EASTERN CO
Form 10-Q
July 26, 2013

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

FORM 10-Q

(Mark One)

[X] QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934 FOR THE QUARTERLY PERIOD ENDED June 29, 2013

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: 0599

THE EASTERN COMPANY
(Exact name of registrant as specified in its charter)

Connecticut (State or other jurisdiction of incorporation or organization)	06-0330020 (I.R.S. Employer Identification No.)
112 Bridge Street, Naugatuck, Connecticut (Address of principal executive offices)	06770 (Zip Code)

(203) 729-2255
(Registrant's telephone number, including area code)

Not applicable
(Former name, former address and former fiscal year, if changed since last report)

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 [X] 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 (Section 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 [X] No [ ]

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

Large accelerated filer [ ]	Accelerated filer [X]
Non-accelerated filer [ ] (Do not check if a smaller reporting company)	Smaller reporting company [ ]

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes [ ] No [X]

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

Class	Outstanding as of July 24, 2013
Common Stock, No par value	6,221,456

PART 1 – FINANCIAL INFORMATION

ITEM 1 – FINANCIAL STATEMENTS

THE EASTERN COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

ASSETS	June 29, 2013	December 29, 2012
Current Assets		
Cash and cash equivalents	$ 18,166,988	$ 18,482,144
Accounts receivable, less allowances: $393,000 - 2013; $487,000 - 2012	19,455,843	18,368,774
Inventories	29,668,583	29,384,780
Prepaid expenses and other assets	3,042,021	3,365,904
Recoverable income taxes receivable	408,632	1,158,632
Deferred income taxes	1,064,202	1,064,202
Total Current Assets	71,806,269	71,824,436
Property, Plant and Equipment	60,563,028	58,130,024
Accumulated depreciation	(34,117,902)	(32,469,281)
	26,445,126	25,660,743
Goodwill	13,867,312	13,933,599
Trademarks	174,790	170,512
Patents, technology, and other intangibles net of accumulated amortization	1,569,556	1,653,957
Deferred income taxes	2,317,070	2,610,903
	17,928,728	18,368,971
TOTAL ASSETS	$ 116,180,123	$ 115,854,150

LIABILITIES AND SHAREHOLDERS' EQUITY	June 29, 2013	December 29, 2012
Current Liabilities		
Accounts payable	$ 8,022,473	$ 7,607,658
Accrued compensation	2,023,840	3,453,709
Other accrued expenses	1,902,549	2,414,135
Current portion of long-term debt	1,428,571	1,428,571
Total Current Liabilities	13,377,433	14,904,073
Other long-term liabilities	607,463	607,463
Long-term debt, less current portion	5,357,143	6,071,428
Accrued postretirement benefits	2,619,586	2,507,726
Accrued pension cost	20,674,879	20,181,361
Shareholders' Equity		
Voting Preferred Stock, no par value:		
Authorized and unissued: 1,000,000 shares		
Nonvoting Preferred Stock, no par value:		
Authorized and unissued: 1,000,000 shares		
Common Stock, no par value:		
Authorized: 50,000,000 shares		
Issued: 8,916,185 shares in 2013 and 8,914,478 shares in 2012	28,610,330	28,585,498
Treasury Stock: 2,694,729 shares in 2013 and 2012	(19,105,723)	(19,105,723)
Retained earnings	80,653,055	78,717,589
Accumulated other comprehensive income (loss):		
Foreign currency translation	2,103,616	2,640,478
Unrecognized net pension and postretirement benefit costs, net of tax	(18,717,659)	(19,255,743)
Accumulated other comprehensive loss	(16,614,043)	(16,615,265)
Total Shareholders' Equity	73,543,619	71,582,099
TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	$ 116,180,123	$ 115,854,150

See accompanying notes.

THE EASTERN COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Six Months Ended		Three Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Net sales	$ 73,940,154	$ 82,055,483	$ 39,247,980	$ 41,559,589
Cost of products sold	(59,142,732)	(64,625,627)	(30,717,138)	(32,314,199)
Gross margin	14,797,422	17,429,856	8,530,842	9,245,390
Selling and administrative expenses	(9,904,481)	(10,116,208)	(5,223,185)	(5,101,156)
Operating profit	4,892,941	7,313,648	3,307,657	4,144,234
Interest expense	(170,852)	(187,904)	(84,776)	(98,667)
Other income	28,459	10,723	19,871	4,587
Income before income taxes	4,750,548	7,136,467	3,242,752	4,050,154
Income taxes	1,571,006	2,458,513	1,068,458	1,417,808
Net income	$ 3,179,542	$ 4,677,954	$ 2,174,294	$ 2,632,346
Earnings per Share:				
Basic	$ .51	$ .75	$ .35	$ .42
Diluted	$ .51	$ .75	$ .35	$ .42
Cash dividends per share:	$ .20	$ .20	$ .10	$ .10

See accompanying notes.

THE EASTERN COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (UNAUDITED)

	Six Months Ended		Three Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Net income	$ 3,179,542	$ 4,677,954	$ 2,174,294	$ 2,632,346
Other comprehensive income/(loss):				
Change in foreign currency translation	(536,862)	51,933	(435,779)	(410,952)
Change in pension and postretirement benefit costs, net of taxes of:	538,084	360,377	269,042	180,206

2013 – $293,833 and $146,917, respectively								
2012 – $196,189 and $98,104, respectively								
Total other comprehensive income/(loss)		1,222		412,310		(166,737)		(230,746)
Comprehensive income	$	3,180,764	$	5,090,264	$	2,007,557	$	2,401,600

See accompanying notes.

