 million in the comparable period in fiscal 2011. EBITDA in the second quarter of fiscal 2012 was \$4.4 million, or 13.0% of net sales, compared with \$4.4 million, or 16.5% of net sales, in the comparable period in fiscal 2011. Adjusted EBITDA in the second quarter of fiscal 2012 was \$5.3 million, or 15.7% of net sales, compared with \$4.9 million, or 18.1% of net sales, in the comparable period in fiscal 2011. See **Non-GAAP Financial Measures** above for certain information regarding EBITDA and Adjusted EBITDA, including reconciliations of EBITDA and Adjusted EBITDA to net income. As discussed more fully in Note 11 to the unaudited consolidated condensed financial statements, the Company completed the purchase of the forging business and substantially all related operating assets of QAF and TWF on October 28, 2011 and December 10, 2010, respectively.

### Forged Components Group ( Forge Group )

The Forge Group consists of the production, heat-treatment, surface-treatment, non-destructive testing, and machining of both conventional and precision forged components in various steel, titanium and aluminum alloys utilizing a variety of processes for application principally in the aerospace and power generation industries. The Forge Group's results for the second quarter of fiscal 2012 include the results of QAF and TWF. The Forge Group's results for the second quarter of fiscal 2011 include the results of TWF.

Net sales in the second quarter of fiscal 2012 increased 36.6% to \$28.2 million, compared with \$20.6 million in the comparable period of fiscal 2011. The Forge Group produces forged components for (i) turbine engines that power commercial, business and regional aircraft as well as various military aircraft and armored military vehicles; (ii) airframe applications for a variety of aircraft; (iii) industrial gas turbine engines for power generation units; and (iv) other commercial applications. Net sales comparative information for the second quarter of fiscal 2012 and 2011, respectively, is as follows:

|  |                    |                |                        |
|--|--------------------|----------------|------------------------|
| (Dollars in millions)                      | Three Months Ended |                | Increase<br>(Decrease) |
|  | 2012               | 2011           |                        |
| <b>Net Sales</b>                           |                    |                |                        |
| Aerospace components for:                  |                    |                |                        |
| Fixed wing aircraft                        | \$ 13.9            | \$ 9.1         | \$ 4.8                 |
| Rotorcraft                                 | 7.7                | 5.2            | 2.5                    |
| Components for power generation units      | 4.7                | 4.9            | (0.2)                  |
| Commercial product sales and other revenue | 1.9                | 1.4            | 0.5                    |
| <b>Total</b>                               | <b>\$ 28.2</b>     | <b>\$ 20.6</b> | <b>\$ 7.6</b>          |

The increase in net sales of forged components for fixed wing aircraft during the second quarter of fiscal 2012, compared with the comparable period in fiscal 2011, is principally due to the impact of the acquisition of QAF during the first quarter of fiscal 2012. Net sales of aerospace components for rotorcraft increased in the second quarter of fiscal 2012, compared with the same period in fiscal 2011, principally due to the

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negative impact on sales volumes during the second quarter of fiscal 2011 resulting from a significant customer that was in the process of adjusting its inventory levels of certain components.

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The Forge Group's aerospace components have both military and commercial applications. Net sales of such components that solely have military applications were \$8.6 million in the second quarter of fiscal 2012, compared with \$7.8 million in the comparable period in fiscal 2011. Demand for additional military helicopters and related replacement components are the primary driver of the sales demand for components for military applications.

The Forge Group's cost of goods sold increased \$6.6 million to \$22.4 million, or 79.4% of net sales, during the second quarter of fiscal 2012, compared with \$15.8 million, or 76.2% of net sales, in the comparable period in fiscal 2011. Cost of goods sold as a percentage of net sales reflected an increase in 2012, compared to 2011, due to the net impact of the changes in the following components of manufacturing related expenditures:

The material component of manufacturing costs was approximately 35.9% of net sales during the second quarter of fiscal 2012, compared with 35.3% of net sales in the comparable period in fiscal 2011, due primarily to the mix of product - a higher concentration of products, with higher material content, were sold during the second quarter of fiscal 2012, compared with the comparable period in fiscal 2011.

