

ASTRONICS CORP  
Form 10-Q  
August 05, 2014  
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**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 June 28, 2014**

**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 0-7087**

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

**New York**  
**(State or other jurisdiction of**  
**incorporation or organization)**

**16-0959303**  
**(IRS Employer**

**Identification Number)**

**130 Commerce Way, East Aurora, New York**  
**(Address of principal executive offices)**

**14052**  
**(Zip code)**

**(716) 805-1599**

**(Registrant's telephone number, including area code)**

**NOT APPLICABLE**

**(Former name, former address and former fiscal year, if changed since last report)**

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

**\$.01 par value Common Stock, \$.01 par value Class B Stock**

**(Title of Class)**

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, 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 (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  No

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

Large accelerated filer  Accelerated filer

Non-accelerated filer  Smaller Reporting Company

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

As of June 28, 2014, 18,102,867 shares of common stock were outstanding consisting of 14,017,831 shares of common stock (\$.01 par value) and 4,085,036 shares of Class B common stock (\$.01 par value).



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## ASTRONICS CORPORATION

**Consolidated Condensed Balance Sheets**

June 28, 2014 with Comparative Figures for December 31, 2013

(In thousands)

|  | June 28,<br>2014<br>(Unaudited) | December 31,<br>2013 |
|--|---------------------------------|----------------------|
| <b>Current Assets:</b>   |                                 |                      |
| Cash and Cash Equivalents                                      | \$ 20,825                       | \$ 54,635            |
| Accounts Receivable, net of allowance for doubtful accounts    | 105,108                         | 60,942               |
| Inventories  | 127,320                         | 85,269               |
| Prepaid Expenses and other current assets                      | 13,979                          | 10,352               |
| <b>Total Current Assets</b>                                    | <b>267,232</b>                  | <b>211,198</b>       |
| Property, Plant and Equipment, net of accumulated depreciation | 110,152                         | 70,900               |
| Other Assets   | 5,703                           | 5,474                |
| Intangible Assets, net of accumulated amortization             | 96,959                          | 102,701              |
| Goodwill   | 102,729                         | 100,998              |
| <b>Total Assets</b>  | <b>\$ 582,775</b>               | <b>\$ 491,271</b>    |
| <b>Current Liabilities:</b>                                    |                                 |                      |
| Current Maturities of Long-term Debt                           | \$ 13,325                       | \$ 12,279            |
| Accounts Payable   | 39,520                          | 25,255               |
| Accrued Expenses   | 28,556                          | 24,668               |
| Accrued Income Taxes   | 4,005                           | 1,318                |
| Customer Advance Payments and Deferred Revenue                 | 27,392                          | 20,747               |
| Deferred Income Taxes  |                                 | 970                  |
| <b>Total Current Liabilities</b>                               | <b>112,798</b>                  | <b>85,237</b>        |
| Long-term Debt   | 232,293                         | 188,041              |
| Other Liabilities  | 42,961                          | 46,484               |
| <b>Total Liabilities</b>                                       | <b>388,052</b>                  | <b>319,762</b>       |
| <b>Shareholders' Equity:</b>                                   |                                 |                      |
| Common Stock   | 181                             | 179                  |
| Accumulated Other Comprehensive Loss                           | (3,979)                         | (3,611)              |

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|   |            |            |
|---|------------|------------|
| Other Shareholders Equity                 | 198,521    | 174,941    |
| Total Shareholders Equity                 | 194,723    | 171,509    |
| Total Liabilities and Shareholders Equity | \$ 582,775 | \$ 491,271 |

See notes to consolidated condensed financial statements

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## ASTRONICS CORPORATION

**Consolidated Condensed Statements of Operations**

Three and Six Months Ended June 28, 2014 With Comparative Figures for 2013

(Unaudited)

(In thousands, except per share data)

|  | Six Months Ended |                  | Three Months Ended |                  |
|--|------------------|------------------|--------------------|------------------|
|  | June 28,<br>2014 | June 29,<br>2013 | June 28,<br>2014   | June 29,<br>2013 |
| Sales  | \$ 315,514       | \$ 144,800       | \$ 174,563         | \$ 70,833        |
| Cost of Products Sold                        | 242,307          | 105,900          | 131,361            | 52,152           |
| Gross Profit                                 | 73,207           | 38,900           | 43,202             | 18,681           |
| Selling, General and Administrative Expenses | 37,099           | 19,858           | 20,721             | 10,701           |
| Income from Operations                       | 36,108           | 19,042           | 22,481             | 7,980            |
| Interest Expense, Net of Interest Income     | 4,882            | 480              | 2,559              | 262              |
| Income Before Income Taxes                   | 31,226           | 18,562           | 19,922             | 7,718            |
| Provision for Income Taxes                   | 10,575           | 4,840            | 6,778              | 2,560            |
| Net Income                                   | \$ 20,651        | \$ 13,722        | \$ 13,144          | \$ 5,158         |
| Earnings per share:                          |                  |                  |                    |                  |
| Basic  | \$ 1.15          | \$ 0.79          | \$ 0.73            | \$ 0.30          |
| Diluted                                      | \$ 1.09          | \$ 0.75          | \$ 0.70            | \$ 0.28          |

See notes to consolidated condensed financial statements.



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## ASTRONICS CORPORATION

**Consolidated Condensed Statements of Comprehensive Income**

Three and Six Months Ended June 28, 2014 With Comparative Figures for 2013

(Unaudited)

(In thousands)

|   | Six Months Ended |                  | Three Months Ended |                  |
|---|------------------|------------------|--------------------|------------------|
|   | June 28,<br>2014 | June 29,<br>2013 | June 28,<br>2014   | June 29,<br>2013 |
| Net Income  | \$ 20,651        | \$ 13,722        | \$ 13,144          | \$ 5,158         |
| Other Comprehensive Income (Loss):                            |                  |                  |                    |                  |
| Foreign Currency Translation Adjustments                      | (568)            | (389)            | (182)              | (192)            |
| Change in Accumulated (Loss) Income on Derivatives Net of Tax | (8)              | 38               | (28)               | 23               |
| Retirement Liability Adjustment Net of Tax                    | 208              | 211              | 106                | 105              |
| Other Comprehensive Loss                                      | (368)            | (140)            | (104)              | (64)             |
| Comprehensive Income  | \$ 20,283        | \$ 13,582        | \$ 13,040          | \$ 5,094         |

See notes to consolidated condensed financial statements.

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## ASTRONICS CORPORATION

**Consolidated Condensed Statements of Cash Flows**

Six Months Ended June 28, 2014

With Comparative Figures for 2013

(Unaudited)

(In thousands)

|   | June 28,<br>2014 | June 29,<br>2013 |
|---|------------------|------------------|
| <b>Cash Flows From Operating Activities:</b>                                  |                  |                  |
| Net Income  | \$ 20,651        | \$ 13,722        |
| Adjustments to Reconcile Net Income to Cash Provided By Operating Activities: |                  |                  |
| Depreciation and Amortization   | 10,309           | 3,470            |
| Provisions for Non-Cash Losses on Inventory and Receivables                   | 510              | 515              |
| Stock Compensation Expense  | 866              | 709              |
| Deferred Tax (Benefit) Expense  | (2,765)          | 1,087            |
| Other   |                  | (376)            |
| Cash Flows from Changes in Operating Assets and Liabilities:                  |                  |                  |
| Accounts Receivable   | (33,723)         | 2,504            |
| Inventories   | 17,736           | (5,164)          |
| Accounts Payable  | 3,702            | 4,474            |
| Other Current Assets and Liabilities  | (1,207)          | (2,926)          |
| Customer Advanced Payments and Deferred Revenue                               | 3,852            | (2,362)          |
| Income Taxes  | 2,684            | 1,079            |
| Supplemental Retirement and Other Liabilities                                 | 615              | 587              |
| <b>Cash Provided By Operating Activities</b>                                  | <b>23,230</b>    | <b>17,319</b>    |
| <b>Cash Flows From Investing Activities:</b>                                  |                  |                  |
| Acquisition of Business   | (67,851)         |                  |
| Capital Expenditures  | (23,091)         | (3,671)          |
| <b>Cash Used For Investing Activities</b>                                     | <b>(90,942)</b>  | <b>(3,671)</b>   |
| <b>Cash Flows From Financing Activities:</b>                                  |                  |                  |
| Proceeds from Debt  | 58,150           |                  |
| Payments for Long-term Debt   | (25,883)         | (4,478)          |
| Debt Acquisition Costs  | (280)            | (160)            |
| Acquisition Earnout Payments  | (42)             | (81)             |
| Proceeds from Exercise of Stock Options                                       | 804              | 175              |
| Income Tax Benefit from Exercise of Stock Options                             | 1,261            | 57               |

|  |           |           |
|--|-----------|-----------|
| Cash Provided By (Used For) Financing Activities | 34,010    | (4,487)   |
| Effect of Exchange Rates on Cash                 | (108)     | (6)       |
| (Decrease) Increase in Cash and Cash Equivalents | (33,810)  | 9,155     |
| Cash and Cash Equivalents at Beginning of Period | 54,635    | 7,380     |
| Cash and Cash Equivalents at End of Period       | \$ 20,825 | \$ 16,535 |

See notes to consolidated condensed financial statements.