THE EASTERN COMPANY AND SUBSIDIARIES
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Six Months Ended	
	June 29, 2013	June 30, 2012
Operating Activities		
Net income	$ 3,179,542	$ 4,677,954
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	1,948,878	1,710,686
Loss on sale of equipment and other assets	11,394	17,756
Provision for doubtful accounts	40,410	65,159
Issuance of Common Stock for directors' fees	11,253	12,298
Changes in operating assets and liabilities:		
Accounts receivable	(1,301,746)	(1,811,994)
Inventories	(387,175)	268,835
Prepaid expenses and other	(224,680)	411,292
Prepaid pension cost	1,327,949	(517,902)
Recoverable taxes receivable	750,000	647,949
Other assets	(51,997)	(34,196)
Accounts payable	454,402	(228,004)
Accrued compensation	(1,397,640)	(395,312)
Other accrued expenses	165,827	570,077
Net cash provided by operating activities	4,526,417	5,394,598
Investing Activities		
Purchases of property, plant and equipment	(2,714,190)	(2,371,770)
Proceeds from sales of equipment and other assets	-	19,000
Net cash used in investing activities	(2,714,190)	(2,352,770)
Financing Activities		
Principal payments on long-term debt	(714,286)	(535,714)
Principal payments on revolving credit loan	-	(3,000,000)
Proceeds from issuance of long-term debt	-	5,000,000
Proceeds from sales of Common Stock	13,580	61,110
Dividends paid	(1,244,076)	(1,242,807)
Net cash (used in)/provided by financing activities	(1,944,782)	282,589
Effect of exchange rate changes on cash	(182,601)	12,785
Net change in cash and cash equivalents	(315,156)	3,337,202
Cash and cash equivalents at beginning of period	18,482,144	11,147,297
Cash and cash equivalents at end of period	$ 18,166,988	$ 14,484,499

See accompanying notes.

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THE EASTERN COMPANY
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
June 29, 2013

Note A – Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the instructions to Form 10-Q and do not include all of the information and footnotes required by generally accepted accounting principles in the United States for complete financial statements. Refer to the Company's consolidated financial statements and notes thereto included in its Form 10-K for the year ended December 29, 2012 for additional information.

The accompanying condensed consolidated financial statements are unaudited. However, in the opinion of management, all adjustments (consisting only of normal recurring accruals) necessary for a fair presentation of the results of operations for interim periods have been reflected therein. All intercompany accounts and transactions are eliminated. Operating results for interim periods are not necessarily indicative of the results that may be expected for the full year.

The condensed consolidated balance sheet as of December 29, 2012 has been derived from the audited consolidated balance sheet at that date.

Note B – Earnings Per Share

The denominators used in the earnings per share computations follow:

	Six Months Ended		Three Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Basic:				
Weighted average shares outstanding	6,220,171	6,214,644	6,220,569	6,217,198
Diluted:				
Weighted average shares outstanding	6,220,171	6,214,644	6,220,569	6,217,198
Dilutive stock options	17,262	15,981	17,456	14,137
Denominator for diluted earnings per share	6,237,433	6,230,625	6,238,025	6,231,335

Note C – Inventories

The components of inventories follow:

	June 29, 2013	December 29, 2012
Raw material and component parts	$ 8,544,552	$ 8,473,007
Work in process	6,230,402	6,160,578

Finished goods	14,893,629	14,751,195
	$ 29,668,583	$ 29,384,780

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Note D – Segment Information

Segment financial information follows:

	Six Months Ended		Three Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Revenues:				
Sales to unaffiliated customers:				
Industrial Hardware	$ 31,615,564	$ 36,954,659	$ 16,399,474	$ 17,746,959
Security Products	23,957,489	26,096,043	12,977,338	13,981,220
Metal Products	18,367,101	19,004,781	9,871,168	9,831,410
	$ 73,940,154	$ 82,055,483	$ 39,247,980	$ 41,559,589
Income before income taxes:				
Industrial Hardware	$ 2,063,104	$ 4,089,783	$ 1,459,117	$ 2,125,226
Security Products	1,237,434	2,343,204	988,732	1,547,636
Metal Products	1,592,403	880,661	859,808	471,372
Operating Profit	4,892,941	7,313,648	3,307,657	4,144,234
Interest expense	(170,852)	(187,904)	(84,776)	(98,667)
Other income	28,459	10,723	19,871	4,587
	$ 4,750,548	$ 7,136,467	$ 3,242,752	$ 4,050,154

Note E – Recent Accounting Pronouncements

In July 2012, the FASB issued authoritative guidance to amend previous guidance on the annual and interim testing of indefinite-lived intangible assets for impairment. The guidance provides entities with the option of first assessing qualitative factors to determine whether it is more likely than not that the fair value of an indefinite-lived intangible asset is less than its carrying amount. If it is determined, on the basis of qualitative factors, that the fair value of the indefinite-lived intangible asset is more likely than not less than the carrying amount, a quantitative impairment test would still be required. The Company adopted this guidance effective December 30, 2012 and it had no impact on the consolidated financial statements of the Company.

In February 2013, the FASB issued authoritative guidance which adds new disclosure requirements for items reclassified out of Accumulated Other Comprehensive Income. The guidance requires that an entity present either in a single note or parenthetically on the face of the financial statements, the effect of significant amounts reclassified from each component of Accumulated Other Comprehensive Income based on its source and the income statement line items affected by the reclassification. The guidance is effective for interim and annual reporting periods beginning on or after December 15, 2012. The Company adopted this guidance effective December 30, 2012 and it had no impact on the consolidated financial statements of the Company.