All other manufacturing costs were approximately 43.5% of net sales during the second quarter of fiscal 2012, compared with 40.9% of net sales in the comparable period in fiscal 2011. Labor costs were higher principally due to the mix of product - a higher concentration of products with higher labor content were sold during the second quarter of fiscal 2012, compared with the comparable period in fiscal 2011. The Forge Group also experienced a reduction in its labor efficiency during the second quarter of fiscal 2012, compared with the same period in fiscal 2011. The following changes in the components of the Forge Group's other manufacturing overhead expenditures during the second quarter of fiscal 2012, a portion of which was due to the acquisition of QAF, compared with the same period in fiscal 2011, also impacted cost of goods sold:

(Dollars in millions)

| (Dollars in millions)               | Three Months Ended<br>March 31, |       |        |       |            |
|-------------------------------------|---------------------------------|-------|--------|-------|------------|
|                                     | 2012                            |       | 2011   |       | \$         |
|                                     |                                 | % of  |        | % of  | Amount     |
|                                     | \$                              | Net   | \$     | Net   | Increase   |
| Manufacturing overhead expenditures | Amount                          | Sales | Amount | Sales | (Decrease) |
| Utilities                           | 1.3                             | 4.8   | 1.3    | 6.4   | 0.0        |
| Repairs, maintenance and supplies   | 1.1                             | 4.0   | 0.8    | 4.1   | 0.3        |
| Depreciation                        | 0.7                             | 2.5   | 0.5    | 2.5   | 0.2        |
| Tooling                             | 0.8                             | 3.0   | 0.7    | 3.4   | 0.1        |

Manufacturing costs in the second quarter of fiscal 2012, compared with the same period in fiscal 2011, increased due to (i) an increase in manufacturing expenditures required to support the \$7.6 million of additional product sales volume and (ii) an increase in depreciation expense, both of which were primarily attributable to the acquisition of QAF. These higher costs were partially offset by a decrease in the cost of natural gas in the second quarter of fiscal 2012, compared with the same period in fiscal 2011.

The Forge Group's selling, general and administrative expenses increased \$0.5 million to \$2.2 million, or 7.8% of net sales, in the second quarter of fiscal 2012, compared with \$1.7 million, or 8.5% of net sales, in the comparable period in fiscal 2011. The increase in selling, general and administrative expenses is principally due to the impact of the acquisition of QAF. The Forge Group's selling, general and administrative expenses in the second quarter of fiscal 2012, before the impact of the \$0.7 million amortization of intangible assets in both periods, was \$1.5 million, or 5.4% of net sales, compared with \$1.1 million, or 5.1% of net sales, in the comparable period in fiscal 2011.

The Forge Group's operating income increased \$0.4 million to \$3.6 million in the second quarter of fiscal 2012, compared with \$3.2 million in the comparable period in fiscal 2011. The following is a comparison of operating income on both a LIFO and FIFO basis:

(Dollars in millions)

| Operating Income | Three Months Ended<br>March 31, |      | Increase<br>(Decrease) |
|------------------|---------------------------------|------|------------------------|
|                  | 2012                            | 2011 |                        |

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|                                       |               |        |        |
|---------------------------------------|---------------|--------|--------|
| Operating income                      | <b>\$ 3.6</b> | \$ 3.2 | \$ 0.4 |
| LIFO expense                          | <b>0.3</b>    | 0.2    | 0.1    |
| Operating income without LIFO expense | <b>\$ 3.9</b> | \$ 3.4 | \$ 0.5 |

The Forge Group's operating income in the second quarter of fiscal 2012 was favorably impacted by the increase in gross profit that resulted from the \$5.4 million of additional product sales volumes that resulted from the acquisitions of QAF plus the net impact of the other cost of goods sold and selling, general and administrative expense factors noted above.