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ASTRONICS CORPORATION

**Notes to Consolidated Condensed Financial Statements**

June 28, 2014

(Unaudited)

***1) Basis of Presentation***

The accompanying unaudited statements have been prepared in accordance with U.S. generally accepted accounting principles for interim financial information. Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals, considered necessary for a fair presentation have been included.

**Operating Results**

The results of operations for any interim period are not necessarily indicative of results for the full year. Operating results for the three and six month periods ended June 28, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014.

The balance sheet at December 31, 2013 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements.

For further information, refer to the financial statements and footnotes thereto included in Astronics Corporation's 2013 annual report on Form 10-K.

**Description of the Business**

Astronics is a leading supplier of products to the aerospace and defense industries. Our products include advanced, high-performance lighting and safety systems, electrical power generation, distribution and motion systems, avionics and structure and other products for the global aerospace industry as well as test, training and simulation systems for the military, semi-conductor and consumer electronics markets.

The Company has two reportable segments, Aerospace and Test Systems. The Aerospace segment designs and manufactures products for the global aerospace industry. The Test Systems segment designs, manufactures and maintains communications and weapons test systems and training and simulation devices for military applications as well as automatic test systems, subsystems and instruments for semi-conductor and consumer electronics products.

We have twelve primary locations, ten in the United States, one in Canada, and one in France. We design and build our products through our wholly owned subsidiaries Astronics Advanced Electronic Systems Corp. ( AES ); Astronics AeroSat Corporation ( AeroSat ); Astronics Test Systems, Inc. ( ATS ); Ballard Technology, Inc. ( Ballard ); DME Corporation ( DME ); Luminescent Systems, Inc. ( LSI ); Luminescent Systems Canada, Inc. ( LSI Canada ); Max-Viz, Inc. ( Max-Viz ); Peco, Inc. ( Peco ) and PGA Electronic s.a. ( PGA ).

On February 28, 2014, Astronics acquired, through a wholly owned subsidiary ATS, certain assets and liabilities of EADS North America's Test and Services division, located in Irvine, California. ATS is a leading provider of highly engineered automatic test systems, subsystems and instruments for semi-conductor and consumer electronics products to both the commercial and defense industries. ATS is reported as a member of our Test Systems segment.

**Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany transactions and balances have been eliminated. Acquisitions are accounted for under the purchase method and, accordingly, the operating results for the acquired companies are included in the consolidated statements of earnings from the respective dates of acquisition.

**Revenue and Expense Recognition**

In the Aerospace segment, segment revenue is recognized on the accrual basis at the time of shipment of goods and transfer of title. There are no significant contracts allowing for right of return.

In the Test Systems segment, revenue of approximately 1% and 30% for the three months ending June 28, 2014 and June 29, 2013, respectively, and approximately 2% and 28% for the six months ending June 28, 2014 and June 29, 2013 respectively, is recognized from long-term, fixed-price contracts using the percentage-of-completion method of accounting, measured by multiplying the estimated total contract value by the ratio of actual contract costs incurred to date to the estimated total contract costs. Substantially all long-term contracts are with U.S. government agencies and contractors

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thereto. The Company makes significant estimates involving its usage of percentage-of-completion accounting to recognize contract revenues. The Company periodically reviews contracts in process for estimates-to-completion, and revises estimated gross profit accordingly. While the Company believes its estimated gross profit on contracts in process is reasonable, unforeseen events and changes in circumstances can take place in a subsequent accounting period that may cause the Company to revise its estimated gross profit on one or more of its contracts in process. Accordingly, the ultimate gross profit realized upon completion of such contracts can vary significantly from estimated amounts between accounting periods. Revenue not recognized using the percentage-of-completion method is recognized at the time of shipment of goods and transfer of title.

With the acquisition of ATS, a portion of our Test Systems segment sales are recognized as multiple element arrangements, whereby revenue is allocated to the equipment and post installation maintenance service components based upon vendor specific objective evidence, typically pricing established in the contracts for the post installation services. If vendor-specific objective evidence of selling price is not available, we allocate revenue to the elements of the bundled arrangement using the estimated selling price method in order to qualify the components as separate units of accounting. Revenue on the equipment component is recognized when the equipment is accepted by the customers and title passes. Revenue on the post installation maintenance service component is recognized over the contractual life of the service to be provided, typically 24 months from installation.

**Cost of Products Sold, Engineering and Development and Selling, General and Administrative Expenses**

Cost of products sold includes the costs to manufacture products such as direct materials and labor and manufacturing overhead as well as all engineering and developmental costs. The Company is engaged in a variety of engineering and design activities as well as basic research and development activities directed to the substantial improvement or new application of the Company's existing technologies. These costs are expensed when incurred and included in cost of products sold. Research and development, design and related engineering amounted to \$20.6 million and \$13.3 million for the three months ended June 28, 2014 and June 29, 2013, respectively, and \$37.9 million and \$26.1 million for the six months ended June 28, 2014 and June 29, 2013, respectively. Selling, general and administrative expenses include costs primarily related to our sales and marketing departments and administrative departments. Interest expense is shown net of interest income. Interest income was insignificant for the three and six months ended for both June 28, 2014 and June 29, 2013.

**Financial Instruments**

The Company's financial instruments consist primarily of cash and cash equivalents, accounts receivable, accounts payable, notes payable, long-term debt and interest rate swaps. The Company performs periodic credit evaluations of its customers' financial condition and generally does not require collateral. The Company does not hold or issue financial instruments for trading purposes. Due to their short-term nature, the carrying values of cash and equivalents, accounts receivable, accounts payable, and notes payable, if any, approximate fair value. The carrying value of the Company's variable rate long-term debt also approximates fair value due to the variable rate feature of these instruments. The Company's interest rate swaps are recorded at fair value as described under Note 16 - Fair Value and Note 17 - Derivative Financial Instruments.

**Derivatives**

The accounting for changes in the fair value of derivatives depends on the intended use and resulting designation. The Company's use of derivative instruments is limited to cash flow hedges for interest rate risk associated with long-term debt. Interest rate swaps are used to adjust the proportion of total debt that is subject to variable and fixed interest rates. The interest rate swaps are designated as hedges of the amount of future cash flows related to interest payments

on variable-rate debt that, in combination with the interest payments on the debt, convert a portion of the variable-rate debt to fixed-rate debt. The Company records all derivatives on the balance sheet at fair value as described under Note 16 - Fair Value and Note 17 - Derivative Financial Instruments. The related gains or losses, to the extent the derivatives are effective as a hedge, are deferred in shareholders' equity as a component of Accumulated Other Comprehensive Income (Loss) (AOCI) and reclassified into earnings at the time interest expense is recognized on the associated long-term debt. Any ineffectiveness is immediately recorded in the statement of operations.

**Foreign Currency Translation**

The Company accounts for its foreign currency translation in accordance with Accounting Standards Codification (ASC) Topic 830, *Foreign Currency Translation*. The aggregate transaction gain or loss included in operations was insignificant for the periods ending June 28, 2014 and June 29, 2013.

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Loss contingencies may from time to time arise from situations such as claims and other legal actions. Loss contingencies are recorded as liabilities when it is probable that a liability has been incurred and the amount of the loss is reasonably estimable. Disclosure is required when there is a reasonable possibility that the ultimate loss will exceed the recorded provision. Contingent liabilities are often resolved over long time periods. In recording liabilities for probable losses, management is required to make estimates and judgments regarding the amount or range of the probable loss. Management continually assesses the adequacy of estimated loss contingencies and, if necessary, adjusts the amounts recorded as better information becomes known.

**Accounting Pronouncements Adopted in 2014**

On January 1, 2014, the Company adopted the new provisions of Accounting Standards Update ( ASU ) 2013-11, Income Taxes (Topic 740): Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists. The ASU requires the netting of unrecognized tax benefits against a deferred tax asset for a loss or other carryforward that would apply in settlement of the uncertain tax positions. Unrecognized tax benefits are required to be netted against all available same-jurisdiction loss or other tax carryforwards, rather than only against carryforwards that are created by the unrecognized tax benefits. The ASU did not have a significant impact on the Company's financial statements.

On January 1, 2014, the Company adopted the new provisions of Accounting Standards Update ASU 2013-12, Definition of a Public Business Entity - An Addition to the Master Glossary. The ASU amends the Master Glossary of the FASB Accounting Standards Codification to include one definition of public business entity for future use in U.S. GAAP and identifies the types of business entities that are excluded from the scope of the Private Company Decision-Making Framework: A Guide for Evaluating Financial Accounting and Reporting for Private Companies. The ASU did not have a significant impact on the Company's financial statements.

**2) Inventories**

Inventories are stated at the lower of cost or market, cost being determined in accordance with the first-in, first-out method. Inventories are as follows:

| (In thousands)   | June 28,<br>2014 | December 31,<br>2013 |
|------------------|------------------|----------------------|
| Finished Goods   | \$ 25,061        | \$ 21,627            |
| Work in Progress | 45,238           | 15,017               |
| Raw Material     | 57,021           | 48,625               |
|                  | \$ 127,320       | \$ 85,269            |

The Company records valuation reserves to provide for excess, slow moving or obsolete inventory or to reduce inventory to the lower of cost or market value. In determining the appropriate reserve, the Company considers the age of inventory on hand, the overall inventory levels in relation to forecasted demands as well as reserving for specifically identified inventory that the Company believes is no longer salable.