The Company has implemented all new accounting pronouncements that are in effect and that could impact its consolidated financial statements and does not believe that there are any other new accounting pronouncements that have been issued, but are not yet effective, that might have a material impact on the consolidated financial statements of the Company.

Note F – Debt

On January 25, 2012, the Company signed an amendment to its secured Loan Agreement with People's United Bank ("People's") which included an additional $5,000,000 term portion (the "2012 Term Loan"). The 2012 Term Loan requires quarterly payments of $178,571 for a period of seven (7) years, maturing on January 31, 2019.

Interest on the original term portion of the Loan Agreement is fixed at 4.98%. Interest on the 2012 Term Loan is fixed at 3.90% Prior to the amendment, the interest rate on the revolving credit portion of the Loan Agreement varied based on the LIBOR rate or People's Prime rate plus a margin spread of 2.25%, with a floor rate of 4.0%. As part of the amendment signed on January 25, 2012, this was changed to the LIBOR rate or People's Prime rate plus 2.25%, with a floor of 3.25%; additionally the maturity date was extended to January 31, 2014. During December 2011, the Company used $3,000,000 of the revolving credit, the proceeds of which, along with existing cash, to fund a discretionary pension payment made in December, 2011. This amount was repaid in January 2012. The Company did not utilize the revolving credit during the remainder of Fiscal 2012 or during the quarter or six month period ended June 29, 2013.

The Company has loan covenants under the Loan Agreement which require the Company to maintain a fixed charge coverage ratio of at least 1.1 to 1, a leverage ratio of no more than 1.75 to 1, and minimum tangible net worth of $43 million as of the end of Fiscal 2010 increasing each year by 50% of consolidated net income. This amount is approximately $52.8 million for Fiscal 2013 and was $48.5 million for Fiscal 2012. In addition, the Company has restrictions on, among other things, new capital leases, purchases or redemptions of its capital stock, mergers and divestitures, and new borrowing. The Company was in compliance with all covenants in 2012 and for the three and six month periods ended June 29, 2013.

Note G – Goodwill

The following is a roll-forward of goodwill from year-end 2012 to the end of the second quarter 2013:

	Industrial Hardware Segment	Security Products Segment	Metal Products Segment	Total
Beginning balance	$ 2,099,783	$ 11,833,816	$ —	$ 13,933,599
Foreign exchange	(66,287)	—	—	(66,287)
Ending balance	$ 2,033,496	$ 11,833,816	$ —	$ 13,867,312

Note H – Intangibles

Patents are recorded at cost and are amortized using the straight-line method over the lives of the patents. Technology and licenses are recorded at cost and are generally amortized on a straight-line basis over periods ranging from 5 to 17 years. Non-compete agreements and customer relationships are being amortized using the straight-line method over a period of 5 years. Trademarks are not amortized as their lives are deemed to be indefinite.

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The gross carrying amount and accumulated amortization of amortizable intangible assets:

	Industrial Hardware Segment	Security Products Segment	Metal Products Segment	Total	Weighted-Average Amortization Period (Years)
2013 Patents and developed technology					
Gross Amount:	$ 2,656,675	$ 1,042,132	$ 5,839	$ 3,704,646	15.4
Accumulated Amortization:	1,648,103	481,149	5,838	2,135,090	
Net June 29, 2013 per Balance Sheet	$ 1,008,572	$ 560,983	$ 1	$ 1,569,556	

2012 Patents and developed technology					
Gross Amount:	$ 2,732,307	$ 1,021,409	$ 5,839	$ 3,759,555	15.8
Accumulated Amortization:	1,652,199	447,732	5,667	2,105,598	
Net December 29, 2012 per Balance Sheet	$ 1,080,108	$ 573,677	$ 172	$ 1,653,957	

Note I – Retirement Benefit Plans

The Company has non-contributory defined benefit pension plans covering certain U.S. employees. Plan benefits are generally based upon age at retirement, years of service and, for its salaried plan, the level of compensation. The Company also sponsors unfunded nonqualified supplemental retirement plans that provide certain current and former officers with benefits in excess of limits imposed by federal tax law.

The Company also provides health care and life insurance for retired salaried employees in the United States who meet specific eligibility requirements.

Significant disclosures relating to these benefit plans for the second quarter and first six months of fiscal 2013 and 2012 follow:

	Pension Benefits			
	Six Months Ended		Three Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Service cost	$ 1,504,062	$ 1,347,196	$ 752,030	$ 674,549
Interest cost	1,420,117	1,427,960	710,058	713,980
Expected return on plan assets	(2,201,824)	(1,965,495)	(1,100,912)	(982,748)
Amortization of prior service cost	122,715	82,819	61,359	41,410
Amortization of the net loss	711,716	485,692	355,857	242,845
Net periodic benefit cost	$ 1,556,786	$ 1,378,172	$ 778,392	$ 690,036

	Postretirement Benefits			
	Six Months Ended		Three Months Ended	
	June 29, 2013	June 30, 2012	June 29, 2013	June 30, 2012
Service cost	$ 101,284	$ 86,807	$ 50,642	$ 49,307
Interest cost	71,043	71,694	35,521	37,694
Expected return on plan assets	(48,694)	(48,520)	(24,347)	(24,270)
Amortization of prior service cost	(11,944)	(11,945)	(5,972)	(5,945)
Amortization of the net loss	9,430	-	4,715	-
Net periodic benefit cost	$ 121,119	$ 98,036	$ 60,559	$ 56,786

The Company's funding policy with respect to its qualified plans is to contribute at least the minimum amount required by applicable laws and regulations. In 2013, the Company expects to contribute $2,057,000 into its pension plans and $55,000 into its postretirement plan. As of June 29, 2013, the Company has made contributions totaling $207,000 into its pension plans and $15,000 to its postretirement plan and will make the remaining contributions as required during the remainder of the year.