#### ***Turbine Component Services and Repair Group ( Repair Group )***

Net sales in the second quarter of fiscal 2012, which consists principally of component repair services (including precision component machining and industrial coatings) for small aerospace turbine engines, decreased 22.9% to \$2.0 million, compared with \$2.6 million in the comparable fiscal 2011 period.

The Repair Group's cost of goods sold decreased \$0.1 million to \$2.0 million, or 100.0% of net sales, during the second quarter of fiscal 2012, compared with \$2.1 million, or 80.3% of net sales, in the comparable period in fiscal 2011. Cost of goods sold as a percentage of net sales reflected an increase in the second quarter of fiscal 2012, compared to the second quarter of fiscal 2011, due principally to the Repair Group maintaining a minimum/base cost structure that has a large fixed component that is determined necessary to sustain an operation with relevant capabilities.

During the second quarter of fiscal 2012, the Repair Group's selling, general and administrative expenses were \$0.3 million, or 16.6% of net sales, compared with \$0.4 million, or 14.8% of net sales, in the comparable fiscal 2011 period.

The Repair Group's operating income decreased \$0.4 million to a loss of \$0.3 million in the second quarter of fiscal 2012, compared with income of \$0.1 million in the comparable period in fiscal 2011. Operating income in the second quarter of fiscal 2012 was negatively impacted by the significantly lower product sales volumes in relation to the large fixed component of the Repair Group's operating cost structure.

#### ***Applied Surface Concepts Group ( ASC Group )***

Net sales in the second quarter of fiscal 2012 increased 8.9% to \$3.9 million, compared with \$3.6 million in the comparable fiscal 2011 period. For purposes of the following discussion, (i) product net sales consist of selective plating equipment and solutions and (ii) contract service net sales consist of customized selective plating services. Net sales comparative information for the second quarter of fiscal 2012 and 2011, respectively, is as follows:

| (Dollars in millions) |  | <b>Three Months Ended</b> |             | <b>Increase<br/>(Decrease)</b> |
|-----------------------|--|---------------------------|-------------|--------------------------------|
|                       |  | <b>March 31,<br/>2012</b> | <b>2011</b> |                                |
| <b>Net Sales</b>      |  |                           |             |                                |
| Product               |  | <b>\$ 2.0</b>             | \$ 1.8      | \$ 0.2                         |
| Contract service      |  | <b>1.9</b>                | 1.7         | 0.2                            |
| Other                 |  | <b>0.0</b>                | 0.1         | (0.1)                          |
| <b>Total</b>          |  | <b>\$ 3.9</b>             | \$ 3.6      | \$ 0.3                         |

The increase in product net sales in the second quarter of fiscal 2012, compared with the same period in fiscal 2011, is attributed to an increase in net sales volumes of selective plating products, as well as a general price increase implemented at the beginning of the second quarter of fiscal 2012. The increase in contract service net sales in the second quarter of fiscal 2012, compared with the same period in fiscal 2011, is attributed to an increase in the volume of contract services provided to customers. A portion of the ASC Group's business is conducted in Europe and is denominated in local European currencies. Fluctuations in currency exchange rates during the second quarter of fiscal 2012, compared with the same period in fiscal 2011, had a nominal impact on net sales.

The ASC Group's cost of goods sold increased \$0.2 million to \$2.3 million, or 57.4% of net sales, in the second quarter of fiscal year 2012, compared with \$2.1 million, or 56.8% of net sales, in the comparable period in fiscal 2011. Cost of goods

sold as a percentage of net sales reflected an increase in the second quarter of fiscal 2012, compared with the same period in fiscal 2011, due principally to the following:

The material component of cost of goods sold was approximately 20.6% of net sales in the second quarter of fiscal 2012, compared with 16.7% in the comparable period in fiscal 2011, due principally to certain higher commodity material costs and mix of product a higher concentration of products and contract services with higher material content, were sold during the second quarter of fiscal 2012, compared with the same period in fiscal 2011.