**3) Property, Plant and Equipment**



The following table summarizes Property, Plant and Equipment as follows:

| (In thousands)                | June 28,<br>2014 | December 31,<br>2013 |
|-------------------------------|------------------|----------------------|
| Land                          | \$ 6,724         | \$ 6,742             |
| Buildings and Improvements    | 57,479           | 45,551               |
| Machinery and Equipment       | 66,767           | 54,369               |
| Construction in Progress      | 21,409           | 1,527                |
|                               | 152,379          | 108,189              |
| Less Accumulated Depreciation | 42,227           | 37,289               |
|                               | \$ 110,152       | \$ 70,900            |

**Table of Contents****4) Intangible Assets**

The following table summarizes acquired intangible assets as follows:

| (In thousands)                      | Weighted<br>Average Life | June 28, 2014            |                             | December 31, 2013        |                             |
|-------------------------------------|--------------------------|--------------------------|-----------------------------|--------------------------|-----------------------------|
|                                     |                          | Gross Carrying<br>Amount | Accumulated<br>Amortization | Gross Carrying<br>Amount | Accumulated<br>Amortization |
| Patents                             | 7 Years                  | \$ 2,146                 | \$ 984                      | \$ 2,146                 | \$ 891                      |
| Trade Names                         | 8 Years                  | 7,453                    | 893                         | 7,453                    | 552                         |
| Completed and Unpatented Technology | 9 Years                  | 16,667                   | 3,356                       | 15,377                   | 2,620                       |
| Backlog and Customer Relationships  | 11 Years                 | 86,867                   | 10,941                      | 88,998                   | 7,210                       |
| <b>Total Intangible Assets</b>      | <b>8 Years</b>           | <b>\$ 113,133</b>        | <b>\$ 16,174</b>            | <b>\$ 113,974</b>        | <b>\$ 11,273</b>            |

All acquired intangible assets other than goodwill and one trade name are being amortized. Amortization expense for acquired intangibles is summarized as follows:

| (In thousands)       | Six Months Ended |                  | Three Months Ended |                  |
|----------------------|------------------|------------------|--------------------|------------------|
|                      | June 28,<br>2014 | June 29,<br>2013 | June 28,<br>2014   | June 29,<br>2013 |
| Amortization Expense | \$ 4,904         | \$ 935           | \$ 2,437           | \$ 468           |

Amortization expense for intangible assets expected for 2014 and for each of the next five years is summarized as follows:

| (In thousands) |          |
|----------------|----------|
| 2014           | \$ 9,927 |
| 2015           | 7,907    |
| 2016           | 7,731    |
| 2017           | 7,723    |
| 2018           | 7,632    |
| 2019           | 7,513    |

**5) Goodwill**

The following table summarizes the changes in the carrying amount of goodwill for 2014:

| (In thousands) | December 31,<br>2013 | Acquisition | Foreign<br>Currency<br>Translation | June 28,<br>2014 |
|----------------|----------------------|-------------|------------------------------------|------------------|
| Aerospace      | \$ 100,998           | 23          | (246)                              | \$ 100,775       |

|              |            |       |       |            |
|--------------|------------|-------|-------|------------|
| Test Systems |            | 1,954 |       | 1,954      |
|              | \$ 100,998 | 1,977 | (246) | \$ 102,729 |

#### 6) *Long-term Debt and Notes Payable*

In connection with the funding of the acquisition of ATS, the Company amended its existing credit facility by entering into Amendment No. 2. to Third Amended and Restated Credit Agreement, dated as of February 28, 2014. The Company elected to exercise its option to increase the revolving credit commitment. The Credit Agreement now provides for a \$125 million five-year revolving credit facility maturing on June 30, 2018, of which \$58.0 million was drawn to finance the acquisition. At June 28, 2014, there is \$36.0 million outstanding on the revolving credit facility. On May 5, 2014, the Company entered into Amendment No. 3 to Third Amended and Restated Credit Agreement for the purpose of revising certain definitions under the Credit Agreement.

There remains approximately \$79.9 million available under the revolving credit facility on June 28, 2014, net of outstanding letters of credit. The credit facility allocates up to \$20 million of the \$125 million revolving credit line for the issuance of letters of credit, including certain existing letters of credit. At June 28, 2014, outstanding letters of credit totaled \$9.1 million. In addition, the Company is required to pay a commitment fee quarterly at a rate of between 0.25% and 0.50% per annum on the unused portion of the total revolving credit commitment, based on the Company's Leverage Ratio.

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There is \$182.9 million outstanding under the term loan under the Credit Agreement and such term loan continues to mature on June 30, 2018.

The amended facility temporarily increases the maximum leverage ratio permitted under the agreement to 4.0 to 1.0 for fiscal quarters ending March 29, 2014 and June 28, 2014, 3.75 to 1.0 as of the end of fiscal quarters from September 30, 2014 through March 31, 2015 and 3.5 to 1.0 as of the end of each fiscal quarter subsequent to March 31, 2015 to maturity. There were no changes to the other covenants, interest rates being charged or commitment fees.

Remaining principal maturities of long-term debt each year are approximately:

|                |                   |
|----------------|-------------------|
| (In thousands) |                   |
| 2014           | \$ 9,190          |
| 2015           | 15,563            |
| 2016           | 20,398            |
| 2017           | 22,703            |
| 2018           | 168,002           |
| Thereafter     | 9,762             |
|                | <b>\$ 245,618</b> |

**7) Product Warranties**

In the ordinary course of business, the Company warrants its products against defects in design, materials and workmanship typically over periods ranging from twelve to sixty months. The Company determines warranty reserves needed by product line based on experience and current facts and circumstances. Activity in the warranty accrual is summarized as follows:

| (In thousands)                 | Six Months Ended |                  | Three Months Ended |                  |
|--------------------------------|------------------|------------------|--------------------|------------------|
|                                | June 28,<br>2014 | June 29,<br>2013 | June 28,<br>2014   | June 29,<br>2013 |
| Balance at beginning of period | \$ 2,796         | \$ 2,551         | \$ 3,737           | \$ 2,451         |
| Acquisitions                   | 790              |                  |                    |                  |
| Warranties issued              | 876              | 333              | 547                | 285              |
| Warranties settled             | (803)            | (416)            | (469)              | (278)            |
| Reassessed warranty exposure   | 266              | 116              | 110                | 126              |
| Balance at end of period       | \$ 3,925         | \$ 2,584         | \$ 3,925           | \$ 2,584         |

**8) Income Taxes**

The Company recognizes deferred tax assets and liabilities for the expected future tax consequences of temporary differences between the financial reporting and tax basis of assets and liabilities. Deferred tax assets are reduced, if deemed necessary, by a valuation allowance for the amount of tax benefits which are not expected to be realized.

Investment tax credits are recognized on the flow through method.

ASC Topic 740-10 *Overall - Uncertainty in Income Taxes* ( ASC Topic 740-10 ) clarifies the accounting and disclosure for uncertainty in tax positions. ASC Topic 740-10 seeks to reduce the diversity in practice associated with certain aspects of the recognition and measurement related to accounting for income taxes. The Company is subject to the provisions of ASC Topic 740-10 and has analyzed filing positions in all of the federal and state jurisdictions where it is required to file income tax returns, as well as all open tax years in these jurisdictions. Should the Company need to accrue a liability for uncertain tax benefits, any interest associated with that liability will be recorded as interest expense. Penalties, if any, would be recognized as operating expenses. There were no penalties or interest liability accrued as of June 28, 2014 or December 31, 2013, nor were any penalties or interest costs included in expense for the three and six month periods ending June 28, 2014 and June 29, 2013. The years under which we conducted our evaluation coincided with the tax years currently still subject to examination by major federal and state tax jurisdictions, those being 2010 through 2013 for federal purposes and 2009 through 2013 for state purposes.

The effective tax rates were approximately 33.9% and 26.1% for the six months and 34.0% and 33.2% for the three months ended June 28, 2014 and June 29, 2013, respectively. The effective tax rate for the second quarter of 2014 was lower than the federal statutory rate, due to the domestic production activity deduction and lower effective tax rates on foreign income. The effective tax rate for the first six months of 2013 was impacted primarily by the domestic production activity deduction, the recognition of approximately \$1.1 million in domestic 2012 R&D tax credits and \$0.4 million in domestic 2013 R&D tax credits.