The Company has a contributory savings plan under Section 401(k) of the Internal Revenue Code covering substantially all U.S. non-union employees. The plan allows participants to make voluntary contributions of up to 100% of their annual compensation on a pretax basis, subject to IRS limitations. The plan provides for contributions by the Company at its discretion. The Company made contributions of $49,385 and $100,736 in the second quarter and first six months of 2013, respectively and $47,272 and $96,729 in the second quarter and first six months of 2012, respectively.

Note J – Stock Based Compensation and Stock Options

The Company has stock option plans for officers, other key employees, and non-employee directors. As of June 29, 2013 two plans have shares reserved for future issuance, the 1995 and 2010 plans. Incentive stock options granted under the 1995 and 2010 plans must have exercise prices that are not less than 100% of the fair market value of the stock on the dates the options are granted. Restricted stock awards may also be granted to participants under the 2010 plan with restrictions determined by the Compensation Committee of the Company's Board of Directors. Under the 1995 and 2010 plans, nonqualified stock options granted to participants will have exercise prices determined by the Compensation Committee of the Company's Board of Directors. No options or restricted stock were granted in the first six months of 2013 or 2012.

As of June 29, 2013, there were 500,000 shares available for future grant under the above noted 2010 plan and there were no shares available for grant under the 1995 plan. As of June 29, 2013, there were 520,000 shares of common stock reserved under all option plans for future issuance.

	Six Months Ended June 29, 2013		Year Ended December 29, 2012	
	Shares	Weighted - Average Exercise Price	Shares	Weighted - Average Exercise Price
Outstanding at beginning of period	21,000	$ 13.580	25,500	$13.580
Exercised	(1,000)	13.580	(4,500)	13.580
Outstanding at end of period	20,000	13.580	21,000	13.580

Options Outstanding and Exercisable

Weighted-
Average
Remaining

Range of Exercise Prices	Outstanding as of June 29, 2013	Contractual Life	Weighted-Average Exercise Price
$13.58	20,000	1.5	$13.580

At June 29, 2013, outstanding and exercisable options had an intrinsic value of $48,400. The total intrinsic value of stock options exercised in the first six months of 2013 was $1,590.

Note K – Income Taxes

The Company files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2009 and non-U.S. income tax examinations by tax authorities prior to 2006. During the first quarter of 2013, the Company was notified by the Internal Revenue Service that they will be examining the tax returns for Fiscal 2010 and 2011. The Company does not expect any material change to its financial statements as a result of this audit.

The total amount of unrecognized tax benefits could increase or decrease within the next twelve months for a number of reasons, including the closure of federal, state and foreign tax years by expiration of the statute of limitations and the recognition and measurement considerations under FASB Accounting Standards Codification ("ASC") 740. There have been no significant changes to the amount of unrecognized tax benefits during the three or six month period ended June 29, 2013. The Company believes that it is reasonably possible that the total amount of unrecognized tax benefits will not increase or decrease significantly over the next twelve months.

Note L - Financial Instruments and Fair Value Measurements

Financial Risk Management Objectives and Policies

The Company is exposed primarily to credit, interest rate and currency exchange rate risks which arise in the normal course of business.

Credit Risk

Credit risk is the potential financial loss resulting from the failure of a customer or counterparty to settle its financial and contractual obligations to the Company, as and when they become due. The primary credit risk for the Company is its receivable accounts with customers. The Company has established credit limits for customers and monitors their balances to mitigate the risk of loss. At June 29, 2013 and December 29, 2012, there were no significant concentrations of credit risk. No one customer represented more than 10% of the Company's net trade receivables at June 29, 2013 or at December 29, 2012. The maximum exposure to credit risk is primarily represented by the carrying amount of the Company's accounts receivable.

Interest Rate Risk

On June 29, 2013, the Company has no exposure to the risk of changes in market interest rates as the interest rates on the outstanding debt are fixed at 4.98% and 3.90%.

Fair Value Measurements

Assets and liabilities that require fair value measurement are recorded at fair value using market and income valuation approaches and considering the Company's and counterparty's credit risk. The Company uses the market approach and the income approach to value assets and liabilities as appropriate. There are no assets or liabilities requiring fair value measurements on June 29 2013 or December 29, 2012.

ITEM 2 – MANAGEMENT’S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion is intended to highlight significant changes in the Company’s financial position and results of operations for the twenty-six weeks ended June 29, 2013. The interim financial statements and this Management’s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the Consolidated Financial Statements and Notes thereto for the fiscal year ended December 29, 2012 and the related Management’s Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in the Company’s Annual Report on Form 10-K for the fiscal year ended December 29, 2012.

Certain statements set forth in this discussion and analysis of financial condition and results of operations are forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. They use such words as “may,” “will,” “expect,” “believe,” “plan” and other similar terminology. These statements reflect manageme current expectations regarding future events and operating performance and speak only as of the date of this release. These forward-looking statements involve a number of risks and uncertainties, and actual future results and trends may differ materially depending on a variety of factors, including changing customer preferences, lack of success of new products, loss of customers, competition, increased raw material prices, problems associated with foreign sourcing of parts and products, changes within our industry segments and in the overall economy, litigation and legislation. In addition, terrorist threats and the possible responses by the U.S. government, the effects on consumer demand, the financial markets, the travel industry, the trucking industry and other conditions increase the uncertainty inherent in forward-looking statements. Forward-looking statements reflect the expectations of the Company at the time they are made, and investors should rely on them only as expressions of opinion about what may happen in the future and only at the time they are made. The Company undertakes no obligation to update any forward-looking statement. Although the Company believes it has an appropriate business strategy and the resources necessary for its operations, future revenue and margin trends cannot be reliably predicted and the Company may alter its business strategies to address changing conditions.