All other cost of goods sold were approximately 36.8% of net sales during the second quarter of fiscal 2012, compared with 40.1% of net sales in the comparable period of fiscal 2011. The primary reason for the reduction of all other cost of goods sold as a percentage of net sales is the impact of higher sales volumes during the second quarter of fiscal 2012, compared with the same period in fiscal 2011, which allowed the ASC Group to favorably leverage the fixed component of its operating cost structure.

The ASC Group's selling, general and administrative expenses were \$1.3 million, or 33.5% of net sales, in the second quarter of fiscal 2012, compared with \$1.2 million, or 33.5% of net sales in the comparable fiscal 2011 period. The \$0.1 million increase is due primarily to an increase in sales promotion efforts.

The ASC Group's operating income in the second quarters of both fiscal 2012 and 2011 was \$0.3 million.

#### *Corporate Unallocated Expenses*

Corporate unallocated expenses, consisting of corporate salaries and benefits, legal and professional and other expenses that are not related to and, therefore, not allocated to the business segments, were \$0.9 million in the second quarter of fiscal 2012, compared with \$0.7 million in the same period in fiscal 2011. The \$0.2 million increase is due to a \$0.1 million increase in compensation and benefits expense principally related to the Company's long-term equity incentive plan and \$0.1 million increase in legal and professional expense.

#### *Other/General*

Interest expense was \$0.1 million in the second quarter of fiscal 2012, compared to a nominal amount in the same period in fiscal 2011. In connection with the October 2011 acquisition of the QAF business, the Company borrowed \$12.4 million from its revolving credit agreement and \$10.0 million on a term note, and issued a \$2.4 million promissory note to the seller of the QAF business. The following table sets forth the weighted average interest rates and weighted average outstanding balances under the Company's debt agreement in the second quarter of both fiscal 2012 and 2011:

|                            | Weighted Average<br>Interest Rate<br>Three Months Ended<br>March 31, |      | Weighted Average<br>Outstanding Balance<br>Three Months Ended<br>March 31, |                |
|----------------------------|--|------|--|----------------|
|                            | 2012   | 2011 | 2012   | 2011           |
| Revolving credit agreement | 1.3%   | 1.4% | \$ 13.1 million  | \$ 8.8 million |
| Term note                  | 2.9%   | N/A  | \$ 9.3 million   | N/A            |
| Promissory note            | 2.0%   | N/A  | \$ 2.3 million   | N/A            |

Other income, net consists principally of \$0.1 million of rental income earned from the lease of the Cork, Ireland facility.

#### **B. Liquidity and Capital Resources**

Cash and cash equivalents increased \$0.6 million to \$7.0 million at March 31, 2012 from \$6.4 million at September 30, 2011. At March 31, 2012, essentially all of the \$7.0 million of the Company's cash and cash equivalents were in the possession of its non-U.S. subsidiaries. Distributions from the Company's non-U.S. subsidiaries to the Company may be subject to adverse tax consequences.

The Company's operating activities provided \$4.1 million of cash in the first six months of fiscal 2012 compared with \$7.4 million of cash provided by operating activities in the first six months of fiscal 2011. The \$4.1 million of cash provided by operating activities in the first six

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months of fiscal 2012 was primarily due to (i) net income of \$2.9 million; (ii) \$4.2 million from the impact of such non-cash items as depreciation and amortization expense, deferred taxes, equity based compensation expense and LIFO expense; (iii) a \$1.2 million increase in accounts payable and accrued expenses; (iv) a \$0.7 million



decrease in accounts receivable and (v) a \$0.2 million reduction in refundable income taxes. These items were partially offset by a \$4.4 million increase in inventories. These changes in the components of working capital do not take into consideration the impact of the opening balance sheet related to the acquisition of QAF and were due primarily to factors resulting from normal business conditions of the Company, including (i) to support growth in business, (ii) the relative timing of collections from customers and (iii) the relative timing of payments to suppliers and tax authorities.