**Table of Contents****9) Shareholders Equity**

The changes in shareholders equity for the six months ended June 28, 2014 are summarized as follows as adjusted to reflect the impact of the one-for-five distribution of Class B Stock as discussed in Note 10:

| (Dollars and Shares in thousands)                             | Amount     | Number of Shares |                           |
|---|------------|------------------|---------------------------|
|   |            | Common Stock     | Convertible Class B Stock |
| Shares Authorized   |            | 40,000           | 10,000                    |
| Share Par Value   |            | \$ 0.01          | \$ 0.01                   |
| <b>COMMON STOCK</b>   |            |                  |                           |
| Beginning of Period   | \$ 179     | 13,268           | 4,590                     |
| Conversion of Class B Shares to Common Shares                 |            | 618              | (618)                     |
| Exercise of Stock Options                                     | 2          | 131              | 113                       |
| End of Period   | \$ 181     | 14,017           | 4,085                     |
| <b>ADDITIONAL PAID IN CAPITAL</b>                             |            |                  |                           |
| Beginning of Period   | \$ 40,826  |                  |                           |
| Stock Compensation Expense                                    | 866        |                  |                           |
| Exercise of Stock Options                                     | 2,063      |                  |                           |
| End of Period   | \$ 43,755  |                  |                           |
| <b>ACCUMULATED OTHER COMPREHENSIVE LOSS</b>                   |            |                  |                           |
| Beginning of Period   | \$ (3,611) |                  |                           |
| Foreign Currency Translation Adjustment                       | (568)      |                  |                           |
| Change in Accumulated (Loss) Income on Derivatives Net of Tax | (8)        |                  |                           |
| Retirement Liability Adjustment Net of Tax                    | 208        |                  |                           |
| End of Period   | \$ (3,979) |                  |                           |
| <b>RETAINED EARNINGS</b>                                      |            |                  |                           |
| Beginning of Period   | \$ 134,115 |                  |                           |
| Net Income  | 20,651     |                  |                           |
| End of Period   | \$ 154,766 |                  |                           |
| <b>TOTAL SHAREHOLDERS EQUITY</b>                              |            |                  |                           |
| Beginning of Period   | \$ 171,509 |                  |                           |
| End of Period   | \$ 194,723 |                  |                           |

**10) Earnings Per Share**

Basic and diluted weighted-average shares outstanding are as follows:

| (In thousands)                       | Six Months Ended |                  | Three Months Ended |                  |
|--------------------------------------|------------------|------------------|--------------------|------------------|
|                                      | June 28,<br>2014 | June 29,<br>2013 | June 28,<br>2014   | June 29,<br>2013 |
| Weighted average shares - Basic      | 18,013           | 17,403           | 18,070             | 17,413           |
| Net effect of dilutive stock options | 860              | 806              | 795                | 793              |
| Weighted average shares - Diluted    | 18,873           | 18,209           | 18,865             | 18,206           |

The above information has been adjusted to reflect the impact of the one-for-five distribution of Class B Stock for shareholders of record on October 10, 2013.

Stock options with exercise prices greater than the average market price of the underlying common shares are excluded from the computation of diluted earnings per share because they are out-of-the-money and the effect of their inclusion would be anti-dilutive. The number of common shares covered by out-of-the-money stock options were insignificant at June 28, 2014.

**Table of Contents****11) Accumulated Other Comprehensive Loss and Other Comprehensive Loss**

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

| (In thousands)                                      | June 28,<br>2014 | December 31,<br>2013 |
|---|------------------|----------------------|
| Foreign Currency Translation Adjustments            | \$ 716           | \$ 1,284             |
| Accumulated (Loss) Income on Derivatives Before Tax | (120)            | (107)                |
| Tax Benefit   | 43               | 38                   |
| Accumulated (Loss) Income on Derivatives After Tax  | (77)             | (69)                 |
| Retirement Liability Adjustment Before Tax          | (7,104)          | (7,423)              |
| Tax Benefit   | 2,486            | 2,597                |
| Retirement Liability Adjustment After Tax           | (4,618)          | (4,826)              |
| Accumulated Other Comprehensive Loss                | \$ (3,979)       | \$ (3,611)           |

The components of other comprehensive loss are as follows:

| (In thousands)   | Six Months Ended |                  | Three Months Ended |                  |
|--|------------------|------------------|--------------------|------------------|
|  | June 28,<br>2014 | June 29,<br>2013 | June 28,<br>2014   | June 29,<br>2013 |
| Foreign Currency Translation Adjustments                 | \$ (568)         | \$ (389)         | \$ (182)           | \$ (192)         |
| Change in Accumulated (Loss) Income on Derivatives:      |                  |                  |                    |                  |
| Reclassification to Interest Expense                     | 34               | 70               | 17                 | 33               |
| Net (Decrease) Increase in Fair Value of Derivatives     | (45)             | (11)             | (59)               | 3                |
| Tax Benefit (Expense)                                    | 3                | (21)             | 14                 | (13)             |
| Change in Accumulated (Loss) Income on Derivatives       | (8)              | 38               | (28)               | 23               |
| Retirement Liability Adjustments:                        |                  |                  |                    |                  |
| Reclassifications to General and Administrative Expense: |                  |                  |                    |                  |
| Amortization of prior service cost                       | 265              | 260              | 129                | 130              |
| Amortization of net actuarial gains                      | 54               | 64               | 27                 | 32               |
| Tax Benefit  | (111)            | (113)            | (50)               | (57)             |
| Retirement Liability Adjustment                          | 208              | 211              | 106                | 105              |
| Other Comprehensive Loss                                 | \$ (368)         | \$ (140)         | \$ (104)           | \$ (64)          |



**12) Supplemental Retirement Plan and Related Post Retirement Benefits**

The Company has two non-qualified supplemental retirement defined benefit plans ( SERP and SERP II ) for certain executive officers. The following table sets forth information regarding the net periodic pension cost for the plans.

| (In thousands)                       | Six Months Ended |               | Three Months Ended |               |
|--------------------------------------|------------------|---------------|--------------------|---------------|
|                                      | June 28, 2014    | June 29, 2013 | June 28, 2014      | June 29, 2013 |
| Service cost                         | \$ 124           | \$ 148        | \$ 62              | \$ 74         |
| Interest cost                        | 376              | 310           | 188                | 155           |
| Amortization of prior service cost   | 260              | 248           | 130                | 124           |
| Amortization of net actuarial losses | 54               | 64            | 27                 | 32            |
| Net periodic cost                    | \$ 814           | \$ 770        | \$ 407             | \$ 385        |

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Participants in the SERP are entitled to paid medical, dental and long-term care insurance benefits upon retirement under the plan. The following table sets forth information regarding the net periodic cost recognized for those benefits:

| (In thousands)                     | Six Months Ended |               | Three Months Ended |               |
|------------------------------------|------------------|---------------|--------------------|---------------|
|                                    | June 28, 2014    | June 29, 2013 | June 28, 2014      | June 29, 2013 |
| Service cost                       | \$ 1             | \$ 2          | \$ 1               | \$ 1          |
| Interest cost                      | 16               | 12            | 8                  | 6             |
| Amortization of prior service cost | 12               | 12            | 6                  | 6             |
| Net periodic cost                  | \$ 29            | \$ 26         | \$ 15              | \$ 13         |

**13) Sales to Major Customers**

The Company has a significant concentration of business with three major customers, each in excess of 10% of consolidated sales. The loss of any of these customers would significantly, negatively impact our sales and earnings.

The Company had sales to three customers that represented 17.1%, 17.1% and 14.6% of consolidated sales for the six months ended June 28, 2014 and 22.9%, 15.1% and 14.0% of consolidated sales for the three months ended June 28, 2014. Sales to these customers were in the Aerospace and Test Systems segments.

The Company had sales to one customer in the Aerospace segment that represented 31.5% of consolidated sales for the six months ended June 29, 2013 and 29.5% of consolidated sales for the three months ended June 29, 2013.

Accounts receivable from these customers at June 28, 2014 was \$48.6 million.

**14) Legal Proceedings**

The Company is subject to various legal proceedings, claims, and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, we do not expect these matters will have a material adverse effect on our business, financial position, results of operations, or cash flows. However, the results of these matters cannot be predicted with certainty. Should the Company fail to prevail in any legal matter or should several legal matters be resolved against the Company in the same reporting period, then the financial results of that particular reporting period could be materially adversely affected.

We are a defendant in an action filed in the Regional State Court of Mannheim, Germany (Lufthansa Technik AG v. Astronics Advanced Electronics Systems Corp.) relating to an allegation of patent infringement. The damages sought include injunctive relief, as well as monetary damages. We dispute the allegation and are vigorously defending ourselves in this action. We have filed a nullity action with the Federal Patent Court in Munich, Germany, requesting the court to revoke the German part of the European patent that is subject to the claim. In November 2011, the Regional State Court of Mannheim, Germany, issued an interim decision to the effect that the infringement litigation proceedings be stayed until the Federal Patent Court decides on the concurrent nullity action. In February 2014, The Federal Patent Court issued a written judgment upholding the validity of a portion of the patent. This judgment is subject to appeal. However, as a result the judgment proclaimed by The Federal Patent Court the stay of the

infringement litigation proceedings is no longer effective. At this time we are unable to provide a reasonable estimate of our potential liability or the potential amount of loss related to this action, if any. If the outcome of this litigation is adverse to us, our results and financial condition could be materially affected.