In addition, the Company makes estimates and assumptions that may materially affect reported amounts and disclosures. These relate to valuation allowances for accounts receivable and for excess and obsolete inventories, accruals for pensions and other postretirement benefits (including forecasted future cost increases and returns on plan assets), provisions for depreciation (estimating useful lives), uncertain tax positions, and, on occasion, accruals for contingent losses.

Recent Developments

On July 24, 2013, the Board of Directors of the Company voted to increase the quarterly dividend by 10% effective in the third quarter of 2013. The third quarter 2013 dividend payment at the increased rate of $0.11 per share will represent the 292nd regular consecutive quarterly dividend.

Overview

Sales in the second quarter of 2013 decreased 6% compared to the second quarter of 2012, which was primarily the result of a decrease of 8% in sales of existing products in many of the markets we serve. The decrease was offset in part by selective price increases to customers of 1% and the introduction of new products which increased sales by 1%. In the second quarter of 2013 Industrial Hardware sales decreased 8%, Security Products sales decreased 7% and Metal Products sales were comparable to the prior year period.

Gross margin as a percentage of sales for the three months ended June 29, 2013 was 22% and was comparable to the prior year period.

Sales in the first six months of 2013 decreased 10% compared to the prior year period, which was primarily the result of a decrease of 14% in sales of existing products in many of the markets we serve. The decrease was offset in part by selective price increases to customers of 1% and the introduction of new products which increased sales by 3%. Sales decreased in the first six months of 2013 by 14% in the Industrial Hardware segment, by 8% in the Security Products segment, and by 3% in the Metal Products segment compared to the prior year period.

Gross margin as a percentage of sales for the six months ended June 29, 2013 was 20% compared to 21% in the comparable period a year ago. This decrease was primarily the result of lower sales volume causing lower utilization of the Company's production capacity in the 2013 period.

Raw material prices have increased compared to the prior year periods. The Company, through price increases, is recovering these additional costs from our customers, wherever possible. The Company expects that raw material prices will continue to increase as worldwide economic conditions improve, which may have a negative impact on future operating margins if not recovered by price increases. Currently, there is no indication that the Company will be unable to obtain supplies of all the raw materials that it requires.

Cash flow from operations in the first six months of 2013 decreased compared to the same period in 2012. This decrease is primarily due to the lower level of earnings in the 2013 period and the associated timing differences in the collections of accounts receivable, payments of liabilities, and changes in inventories. Cash on hand, cash flow from operations, along with the result of controlling discretionary expenditures, should enable the Company to meet all its existing obligations and continue its quarterly dividend payments.

A more detailed analysis of the Company's results of operations and financial condition follows:

Results of Operations

The following table shows, for the periods indicated, selected line items from the condensed consolidated statements of operations as a percentage of net sales, by segment:

	Three Months Ended June 29, 2013			
	Industrial Hardware	Security Products	Metal Products	Total
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	75.3%	77.1%	84.7%	78.3%
Gross margin	24.7%	22.9%	15.3%	21.7%
Selling and administrative expense	15.8%	15.3%	6.6%	13.3%
Operating profit	8.9%	7.6%	8.7%	8.4%

	Three Months Ended June 30, 2012			
	Industrial Hardware	Security Products	Metal Products	Total
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	74.1%	74.4%	89.1%	77.8%
Gross margin	25.9%	25.6%	10.9%	22.2%
Selling and administrative expense	13.9%	14.5%	6.1%	12.2%
Operating profit	12.0%	11.1%	4.8%	10.0%

The following table shows the amount of change for the second quarter of 2013 compared to the second quarter of 2012 in sales, cost of products sold, gross margin, selling and administrative expenses and operating profit, by segment (dollars in thousands):

	Industrial Hardware	Security Products	Metal Products	Total
Net sales	$ (1,348)	$ (1,004)	$ 40	$ (2,312)
Volume	-9.7%	-9.0%	-3.0%	-7.9%
Prices	0.0%	1.0%	1.6%	0.7%
New products	2.1%	0.8%	1.8%	1.6%
	-7.6%	-7.2%	0.4%	-5.6%
Cost of products sold	$ (806)	$ (393)	$ (398)	$ (1,597)
	-6.1%	-3.8%	-4.5%	-4.9%
Gross margin	$ (542)	$ (611)	$ 438	$ (715)
	-11.8%	-17.1%	40.9%	-7.7%

Selling and administrative expenses	$ 124	$ (52)	$ 50	$ 122
	5.1%	-2.6%	8.3%	2.4%
Operating profit	$ (666)	$ (559)	$ 388	$ (837)
	-31.3%	-36.1%	82.4%	-20.2%

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The following table shows, for the periods indicated, selected line items from the condensed consolidated statements of income as a percentage of net sales, by segment:

	Six Months Ended June 29, 2013			
	Industrial Hardware	Security Products	Metal Products	Total
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	78.3%	78.6%	84.8%	80.0%
Gross margin	21.7%	21.4%	15.2%	20.0%
Selling and administrative expense	15.2%	16.2%	6.5%	13.4%
Operating profit	6.5%	5.2%	8.7%	6.6%

	Six Months Ended June 30, 2012			
	Industrial Hardware	Security Products	Metal Products	Total
Net sales	100.0%	100.0%	100.0%	100.0%
Cost of products sold	75.5%	75.9%	89.1%	78.8%
Gross margin	24.5%	24.1%	10.9%	21.2%
Selling and administrative expense	13.4%	15.1%	6.3%	12.3%
Operating profit	11.1%	9.0%	4.6%	8.9%