Capital expenditures were \$1.3 million in the first six months of fiscal 2012 compared with \$1.6 million in the comparable fiscal 2011 period. Capital expenditures during the first six months of fiscal 2012 consist of \$1.0 million by the Forge Group, \$0.2 million by the Repair Group and \$0.1 million by the ASC Group. In addition to the \$1.2 million expended during the first six months of fiscal 2012, \$0.2 million has been committed as of March 31, 2012. The Company anticipates that total fiscal 2012 capital expenditures will be within the range of \$2.0 to \$3.5 million and will relate principally to the expansion of the Forge Group's production capabilities.

As described more fully in note 11 to the unaudited consolidated condensed financial statements, the Company acquired a forging business in October 2011 for approximately \$24.8 million at closing. The acquisition was financed by borrowing approximately \$22.4 million from its bank, which borrowing consisted of a new \$10.0 million term loan and drawing approximately \$12.4 million from its revolving credit facility. The balance of the acquisition was financed by the Company issuing a \$2.4 million promissory note to the seller, which note is payable by the Company in November 2013.

In October 2011, the Company entered into an amendment to its existing credit agreement (the "Credit Agreement Amendment") with its bank increasing the maximum borrowing amount from \$30.0 million to \$40.0 million, of which \$10.0 million is a five (5) year term loan and \$30.0 million is a five (5) year revolving loan, secured by substantially all the assets of the Company and its U.S. subsidiaries and a pledge of 65% of the stock of its non-U.S. subsidiaries. The term loan is repayable in quarterly installments of \$0.5 million starting December 1, 2011.

The term loan has a variable interest rate based on Libor, which becomes an effective fixed rate of 2.9% after giving effect to an interest rate swap agreement. Borrowing under the revolving loan bears interest at a rate equal to Libor plus 0.75% to 1.75%, which percentage fluctuates based on the Company's leverage ratio of outstanding indebtedness to EBITDA. The bank loans are subject to certain customary financial covenants including, without limitation, covenants that require the Company to not exceed a maximum leverage ratio and to maintain a minimum fixed charge coverage ratio. There is also a commitment fee ranging from 0.10% to 0.25% to be incurred on the unused balance. The promissory note issued to the seller is non-interest bearing and is due in November of 2013. The Company was in compliance with all applicable loan covenants as of March 31, 2012.

The Company believes it has adequate cash/other liquidity available from the combination (i) its non-U.S subsidiary cash balances and (ii) cash flows from operations and funds available under its revolving credit agreement to finance both its non-U.S. and U.S operations.

### **C. Impact of Newly Issued Accounting Standards**

In December 2011, the Financial Accounting Standards Board ("FASB") issued an Accounting Standard Update ("ASU") 2011-12, *Deferral of the Effective Date for Amendments to the Presentation of Reclassifications of Items Out of Accumulated Other Comprehensive Income* in ASU 2011-05, and as a result entities are required to continue to report reclassifications out of accumulated other comprehensive income consistent with the presentation requirements in effect before ASU 2011-05. This update is effective for public companies with fiscal years beginning after December 15, 2011. The Company does not expect the adoption of this guidance to have a material impact on its consolidated financial statements and disclosures.

### **Item 4. Controls and Procedures**

As defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the "Exchange Act"), disclosure controls and procedures are controls and procedures designed to ensure that information required to be disclosed in reports filed or submitted under the Exchange Act is recorded, processed, summarized and reported on a timely basis, and that such information is accumulated and communicated to management, including the Company's Chief Executive Officer and Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure. The Company's disclosure controls and procedures include components of the Company's internal control over financial reporting. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Management of the Company, under the supervision and with the participation of the Chief Executive Officer and Chief Financial Officer, carried out an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(e) as of March 31, 2012 (the Evaluation Date). Based upon that evaluation, the Chief Executive Officer and Chief Financial Officer concluded that, as of the Evaluation Date, the Company's disclosure controls and procedures were effective. Accordingly, management has concluded that the unaudited consolidated condensed financial statements in this Form 10-Q fairly present, in all material respects, the Company's financial position, results of operations and cash flows for the periods presented.