**Table of Contents****15) Segment Information**

Below are the sales and operating profit by segment for the three and six months ended June 28, 2014 and June 29, 2013 and a reconciliation of segment operating profit to income before income taxes. Operating profit is net sales less cost of products sold and other operating expenses excluding interest and corporate expenses. Cost of products sold and other operating expenses are directly identifiable to the respective segment.

| (Dollars in thousands)                     | Six Months Ended  |                   | Three Months Ended |                  |
|--|-------------------|-------------------|--------------------|------------------|
|  | June 28,<br>2014  | June 29,<br>2013  | June 28,<br>2014   | June 29,<br>2013 |
| <b>Sales</b>                               |                   |                   |                    |                  |
| Aerospace                                  | \$ 243,895        | \$ 140,345        | \$ 121,523         | \$ 68,676        |
| Test Systems                               | 71,856            | 4,547             | 53,167             | 2,157            |
| Less Intersegment Sales                    | (237)             | (92)              | (127)              |                  |
|  | 71,619            | 4,455             | 53,040             | 2,157            |
| <b>Total Consolidated Sales</b>            | <b>\$ 315,514</b> | <b>\$ 144,800</b> | <b>\$ 174,563</b>  | <b>\$ 70,833</b> |
| <b>Operating Profit (Loss) and Margins</b> |                   |                   |                    |                  |
| Aerospace                                  | \$ 38,251         | \$ 25,735         | \$ 20,761          | \$ 11,447        |
|  | 15.7%             | 18.3%             | 17.1%              | 16.7%            |
| Test Systems                               | 2,335             | (2,135)           | 4,030              | (610)            |
|  | 3.2%              | (47.0)%           | 7.6%               | (28.3)%          |
| <b>Total Operating Profit</b>              | <b>40,586</b>     | <b>23,600</b>     | <b>24,791</b>      | <b>10,837</b>    |
|  | 12.9%             | 16.3%             | 14.2%              | 15.3%            |
| <b>Deductions from Operating Profit</b>    |                   |                   |                    |                  |
| Interest Expense, net of interest income   | 4,882             | 480               | 2,559              | 262              |
| Corporate Expenses and Other               | 4,478             | 4,558             | 2,310              | 2,857            |
| <b>Income Before Income Taxes</b>          | <b>\$ 31,226</b>  | <b>\$ 18,562</b>  | <b>\$ 19,922</b>   | <b>\$ 7,718</b>  |

**Identifiable Assets**

| (In thousands)      | June 28,<br>2014  | December 31,<br>2013 |
|---------------------|-------------------|----------------------|
| Aerospace           | \$ 448,447        | \$ 428,619           |
| Test Systems        | 115,325           | 11,035               |
| Corporate           | 19,003            | 51,617               |
| <b>Total Assets</b> | <b>\$ 582,775</b> | <b>\$ 491,271</b>    |

## ***16) Fair Value***

ASC Topic 820, *Fair value Measurements and Disclosures*, ( ASC Topic 820 ) defines fair value, establishes a framework for measuring fair value and expands the related disclosure requirements. This statement applies under other accounting pronouncements that require or permit fair value measurements. The statement indicates, among other things, that a fair value measurement assumes that the transaction to sell an asset or transfer a liability occurs in the principal market for the asset or liability or, in the absence of a principal market, the most advantageous market for the asset or liability. ASC Topic 820 defines fair value based upon an exit price model. The Company's assessment of the significance of a particular input to the fair value measurement in its entirety requires judgment, and involves consideration of factors specific to the asset or liability.

ASC Topic 820 establishes a valuation hierarchy for disclosure of the inputs to valuation used to measure fair value. This hierarchy prioritizes the inputs into three broad levels as follows:

Level 1 inputs are quoted prices (unadjusted) in active markets for identical assets or liabilities.

Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument.

Level 3 inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value.

**Table of Contents****On a Recurring Basis:**

A financial asset or liability's classification within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement. The following table provides the financial assets and liabilities carried at fair value measured on a recurring basis as of June 28, 2014 and December 31, 2013:

| (In thousands)                       | Classification      | Total      | Level 1 | Level 2 | Level 3    |
|--------------------------------------|---------------------|------------|---------|---------|------------|
| Interest rate swaps                  | Other Liabilities   |            |         |         |            |
| June 28, 2014                        |                     | \$ (80)    | \$      | \$ (80) | \$         |
| December 31, 2013                    |                     | (108)      |         | (108)   |            |
| Acquisition contingent consideration | Current Liabilities |            |         |         |            |
| June 28, 2014                        |                     | \$ (2,595) | \$      | \$      | \$ (2,595) |
| December 31, 2013                    |                     | (137)      |         |         | (137)      |
| June 28, 2014                        | Other Liabilities   | \$ (3,634) | \$      | \$      | \$ (3,634) |
| December 31, 2013                    |                     | (5,709)    |         |         | (5,709)    |

Interest rate swaps are securities with no quoted readily available Level 1 inputs, and therefore are measured at fair value using inputs that are directly observable in active markets and are classified within Level 2 of the valuation hierarchy, using the income approach (See Note 17).

Our Level 3 fair value liabilities represent contingent consideration recorded related to the 2011 Ballard acquisition, to be paid up to a maximum of \$5.5 million if certain revenue growth targets are met over the next three years, the 2012 Max-Viz acquisition, to be paid up to a maximum of \$8.0 million if certain revenue growth targets are met over the next two years and the 2013 AeroSat acquisition, to be paid up to a maximum of \$53.0 million if certain revenue growth targets are met over the next two years. The calculation of additional purchase consideration ( Earn Out ) related to the acquisition of AeroSat is as follows:

|      | AeroSat Revenue              | Earn Out Formula  |
|------|------------------------------|---|
| 2014 | <\$30 million                | No Earn Out   |
|      | >\$30 million < \$50 million | (AeroSat Revenue X 15%) x ((AeroSat Revenue-\$30 million)/\$20 million) |
|      | >\$50 million                | AeroSat Revenue X 15%   |
| 2015 | <\$40 million                | No Earn Out   |
|      | >\$40 million < \$60 million | (AeroSat Revenue X 15%) x ((AeroSat Revenue-\$40 million)/\$20 million) |
|      | >\$60 million                | AeroSat Revenue X 15%   |

The amounts recorded were calculated using an estimate of the probability of future revenue. The varying contingent payments were then discounted to the present value utilizing a discounted cash flow methodology. The contingent consideration liabilities have no observable Level 1 or Level 2 inputs.

**On a Non-recurring Basis:**

In accordance with the provisions of ASC Topic 350 *Intangibles - Goodwill and Other*, the Company estimates the fair value of reporting units, utilizing unobservable Level 3 inputs. Level 3 inputs require significant management judgment due to the absence of quoted market prices or observable inputs for assets of a similar nature. The Company utilizes a discounted cash flow analysis to estimate the fair value of reporting units utilizing unobservable inputs. The

fair value measurement of the reporting unit under the step-one and step-two analysis of the quantitative goodwill impairment test are classified as Level 3 inputs.

Intangible assets that are amortized are evaluated for recoverability whenever adverse effects or changes in circumstances indicate that the carrying value may not be recoverable. The recoverability test consists of comparing the undiscounted projected cash flows with the carrying amount. Should the carrying amount exceed undiscounted projected cash flows, an impairment loss would be recognized to the extent the carrying amount exceeds fair value. For the Company's indefinite-lived intangible asset, the impairment test consists of comparing the fair value, determined using the relief from royalty method, with its carrying amount. An impairment loss would be recognized for the carrying amount in excess of its fair value.

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At June 28, 2014, the fair value of goodwill and intangible assets classified using Level 3 inputs are the Max-Viz, Peco, AeroSat, PGA and ATS goodwill and intangible assets acquired were measured at fair value using a discounted cash flow methodology and are classified as Level 3 inputs.

As of June 28, 2014, the Company concluded that no indicators of impairment relating to intangible assets or goodwill existed and an interim test was not performed.

Due to their short-term nature, the carrying value of cash and equivalents, accounts receivable, accounts payable, and notes payable approximate fair value. The carrying value of the Company's variable rate long-term debt instruments also approximates fair value due to the variable rate feature of these instruments.

**17) Derivative Financial Instruments**

At June 28, 2014, we had an interest rate swap with a notional amount of approximately \$1.5 million, entered into on February 6, 2006, related to the Company's Series 1999 New York Industrial Revenue Bond, which effectively fixes the rate at 3.99% plus a spread based on the Company's leverage ratio on this obligation through February 1, 2016.

An interest rate swap entered into on March 19, 2009 related to the Company's term note issued January 30, 2009, was terminated in the third quarter of 2013 with no significant impact to the results of our operations.

At June 28, 2014 and December 31, 2013, the fair value of the interest rate swap was a liability of \$0.1 million which is included in other liabilities (See Note 16 - Fair Value). Amounts expected to be reclassified to earnings in the next twelve months are not expected to be significant.

Activity in AOCI related to these derivatives is summarized below:

| (In thousands)  | Six Months<br>Ended |                  | Three Months Ended |                  |
|---|---------------------|------------------|--------------------|------------------|
|   | June 28,<br>2014    | June 29,<br>2013 | June 28,<br>2014   | June 29,<br>2013 |
| Derivative balance at the beginning of the period in AOCI   | \$ (69)             | \$ (142)         | \$ (49)            | \$ (127)         |
| Net deferral in AOCI of derivatives:                        |                     |                  |                    |                  |
| Net increase in fair value of derivatives                   | (45)                | (11)             | (59)               | 3                |
| Tax effect  | 15                  | 4                | 19                 | (1)              |
|   | (30)                | (7)              | (40)               | 2                |
| Net reclassification from AOCI into earnings:               |                     |                  |                    |                  |
| Reclassification from AOCI into earnings - interest expense | 34                  | 70               | 17                 | 33               |
| Tax effect  | (12)                | (25)             | (5)                | (12)             |
|   | 22                  | 45               | 12                 | 21               |
| Net change in derivatives for the period                    | (8)                 | 38               | (28)               | 23               |
| Derivative balance at the end of the period in AOCI         | \$ (77)             | \$ (104)         | \$ (77)            | \$ (104)         |



***18) Recent Accounting Pronouncements***

The Company's management has reviewed recent accounting pronouncements issued through the date of the issuance of financial statements. In management's opinion, none of these new pronouncements apply or will have a material effect on the Company's financial statements.