The following table shows the amount of change for the first six months of 2013 compared to the first six months of 2012 in sales, cost of products sold, gross margin, selling and administrative expenses and operating profit, by segment (dollars in thousands):

	Industrial Hardware	Security Products	Metal Products	Total
Net sales	$ (5,339)	$ (2,139)	$ (637)	$ (8,115)
Volume	-19.5%	-10.4%	-6.7%	-13.6%
Prices	0.1%	0.9%	1.7%	0.7%
New products	5.0%	1.3%	1.7%	3.0%
	-14.4%	-8.2%	-3.3%	-9.9%
Cost of products sold	$ (3,159)	$ (962)	$ (1,362)	$ (5,483)
	-11.3%	-4.9%	-8.0%	-8.5%
Gross margin	$ (2,180)	$ (1,177)	$ 725	$ (2,632)
	-24.1%	-18.7%	34.9%	-15.1%
Selling and administrative expenses	$ (153)	$ (71)	$ 13	$ (211)
	-3.1%	-1.8%	1.1%	-2.1%
Operating profit	$ (2,027)	$ (1,106)	$ 712	$ (2,421)

-49.6%	-47.2%	80.8%	-33.1%

Industrial Hardware Segment

Net sales in the Industrial Hardware segment were down 8% in the second quarter of 2013 and 14% in the first half compared to the prior year periods. The decrease in sales in the second quarter and first half of 2013 reflected a decrease in sales of existing products, resulting from lower sales to the distribution, trailer, truck accessory, service body and military markets as well as lightweight composite panels used in an interactive electronic board product in 2013 compared to the prior year periods. The decrease was reduced by an increase in sales to the Class 8 truck and fire and rescue markets in both the second quarter and first half of 2013 compared to the same periods in 2012, selective price increases to customers and the introduction of new products. All of the new products were developed internally and included rotary latches, an adjustable rod assembly, a striker pin, a lever latch, a cab door handle and a venting line of products for the Class 8 truck market; a dual latch rotary and a handle and rod for the fire and rescue market; a door latch assembly for the military market; and a trigger latch for the bus market; a platform and small panels made from lightweight composite material; as well as a variety of locking and latching products for the many markets we serve. Third quarter sales for the Industrial Hardware segment may be negatively impacted by a work stoppage at one of our customers in the Class 8 truck market due to their union contract negotiations.

Cost of products sold for the Industrial Hardware segment decreased \$0.8 million or 6% in the second quarter and \$3.2 million or 11% in the first half of 2013 compared to the same periods in 2012.

The most significant factors resulting in changes in cost of products sold in the second quarter of 2013 compared to the 2012 second quarter included:

§ an increase of \$0.1 million or 114% in foreign currency exchange;
§ an increase of \$0.1 million or 31% in depreciation expense;
§ a decrease of \$0.2 million or 2% in raw materials;
§ a decrease of \$0.1 million or 63% from the sale of scrap;
§ a decrease of \$0.1 million or 61% in engineering expenses;
§ a decrease of \$0.1 million or 25% in costs for supplies and tools;
§ and a decrease of \$0.5 million or 14% in costs for payroll and payroll related charges.

The most significant factors resulting in changes in cost of products sold in the first half of 2013 compared to the 2012 first half included:

§ an increase of \$0.1 million or 116% in foreign currency exchange;
§ an increase of \$0.2 million or 26% in depreciation expense;
§ a decrease of \$2.1 million or 12% in raw materials;
§ a decrease of \$0.7 million or 10% in costs for payroll and payroll related charges;
§ a decrease of \$0.2 million or 33% in costs for supplies and tools;
§ a decrease of \$0.2 million or 239% in miscellaneous income;
§ a decrease of \$0.1 million or 53% in engineering expenses;
§ a decrease of \$0.1 million or 18% in utility costs;
§ and a decrease of \$0.1 million or 20% related to costs for maintenance and repair.

Gross margin as a percentage of sales in the second quarter decreased to 25% in 2013 from 26% in the prior year period and in the first half to 22% from 25% in the prior year period. The decreases in both the second quarter and first half of 2013 reflect the lower volume of sales in 2013, the mix of products produced and the changes in cost of products sold discussed above.

Selling and administrative expenses in the Industrial Hardware segment increased $0.1 million or 5% in the second quarter and decreased $0.2 million or 3% in the first half of 2013 as compared to the 2012 periods.

The most significant factor resulting in changes in selling and administrative expenses in the Industrial Hardware segment in the second quarter of 2013 compared to the 2012 second quarter included:

§ an increase of $0.1 million or 13% in costs for payroll and payroll related charges.

The most significant factor resulting in changes in selling and administrative expenses in the Industrial Hardware segment in the first half of 2013 compared to the 2012 first half included:

§ a decrease of $0.1 million or 2% in costs for payroll and payroll related charges.

Security Products Segment

Net sales in the Security Products segment decreased 7% in the second quarter and 8% in the first half of 2013 compared to the 2012 periods. The decrease in sales in both the second quarter and first half of 2013 in the Security Products segment is primarily the result of lower sales volume of existing products across many of the markets we serve. Selective price increases and the introduction of new products offset a portion of the sales decreases. Sales of new products included a clamps and a tubular slam lock for the vehicular market, a puck lock for the OEM market, luggage locks for the travel market, a round body steel padlock for the retail hardware market and mini “D” ring handle assembly for the storage market.