During the six month period ended March 31, 2012, the following occurred:

On October 28, 2011, the Company acquired the forging business and related assets from GEL Industries, Inc., which operated under its own set of systems and internal controls. The Company is maintaining those systems and much of the internal control environment until such time that it is able to incorporate the acquired processes into the Company's own control environment. The Company expects to be substantially complete with the incorporation of the acquired operations, as they relate to systems and internal controls, into its control environment during fiscal 2012.

There were no other changes to the Company's internal controls over financial reporting during the quarter ended March 31, 2012, which would be expected to have a material effect on financial reporting.

## Part II. Other Information

### Item 6. (a) Exhibits

The following exhibits are filed with this report or are incorporated herein by reference to a prior filing in accordance with Rule 12b-32 under the Securities and Exchange Act of 1934 (Asterisk denotes exhibits filed with this report.).

| Exhibit No. | Description  |
|-------------|--|
| 3.1         | Third Amended Articles of Incorporation of SIFCO Industries, Inc., filed as Exhibit 3(a) of the Company's Form 10-Q dated March 31, 2002, and incorporated herein by reference   |
| 3.2         | SIFCO Industries, Inc. Amended and Restated Code of Regulations dated January 29, 2002, filed as Exhibit 3(b) of the Company's Form 10-Q dated March 31, 2002, and incorporated herein by reference  |
| 4.1         | Credit and Security Agreement among Fifth Third Bank and SIFCO Industries, Inc. (and subsidiaries) dated December 10, 2010, filed as Exhibit 4.23 to the Company's Form 8-K dated December 10, 2010 and incorporated herein by reference                             |
| 4.2         | First Amendment and Joinder to Credit and Security Agreement among Fifth Third Bank and SIFCO Industries, Inc. (and subsidiaries) dated October 28, 2011, filed as Exhibit 4.2 to the Company's Form 8-K dated October 28, 2011 and incorporated herein by reference |
| 9.1         | Voting Trust Agreement dated January 30, 2007, filed as Exhibit 9.3 of the Company's Form 10-Q dated December 31, 2006, and incorporated herein by reference   |
| 9.2         | Voting Trust Extension Agreement (effectively) dated January 31, 2010, filed as Exhibit 9.2 of the Company's Form 10-Q dated December 31, 2009, and incorporated herein by reference   |
| 10.1        | SIFCO Industries, Inc. 1998 Long-term Incentive Plan, filed as Exhibit 10.3 of the Company's Form 10-Q dated June 30, 2004, and incorporated herein by reference   |
| 10.2        | SIFCO Industries, Inc. 1995 Stock Option Plan, filed as Exhibit 10(d) of the Company's Form 10-Q dated March 31, 2002, and incorporated herein by reference  |
| 10.3        | Change in Control Severance Agreement between the Company and Frank Cappello, dated September 28, 2000, filed as Exhibit 10(g) of the Company's Form 10-Q/A dated December 31, 2000, and incorporated herein by reference  |