**Table of Contents*****19) Acquisitions*****Astronics Test Systems**

On January 20, 2014, we entered into an agreement to purchase substantially all of the assets and liabilities of the Test and Services Division of EADS North America, Inc. for approximately \$69.4 million in cash, including a net working capital adjustment of approximately \$16.4 million. On February 28, 2014, the assets were acquired by our wholly owned subsidiary Astronics Test Systems, Inc. ( *ATS* ). Located in Irvine, California, *ATS* is a leading provider of highly engineered automatic test systems, subsystems and instruments for the semi-conductor, consumer electronics, commercial aerospace and defense industries. *ATS* provides fully customized testing systems and support services for these markets. It also designs and manufactures test equipment under the test instrument brands known as Racal and Talon. The acquisition will strengthen our service offerings and expertise in the test market. This subsidiary is reported as part of our Test Systems segment. The purchase price allocation for this acquisition is not finalized as the fair value determination of assets and liabilities is not complete.

**PGA Electronic s.a.**

On December 5, 2013 we acquired 100% of the stock of PGA, a designer and manufacturer of seat motion and lighting systems primarily for business and first class aircraft seats and is Europe's leading provider of in-flight entertainment/communication systems as well as cabin management systems for private VVIP aircraft. The addition of PGA further diversifies the products and technologies that Astronics offers. The purchase price was approximately \$31.3 million for which approximately \$9.1 million, net of cash acquired, was paid in cash and the balance paid with 264,168 shares of Astronics stock valued at \$51.00 per share. PGA is included in our Aerospace reporting segment. The purchase price allocation for this acquisition is not finalized as the fair value determination of assets and liabilities is not complete.

**Astronics AeroSat Corporation**

On October 1, 2013, we acquired certain assets and liabilities from AeroSat Corporation and related entities, a supplier of aircraft antenna systems for \$12.5 million in cash, plus the potential additional purchase consideration of up to \$53 million based upon the achievement of certain revenue targets in 2014 and 2015. The addition of AeroSat further diversifies the products and technologies that Astronics offers. The additional contingent purchase consideration is recorded at its estimated fair value of approximately \$5.0 million at the date of acquisition based upon the Company's assessment of the probability of AeroSat achieving the revenue growth targets. Substantially all of the goodwill and purchased intangible assets are expected to be deductible for tax purposes over 15 years. AeroSat is included in our Aerospace reporting segment.

The allocation of the purchase price paid for AeroSat is based on fair values of the acquired assets and liabilities assumed of AeroSat as of October 1, 2013.

The allocation of purchase price based on appraised fair values was as follows (In thousands):

|                     |          |
|---------------------|----------|
| Accounts Receivable | \$ 1,712 |
| Inventory           | 4,009    |
| Prepaid Deposits    | 687      |
| Fixed Assets        | 448      |

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|                             |                  |
|-----------------------------|------------------|
| Purchased Intangible Assets | 13,800           |
| Goodwill                    | 1,610            |
| Other Assets                | 65               |
| Accounts Payable            | (286)            |
| Accrued Expenses            | (543)            |
| Customer Deposits           | (4,048)          |
| <b>Total Purchase Price</b> | <b>\$ 17,454</b> |

The amounts allocated to the purchased intangible assets consist of the following:

| (In thousands)        | Weighted<br>Average Life | Acquisition<br>Fair Value |
|-----------------------|--------------------------|---------------------------|
| Trademark             | 10 Years                 | \$ 800                    |
| Technology            | 10 Years                 | 5,300                     |
| Customer Relationship | 12 Years                 | 7,700                     |
|                       |                          | \$ 13,800                 |

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Goodwill and other intangible assets reflected above were determined to meet the criterion for recognition apart from tangible assets acquired and liabilities assumed. The goodwill is primarily attributable to expected synergies and the assembled workforce. Purchased intangible assets and goodwill are deductible for tax purposes.

**Peco, Inc.**

On July 18, 2013, we acquired 100% of the stock of Peco which designs and manufactures highly engineered commercial aerospace interior components and systems for the aerospace industry. The company specializes in PSUs which incorporate air handling, emergency oxygen, electrical power management and cabin lighting systems. It also manufactures a wide range of fuel access doors that meet stringent strength, fuel sealing and anti-corrosion requirements. The addition of Peco diversifies the products and technologies that Astronics offers. We purchased the outstanding stock of Peco for \$136.0 million in cash. Peco is included in our Aerospace reporting segment.

The following summary, prepared on a pro forma basis, combines the consolidated results of operations of the Company with those of Peco as if the acquisition took place on January 1, 2012. The pro forma consolidated results include the impact of certain adjustments, including increased interest expense on acquisition debt, amortization of purchased intangible assets and income taxes.

|   | Six Months Ended                |                               | Three Months Ended              |                                  |
|---|---------------------------------|-------------------------------|---------------------------------|----------------------------------|
|   | June 28,<br>2014 as<br>Reported | June 29,<br>2013 Pro<br>Forma | June 28,<br>2014 as<br>Reported | June 29,<br>2013<br>Pro<br>Forma |
| (in thousands, except earnings per share) |                                 |                               |                                 |                                  |
| Sales                                     | \$ 315,514                      | \$ 187,197                    | \$ 174,563                      | \$ 92,286                        |
| Net Income                                | 20,651                          | 15,803                        | 13,144                          | 6,647                            |
| Basic earnings per share                  | 1.15                            | 0.91                          | 0.73                            | 0.38                             |
| Diluted earnings per share                | 1.09                            | 0.87                          | 0.70                            | 0.37                             |

The pro forma results are not necessarily indicative of what actually would have occurred if the acquisition had been in effect for the three months and six months ended June 28, 2014. In addition, they are not intended to be a projection of future results.

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

*(The following should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations contained in the Company's Form 10-K for the year ended December 31, 2013.)*

**OVERVIEW**

Astronics Corporation, through our subsidiaries, designs and manufactures advanced, high-performance lighting and safety systems, electrical power generation and distribution systems, aircraft structures and avionics products for the global aerospace industry as well as test, training and simulation systems for the military, semi-conductor and consumer electronics markets. On February 28, 2014 we completed the acquisition of substantially all of the assets and liabilities of EADS North America's Test and Services division (Astronics Test Systems or ATS) which is included in our Test Systems segment.

Our Aerospace segment serves four primary markets. They are the commercial transport, military, business jet and other aerospace markets. The Test Systems segment serves the military and defense markets and with the addition of ATS in 2014, the Test Systems segment also serves the commercial electronics and semi-conductor markets.

Our strategy is to invest significantly in engineering, research and development to develop and maintain positions of technical leadership. We expect to leverage those positions to increase our ship set content, growing the amount of content and volume of products we sell and to selectively acquire businesses with similar technical capabilities.

Important factors affecting our growth and profitability are the rate at which new aircraft are produced, government funding of military programs, our ability to have our products designed into the plans for new aircraft and the rates at which aircraft owners, including commercial airlines, refurbish or install upgrades to their aircraft. New aircraft build rates and aircraft owners spending on upgrades and refurbishments is cyclical and dependent on the strength of the global economy. Once designed into a new aircraft, the spare parts business is frequently retained by the Company. With the acquisition of ATS in 2014, future growth and profitability of the test business will be dependent on developing and procuring new and follow-on business in commercial electronics and semi-conductor markets as well as with the military.

**ACQUISITIONS**

On February 28, 2014, Astronics completed the acquisition of substantially all of the assets and liabilities of EADS North America's Test and Services division. Astronics Test Systems is located in Irvine, California and is a leading provider of highly engineered automatic test systems, subsystems and instruments for the semi-conductor, consumer electronics, commercial aerospace and defense industries. The purchase price was approximately \$69.4 million in cash, including a net working capital adjustment of approximately \$16.4 million. The net working capital adjustment is yet to be finalized. The addition of ATS compliments products and technologies that the Astronics Test Segment offers. ATS is included in our Test Systems segment.

On December 5, 2013 we completed the acquisition of 100% of the stock of PGA Electronic s.a. (PGA) located in Chateauroux, France. PGA designs and manufactures seat motion and lighting systems primarily for premium class aircraft seats and is a provider of in-flight entertainment/communication systems as well as cabin management systems for private VVIP aircraft. The addition of PGA further diversifies the products and technologies that Astronics offers. The purchase price was approximately \$31.3 million for which approximately \$9.1 million, net of cash acquired, was paid in cash and the balance paid with 264,168 shares of Astronics stock valued at \$51.00/share.