Cost of products sold for the Security Products segment decreased $0.4 million or 4% in the second quarter and $1.0 million or 5% in the first half of 2013 compared to the same periods in 2012.

The most significant factors resulting in changes in cost of products sold in the second quarter of 2013 compared to the 2012 second quarter included:

§ an increase of $0.1 million or 63% in costs for supplies and tools;
§ and a decrease of $0.6 million or 7% in raw materials.

The most significant factors resulting in changes in cost of products sold in the first half of 2013 compared to the 2012 first half included:

§ a decrease of $0.1 million or 160% in foreign exchange;
§ and a decrease of $0.9 million or 6.5% in raw materials.

Gross margin as a percentage of sales in the second quarter decreased to 23% in 2013 from 26% in the prior year period and in the first half to 21% from 24% in the prior year period. The decreases in both the second quarter and first half of 2013 were primarily the result of the mix of products produced and the decreased sales volume.

Selling and administrative expenses in the Security Products segment decreased $0.1 million or 3% in the second quarter and $0.1 million or 2% in the first half of 2013 as compared to the 2012 periods.

The most significant factor resulting in changes in selling and administrative expenses in the Security Products segment in the second quarter of 2013 compared to the 2012 second quarter included:

§ a decrease of $0.1 million or 5% in costs for payroll and payroll related charges.

The most significant factor resulting in changes in selling and administrative expenses in the Security Products segment in the first half of 2013 compared to the 2012 first half included:

§ a decrease of $0.1 million or 3% in costs for payroll and payroll related charges.

Metal Products Segment

Net sales in the Metal Products segment were up less than 1% in the second quarter and down 3% in the first half of 2013 as compared to the prior year periods. The higher sales in the second quarter were primarily the result of selective price increases to customers and the introduction of new products. The decrease in sales in the first half of 2013 was the result of lower sales of existing products to the contract casting market. The decrease was partially offset by selective price increases to customers and the introduction of new products. Sales of mining products were up 13% in the second quarter and up 3% in the first half of 2013 compared to the prior year periods. The increase in sales of mining products was the result of continued demand in 2013 in both the U.S. and Canadian mining markets compared to the prior year periods and the introduction of new mining products. New mining products included a rope thread and a cable head. While the Company experienced a strong first half in sales of products for the coal mining industry, it is too early to determine if the mining business will be impacted by the new clean air rules enacted by the U.S. Environmental Protection Agency that went into effect in 2012. Sales of contract castings decreased 55% in the second quarter and 35% in the first half of 2013 from the prior year levels. The decrease in sales of contract casting was primarily the result of a reduction in sales of a tie plate for the railroad industry. Contract casting sales benefited from the sales of new products including rail clamps for a solar panel application and new beam clamps. The Company is actively trying to develop additional new products to replace any softening in sales volume of mining products that may result from the new EPA clean air regulations.

Cost of products sold for the Metal Products segment decreased $0.4 million or 5% in the second quarter and $1.3 million or 8% in the first half of 2013 compared to the same periods in 2012.

The most significant factors resulting in changes in cost of products sold in the second quarter of 2013 compared to the 2012 second quarter included:

§ an increase of $0.5 million or 24% in raw materials;
§ a decrease of $0.5 million or 36% in costs for supplies and tools;
§ and a decrease of $0.3 million or 8% in costs for payroll and payroll related charges.

The most significant factors resulting in changes in cost of products sold in the first half of 2013 compared to the 2012 first half included:

§ a decrease of $0.6 million or 26% in costs for supplies and tools;
§ a decrease of $0.3 million or 5% in costs for payroll and payroll related charges;
§ and a decrease of $0.3 million or 22% related to costs for maintenance and repairs.

Gross margin as a percentage of net sales increased from 11% to 15% in both the second quarter and first half of 2013 as compared to the 2012 periods. The increases in both the second quarter and first half of 2013 are due to the mix of products produced, elimination of products with unacceptable profit margins, selective price increases to customers, and cost reductions related to improved production efficiency resulting from the capital investment made in the operation over the last several years.

Selling and administrative expenses in the Metal Products segment were comparable for the second quarter and first half of 2013 and 2012.

Other Items

Interest expense decreased 14% in the second quarter and 9% in the first six months of 2013 compared to the prior year period due to the decreased level of debt in 2013.

Other income was not material to the financial statements.

Income taxes reflected the change in the operating results. The effective tax rates in the second quarter and first six months of 2013 were both 33%, compared to 35% and 34% in the 2012 periods.

Liquidity and Sources of Capital

The Company provided $4.5 and $5.4 million from its operations during the first six months of 2013 and 2012, respectively. The reduction in cash flows in the quarter was primarily the result of the decreased earnings in the current year over the same period last year and the associated timing differences in the collections of accounts receivable, payments of liabilities, and changes in inventories. Cash flow from operations coupled with cash on hand at the beginning of the year was sufficient to fund capital expenditures, debt service, and dividend payments. The Company did not utilize its revolving line of credit during the second quarter.

Additions to property, plant and equipment were $2.7 million for the first six months of 2013 compared to $2.4 million for the same period in 2012. Total capital expenditures for 2013 are expected to be approximately $5 to $6 million. As of June 29, 2013, there is approximately $1.1 million of outstanding commitments for these capital expenditures.