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| Exhibit No. | Description  |
|-------------|--|
| 10.4        | Change in Control Severance Agreement between the Company and Remigijus Belzinskas, dated September 28, 2000, filed as Exhibit 10(i) of the Company's Form 10-Q/A dated December 31, 2000, and incorporated herein by reference  |
| 10.5        | Separation Pay Agreement between Frank A. Cappello and SIFCO Industries, Inc. dated December 16, 2005, filed as Exhibit 10.14 of the Company's Form 10-K dated September 30, 2005, and incorporated herein by reference  |
| 10.6        | Amendment No. 1 to Change in Control Severance Agreement between the Company and Frank Cappello, dated February 5, 2007, filed as Exhibit 10.17 of the Company's Form 10-Q dated December 31, 2006 and incorporated herein by reference  |
| 10.7        | Amendment No. 1 to Change in Control Severance Agreement between the Company and Remigijus Belzinskas, dated February 5, 2007, filed as Exhibit 10.18 of the Company's Form 10-Q dated December 31, 2006 and incorporated herein by reference  |
| 10.8        | SIFCO Industries, Inc. 2007 Long-Term Incentive Plan, filed as Exhibit A of the Company's Proxy and Notice of 2008 Annual Meeting to Shareholders dated December 14, 2007, and incorporated herein by reference  |
| 10.9        | Letter Agreement between the Company and Jeffrey P. Gotschall, dated August 12, 2009 filed as Exhibit 10.1 of the Company's Form 8-K dated August 12, 2009 and incorporated herein by reference  |
| 10.10       | Interim Chief Executive Officer Agreement, dated as of August 31, 2009, by and among SIFCO Industries, Inc., Aviation Component Solutions and Michael S. Lipscomb filed as Exhibit 10.14 of the Company's Form 10-K dated September 30, 2009, and incorporated herein by reference   |
| 10.11       | Amended and Restated Change in Control and Severance Agreement, between James P. Woidke and SIFCO Industries, Inc., dated April 27, 2010 filed as Exhibit 10.15 of the Company's Form 8-K dated April 30, 2010, and incorporated herein by reference   |
| 10.12       | Asset Purchase Agreement between T&W Forge, Inc and TWF Acquisition, LLC (a wholly-owned subsidiary of SIFCO Industries Inc.) dated December 10, 2010 filed as Exhibit 10.14 to the Company's Form 8-K dated December 10, 2010, and incorporated herein by reference   |
| 10.13       | Amendment No. 1 to the SIFCO Industries, Inc. 2007 Long-Term Incentive Plan, filed as Exhibit A of the Company's Proxy and Notice of 2011 Annual Meeting to Shareholders dated December 15, 2010, and incorporated herein by reference   |
| 10.14       | Asset Purchase Agreement between GEL Industries, Inc (DBA Quality Aluminum Forge) and Forge Acquisition, LLC (a wholly-owned subsidiary of SIFCO Industries Inc.) dated October 28, 2011, filed as Exhibit 10.16 to the Company's Form 8-K dated October 28, 2011, and incorporated herein by reference  |
| 14.1        | Code of Ethics, filed as Exhibit 14.1 of the Company's Form 10-K dated September 30, 2003, and incorporated herein by reference  |
| * 31.1      | Certification of Chief Executive Officer pursuant to Rule 13a-14(a) / 15d-14(a)  |
| * 31.2      | Certification of Chief Financial Officer pursuant to Rule 13a-14(a) / 15d-14(a)  |
| * 32.1      | Certification of Chief Executive Officer pursuant to 18 U.S.C. Section 1350  |
| * 32.2      | Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350  |
| * 101       | The following financial information from SIFCO Industries, Inc. Quarterly Report on Form 10-Q for the quarter ended March 31, 2012 filed with the SEC on May 10, 2012, formatted in XBRL includes: (i) Consolidated Condensed Statements of Operations for the fiscal periods ended March 31, 2012 and 2011, (ii) Consolidated Condensed Balance Sheets at March 31, 2012 and September 30, 2011, (iii) Consolidated Condensed Statements Cash Flow for the fiscal periods ended March 31, 2012 and 2011, and (iv) the Notes to the Consolidated Condensed Financial Statements. |

**SIGNATURES**

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

SIFCO Industries, Inc.  
(Registrant)

Date: May 10, 2012

/s/ Michael S. Lipscomb  
Michael S. Lipscomb  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: May 10, 2012

/s/ Frank A. Cappello  
Frank A. Cappello  
Vice President-Finance and  
Chief Financial Officer  
(Principal Financial Officer)