PGA is included in our Aerospace reporting segment.

On October 1, 2013, we acquired certain assets and liabilities from AeroSat Corporation and related entities, a supplier of aircraft antenna systems for \$12 million in cash, plus contingent purchase consideration ( Earn Out ) of up to a maximum of \$53.0 million based upon the achievement of certain revenue levels in 2014 and 2015. The fair value of the estimated contingent consideration at June 28, 2014 was \$5.6 million. The addition of AeroSat further diversifies the products and technologies that Astronics offers. AeroSat is included in our Aerospace reporting segment.

On July 18, 2013, we completed the acquisition of 100% of the stock of Peco, Inc. which designs and manufactures highly engineered commercial aerospace interior components and systems for the aerospace industry. The company specializes in overhead Passenger Service Units, ( PSUs ) which incorporate air handling, emergency oxygen, electrical power management and cabin lighting systems. It also manufactures a wide range of fuel access doors that meet stringent strength, fuel sealing and anti-corrosion requirements. The addition of Peco diversifies the products and technologies that Astronics offers. We purchased the outstanding stock of Peco for \$136.0 million in cash. Peco is included in our Aerospace reporting segment.

**Table of Contents****CONSOLIDATED RESULTS OF OPERATIONS AND OUTLOOK**

| (Dollars in thousands)                   | Six Months Ended |                  | Three Months Ended |                  |
|--|------------------|------------------|--------------------|------------------|
|  | June 28,<br>2014 | June 29,<br>2013 | June 28,<br>2014   | June 29,<br>2013 |
| Sales                                    | \$ 315,514       | \$ 144,800       | \$ 174,563         | \$ 70,833        |
| Gross Profit                             | \$ 73,207        | \$ 38,900        | \$ 43,202          | \$ 18,681        |
| Gross Profit Percentage                  | 23.2%            | 26.9%            | 24.7%              | 26.4%            |
| SG&A Expenses as a Percentage of Sales   | 11.8%            | 13.7%            | 11.9%              | 15.1%            |
| Interest Expense, net of interest income | \$ 4,882         | \$ 480           | \$ 2,559           | \$ 262           |
| Effective Tax Rate                       | 33.9%            | 26.1%            | 34.0%              | 33.2%            |
| Net Earnings                             | \$ 20,651        | \$ 13,722        | \$ 13,144          | \$ 5,158         |

A discussion by segment can be found at Segment Results of Operations and Outlook in this MD&A.

Financial results include the effect of four business acquisitions Astronics completed from July 2013 through the end of the 2014 first quarter, of which three were in its Aerospace segment and one was in the Test Systems segment.

Consolidated sales for the second quarter of 2014 increased 146.4% to \$174.6 million compared with \$70.8 million for the same period last year. Aerospace segment sales increased \$52.8 million to \$121.5 million and Test Systems segment sales increased \$51.0 million to \$53.0 million. The 2014 second quarter included \$93.8 million in sales from acquired businesses, while organic sales increased \$10.0 million, or 14.1%.

Consolidated sales for the first six months of 2014 increased by 117.9% to \$315.5 million compared with \$144.8 million for the same period last year, an increase of \$170.7 million. Aerospace sales increased \$103.6 million to \$243.9 million and Test Systems sales increased \$67.1 million to \$71.6 million. From July 2013 through the end of the 2014 first quarter, Astronics completed four business acquisitions, three in its Aerospace segment and one in the Test Systems segment. For the first six months of 2014, sales from these acquired businesses contributed \$152.6 million to consolidated sales, while organic sales increased \$18.1 million, or 12.5%.

Consolidated cost of products sold increased \$79.2 million to \$131.4 million in the second quarter of 2014 from \$52.2 million for the same period last year. The increase was due to the cost of products sold associated with increased organic sales volumes and cost of products sold associated with sales from businesses acquired after the second quarter of 2013 totaling \$73.1 million. Consolidated cost of products sold as a percentage of sales was 75.3% in the second quarter of 2014 compared with 73.6% in the second quarter of 2013. Margin leverage achieved from increased organic sales volume was more than offset by costs of approximately \$8.7 million relating to the fair value step-up of inventory from acquired businesses and increased engineering and development ( E&D ) costs. E&D costs were \$20.6 million in the second quarter of 2014, including \$6.7 million for businesses acquired since the second quarter of 2013. E&D costs in last year's second quarter were \$13.3 million.

Consolidated cost of products sold increased \$136.4 million to \$242.3 million in the first six months of 2014 from \$105.9 million for the same period last year. The increase was due to the cost of products sold associated with increased organic sales volumes and the cost of products sold associated with sales from acquired businesses totaling \$124.0 million. Consolidated cost of products sold as a percentage of sales was 76.8% in the first six months of 2014 compared with 73.1% in the first six months of 2013. Margin leverage achieved from increased organic sales volume was more than offset by costs of approximately \$17.4 million relating to the fair value step-up of inventory from acquired businesses and increased E&D costs. Total E&D costs were \$37.9 million in the first six months of 2014,

including \$9.9 million from businesses acquired after last year's second quarter. E&D expense in last year's first six months was \$26.1 million.

Selling, general and administrative ( SG&A ) expenses were \$20.7 million, or 11.9% of sales, in the second quarter of 2014 compared with \$10.7 million, or 15.1% of sales, in the same period last year. The increase was due primarily to the incremental SG&A costs of acquired businesses, which added approximately \$10.6 million to SG&A in the second quarter of 2014, partially offset by lower legal and professional costs when compared with the prior year second quarter.

Selling, general and administrative ( SG&A ) expenses were approximately \$37.1 million, or 11.8% of sales, in the first six months of 2014 compared with \$19.9 million, or 13.7% of sales, in the same period last year. The increase was due primarily to the incremental SG&A costs of acquired businesses, which added approximately \$17.5 million to SG&A in the first six months of 2014 when compared with the same period last year, partially offset by lower legal and professional costs.



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The effective tax rates were approximately 33.9% and 26.1% for the six months and 34.0% and 33.2% for the three months ended June 28, 2014 and June 29, 2013, respectively. The effective tax rate for the second quarter of 2014 was lower than the federal statutory rate, due to the domestic production activity deduction and lower effective tax rates on foreign income. The effective tax rate for the first six months of 2013 was impacted primarily by the domestic production activity deduction, the recognition of approximately \$1.1 million in domestic 2012 U.S. Research & Development ( R&D ) tax credits and \$0.4 million in domestic 2013 R&D tax credits. Assuming that the R&D tax credit is not extended we expect our effective tax rate for the full year of 2014 to be in the range of 33% to 35%.

Net income for the second quarter of 2014 was \$13.1 million or \$0.70 per diluted share, an increase of \$8.0 million from \$5.1 million, or \$0.28 per diluted share in the second quarter of 2013. Net income for the first six months of 2014 was \$20.7 million or \$1.09 per diluted share, an increase of \$7.0 million from \$13.7 million, or \$0.75 per diluted share in the second quarter of 2013. For both the three and six months ended June 28, 2014, the earnings per share increase is due primarily to the increase in net income. Earnings per share for all periods presented have been calculated reflecting the effect of the one-for-five Class B share distribution for shareholders of record on October 10, 2013.

**SEGMENT RESULTS OF OPERATIONS AND OUTLOOK**

Operating profit, as presented below, is sales less cost of products sold and other operating expenses, excluding interest expense and other corporate expenses. Cost of products sold and other operating expenses are directly identifiable to the respective segment. Operating profit is reconciled to earnings before income taxes in Note 15 of the Notes to Consolidated Condensed Financial Statements included in this report.

**AEROSPACE**

| (In thousands)   | Six Months Ended |                  | Three Months Ended |                  |
|------------------|------------------|------------------|--------------------|------------------|
|                  | June 28,<br>2014 | June 29,<br>2013 | June 28,<br>2014   | June 29,<br>2013 |
| Sales            | \$ 243,895       | \$ 140,345       | \$ 121,523         | \$ 68,676        |
| Operating profit | \$ 38,251        | \$ 25,735        | \$ 20,761          | \$ 11,447        |
| Operating Margin | 15.7%            | 18.3%            | 17.1%              | 16.7%            |

|              | June 28,<br>2014 | December 31,<br>2013 |
|--------------|------------------|----------------------|
| Total Assets | \$ 448,447       | \$ 428,619           |
| Backlog      | \$ 204,545       | \$ 207,101           |

**Aerospace Sales by Market**

| (In thousands)       | Six Months Ended |                  | Three Months Ended |                  |
|----------------------|------------------|------------------|--------------------|------------------|
|                      | June 28,<br>2014 | June 29,<br>2013 | June 28,<br>2014   | June 29,<br>2013 |
| Commercial Transport | \$ 195,790       | \$ 97,226        | \$ 96,504          | \$ 46,264        |
| Military             | 21,310           | 20,698           | 12,352             | 12,082           |
| Business Jet         | 18,175           | 15,631           | 8,308              | 6,966            |
| Other                | 8,620            | 6,790            | 4,359              | 3,364            |

\$ 243,895    \$ 140,345    \$ 121,523    \$ 68,676

**Aerospace Sales by Product Line**

| (In thousands)            | Six Months Ended |                  | Three Months Ended |                  |
|---------------------------|------------------|------------------|--------------------|------------------|
|                           | June 28,<br>2014 | June 29,<br>2013 | June 28,<br>2014   | June 29,<br>2013 |
| Electrical Power & Motion | \$ 126,482       | \$ 86,651        | \$ 60,651          | \$ 41,855        |
| Lighting & Safety         | 74,598           | 37,208           | 39,507             | 19,091           |
| Avionics                  | 25,250           | 9,696            | 12,497             | 4,366            |
| Structures                | 7,343            |                  | 3,704              |                  |
| Other                     | 10,222           | 6,790            | 5,164              | 3,364            |
|                           | \$ 243,895       | \$ 140,345       | \$ 121,523         | \$ 68,676        |

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Aerospace segment sales increased by \$52.8 million, or 77.0% when compared with the prior year's second quarter to \$121.5 million. Organic sales grew 15.3%, or \$10.5 million, and sales from acquired businesses added \$42.3 million.