The following table shows key financial ratios at the end of each period:

	Second Quarter 2013	Second Quarter 2012	Year End 2012
Current ratio	5.4	5.0	4.8
Average days' sales in accounts receivable	46	45	47
Inventory turnover	4.0	4.4	4.2
Total debt to shareholders' equity	9.2%	11.2%	10.5%

The following table shows important liquidity measures as of the balance sheet date for each period below (in millions):

	Second Quarter 2013	Second Quarter 2012	Year End 2012
Cash and cash equivalents			
- Held in the United States	$ 9.8	$ 6.7	$ 10.4
- Held by a foreign subsidiary	8.4	7.8	8.1
	18.2	14.5	18.5
Working capital	58.4	55.4	56.9
Net cash provided by operating activities	4.5	5.4	13.6
Change in working capital impact on net cash used in operating activities	(0.7)	(1.1)	0.3
Net cash used in investing activities	(2.7)	(2.4)	(4.2)
Net cash (used in)/provided by financing activities	(1.9)	0.3	(2.3)

U.S. income taxes have not been provided on the undistributed earnings of the Company's foreign subsidiaries except where required under U.S. tax laws. The Company would be required to accrue and pay United States income taxes to repatriate the funds held by foreign subsidiaries not otherwise provided. The Company intends to reinvest these earnings outside the United States indefinitely.

All cash held by foreign subsidiaries is readily convertible into other currencies, including the U.S. Dollar.

Total inventories as of June 29, 2013 were $29.7 million, compared to $29.4 million at year end 2012 and $29.6 million at the end of the second quarter of 2012. Accounts receivable increased slightly to $19.5 million from $18.4 million at year end 2012 but declined slightly compared to the $20.4 million at the end of the second quarter of fiscal 2012.

Cash on hand, cash flow from operating activities and funds available under the revolving credit portion of the Company's Loan Agreement are expected to be sufficient to cover future foreseeable working capital requirements.

ITEM 3 – QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no material changes in market risk from what was reported in the 2012 Annual Report on Form 10-K.

ITEM 4 – CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures:

As of the end of the quarter ended June 29, 2013, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer (the "CEO") and Chief Financial Officer (the "CFO"), of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 240.13a-15. As defined in Exchange Act Rules 240.13a-15(e) and 240.15d-15(e), "the term disclosure controls and procedures means controls and other procedures of an issuer that are designed to ensure that information required to be disclosed by the issuer in the reports that it files or submits under the Act (15 U.S.C. 78a et seq.) is recorded, processed, summarized and reported, within the time periods specified in the Commission's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by an issuer in the reports that it files or submits under the Act is accumulated and communicated to the issuer's management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure." Based upon that evaluation, the CEO and CFO concluded that the Company's current disclosure controls and procedures were effective as of the June 29, 2013 evaluation date.

The Company believes that a controls system, no matter how well designed and operated, cannot provide absolute assurance that the objectives of the controls system are met, and no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within a company have been detected. The Company's disclosure controls and procedures are designed to provide reasonable assurance of achieving their objectives, and the CEO and CFO have concluded that these controls and procedures are effective at the "reasonable assurance" level.

Changes in Internal Controls:

During the period covered by this report, there have been no significant changes in the Company's internal control over financial reporting or in other factors that have materially affected, or are reasonably likely to materially affect, the Company's internal controls.

PART II – OTHER INFORMATION

ITEM 1 – LEGAL PROCEEDINGS

During the fourth quarter of 2010, the Company was contacted by the State of Illinois regarding potential ground contamination at our plant in Wheeling, Illinois. The Company enlisted into a voluntary remediation program in Illinois and has engaged an environmental clean-up company to perform testing and develop a remediation plan, if needed. No estimate for the cost of remediation was available when this Form 10-Q was filed with the SEC.

During 2008, the U.S. Environmental Protection Agency identified the Company as a potentially responsible party in connection with a site in Cleveland, Ohio based on the ownership of the site by a division of the Company in the 1960's. According to the Agency, the current occupant of the site filed bankruptcy, leaving behind plating operations which required remedial action. The Company declined to participate in the remedial action, and intends to defend against any efforts of the Agency to impose any liability against the Company for environmental conditions on this site which may have occurred in the years since its ownership.

There are no other legal proceedings, other than ordinary routine litigation incidental to the Company’s business, to which either the Company or any of its subsidiaries is a party or to which any of their property is the subject.

ITEM 1A – RISK FACTORS

There have been no material changes in risk factors from what was reported in the 2012 Annual Report on Form 10-K.

ITEM 2 – UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There have been no sales of unregistered securities by the Company or purchases of registered equity securities by the Company during the period covered by this report.

ITEM 3 – DEFAULTS UPON SENIOR SECURITIES

None

ITEM 4 – MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5 – OTHER INFORMATION

None

ITEM 6 – EXHIBITS

31) Certifications required by Rule 13a-14(a) of the Securities Exchange Act of 1934, as amended, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

32) Certifications pursuant to Rule 13a-14(b) and 18 USC 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

99(1)) The Registrant’s Annual Report on Form 10-K for the fiscal year ended December 29, 2012 is incorporated herein by reference.

99(2)) Form 8-K filed on April 24, 2013 setting forth the press release reporting the Company’s earnings for the quarter ended March 30, 2013 is incorporated herein by reference.

99(3)) Form 8-K filed on April 25, 2013 setting forth the results of the vote at the annual meeting of shareholders of the Company which was held on April 24, 2013 is incorporated herein by reference.

99(4)) Form 8-K filed on July 24, 2013 setting forth the press release reporting the Company’s earnings for the quarter ended June 29, 2013 is incorporated herein by reference.

SIGNATURES

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

	THE EASTERN COMPANY (Registrant)
DATE: July 26, 2013	/s/Leonard F. Leganza Leonard F. Leganza Chairman, President and Chief Executive Officer
DATE: July 26, 2013	/s/John L. Sullivan III John L. Sullivan III Vice President and Chief Financial Officer