Sales to the Commercial Transport market increased \$50.2 million, of which \$38.0 million was related to the acquired businesses with the remaining increase primarily related to higher organic sales of Electrical Power & Motion products. Excluding acquired businesses, sales of Electrical Power & Motion products to the Commercial Transport market increased approximately \$10.7 million as global demand for passenger power systems continued to be strong.

Military sales increased \$0.3 million when compared with the prior year's second quarter as \$0.8 million of sales contributed by the acquired businesses was partially offset by lower organic sales. Sales to the Business Jet market were up \$1.3 million when compared with last year's second quarter, mostly from the acquired businesses which contributed \$1.2 million in sales.

The \$1.0 million increase in second quarter Other sales was due primarily to approximately \$2.3 million in sales from the acquired businesses which was partially offset by \$1.3 million lower organic revenue.

Aerospace segment sales increased by \$103.6 million, or 73.8%, compared with the prior year's first six months to \$243.9 million. Organic sales grew 14.0%, or \$19.6 million. Sales from acquired businesses were \$83.9 million.

Sales to the Commercial Transport market increased \$98.6 million, including \$73.6 million from the acquired businesses. Excluding acquired businesses, sales of Electrical Power & Motion products to the Commercial Transport market increased approximately \$22.8 million as global demand for passenger power systems continued to be strong. Sales of Lighting and Safety products to this market increased approximately \$2.3 million.

Military sales increased \$0.6 million when compared with the first six months of 2013. The acquired businesses added \$1.8 million, more than offsetting \$1.2 million in lower organic sales. Sales to the Business Jet market increased \$2.5 million when compared with last year's first half. The acquired businesses contributed \$3.9 million in sales to this market, more than offsetting lower organic sales of \$1.4 million. Both Lighting & Safety and Electrical Power & Motion sales to the Business Jet market decreased slightly from the prior year six-month period. The \$1.8 million increase in the first six months of 2014 Other sales reflected approximately \$4.5 million additional sales from the acquired businesses partially offset by lower organic Other sales.

Aerospace operating profit for the second quarter of 2014 was \$20.8 million, or 17.1% of sales, compared with \$11.4 million, or 16.7% of sales, in the same period last year. Approximately \$4.8 million in operating profit was related to the acquired aerospace businesses. Operating leverage gained on volume for the organic business was partially offset by approximately \$0.7 million of higher organic E&D costs. Aerospace SG&A expense increased \$6.2 million in the second quarter of 2014 as compared with 2013. The increase was due primarily to the incremental SG&A for the acquired businesses, offset slightly by lower legal costs.

Aerospace operating profit for the first six months of 2014 was \$38.3 million, or 15.7% of sales, compared with \$25.7 million, or 18.3% of sales, in the same period last year. The acquired businesses contributed approximately \$6.2 million in operating profit in the period. Leverage achieved from higher organic sales volume was offset by increased organic E&D costs of approximately \$1.9 million. Additionally, cost of products sold had approximately \$2.4 million of expense related to the fair value step-up of inventory from acquired businesses. Aerospace SG&A expense increased \$11.9 million in first six months of 2014 as compared with 2013. The increase was due primarily to the incremental SG&A for the acquired businesses.

2014 Outlook for Aerospace We expect 2014 sales for our Aerospace segment to be in the range of \$485 million to \$505 million. The Aerospace segment's backlog at the end of the second quarter of 2014 was \$204.5 million with approximately \$166.7 million expected to be shipped over the remaining part of 2014 and \$190.2 million is expected to ship over the next 12 months.

**Table of Contents****TEST SYSTEMS**

| (In thousands)          | Six Months Ended |                  | Three Months Ended |                  |
|-------------------------|------------------|------------------|--------------------|------------------|
|                         | June 28,<br>2014 | June 29,<br>2013 | June 28,<br>2014   | June 29,<br>2013 |
| Sales                   | \$ 71,856        | \$ 4,547         | \$ 53,167          | \$ 2,157         |
| Less Intersegment Sales | (237)            | (92)             | (127)              |                  |
| <b>Net Sales</b>        | <b>71,619</b>    | <b>4,455</b>     | <b>53,040</b>      | <b>2,157</b>     |
| Operating profit (loss) | \$ 2,335         | \$ (2,135)       | \$ 4,030           | \$ (610)         |
| Operating Margin        | 3.2%             | (47.9)%          | 7.6%               | (28.3)%          |

|              | June 28,<br>2014 | December 31,<br>2013 |
|--------------|------------------|----------------------|
| Total Assets | \$ 115,325       | \$ 11,035            |
| Backlog      | \$ 122,296       | \$ 7,062             |

| Test Systems Sales by Market | Six Months Ended |                  | Three Months Ended |                  |
|------------------------------|------------------|------------------|--------------------|------------------|
|                              | June 28,<br>2014 | June 29,<br>2013 | June 28,<br>2014   | June 29,<br>2013 |
| (In thousands)               |                  |                  |                    |                  |
| Commercial Electronics       | \$ 57,457        | \$               | \$ 43,120          | \$               |
| Military                     | 14,162           | 4,455            | 9,920              | 2,157            |
|                              | <b>\$ 71,619</b> | <b>\$ 4,455</b>  | <b>\$ 53,040</b>   | <b>\$ 2,157</b>  |

Sales in the 2014 second quarter increased approximately \$50.8 million to \$53.0 million compared with sales of \$2.2 million for the same period in 2013. Incremental sales to both the Commercial Electronics and Military markets from the acquisition of Astronics Test Systems ( ATS ) on February 28, 2014 drove the increase. Sales for the acquired ATS business were \$51.5 million in the second quarter of 2014.

Sales in the first six months of 2014 were up \$67.1 million to \$71.6 million over the prior year period. Incremental sales to both the Commercial Electronics and Military markets from the acquisition of ATS drove the growth. Year-to-date ATS sales were \$68.7 million.

Operating income for the second quarter of 2014 was \$4.0 million compared with an operating loss of \$0.6 million in the same period last year, due to the margin leverage achieved from the increased sales volume provided by the acquisition offset by the impact of \$8.7 million in cost of products sold related to the fair value step-up of inventory, incremental SG&A costs of approximately \$4.0 million and increased E&D costs of approximately \$3.5 million from the acquired business.

Operating income for the first six months of 2014 was \$2.3 million compared with an operating loss of \$2.1 million in the same period last year, due to the margin leverage achieved from the increased sales volume provided by the

acquisition; offset by the impact of \$15.0 million in cost of products sold related to the fair value step-up of inventory, incremental SG&A costs of approximately \$5.1 million, plus increased E&D costs of approximately \$3.7 million from the acquired business.

**2014 Outlook for Test Systems** We expect sales for the Test Systems segment for 2014 to be in the range of \$155 million to \$160 million. The Test Systems segment's backlog at the end of the second quarter of 2014 was \$122.3 million with approximately \$81.6 million expected to be shipped over the remaining part of 2014 and approximately \$104.4 million scheduled to ship over the next 12 months.

## ***LIQUIDITY AND CAPITAL RESOURCES***

### **Operating Activities:**

Cash provided by operating activities totaled \$23.2 million for the first six months of 2014, as compared with \$17.3 million during the same period in 2013. Cash flow from operating activities increased due to higher net income and higher non-cash expenses to net income being offset by the impact of cash used by increases in net operating assets for the first six months of 2014 when compared with the first six months of 2013.

### **Investing Activities:**

Cash used for investing activities was \$90.9 million for the first six months of 2014 compared with \$3.7 million used in the same period of 2013. Cash used for the acquisition of ATS in February of 2014 was \$67.9 million. The increase in cash used for capital expenditures of \$19.4 million related primarily to the acquisition of the new buildings in Clackamas, Oregon. The Company expects capital spending in 2014 to be in the range of \$40 million to \$44 million.

### **Financing Activities:**

Net cash provided by financing activities totaled \$34.0 million compared with cash used of \$4.5 million in the first six months of 2013. The increase was due primarily to the draw of \$58.2 million on the Company's credit facility to acquire ATS on February 28, 2014 offset by higher payments on debt including voluntary payments of approximately \$22.0 million on the company's revolving credit facility.

The Company's cash needs for working capital, debt service and capital equipment during 2014 are expected to be met by cash flows from operations, cash balances and if necessary, utilization of the revolving credit facility.

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On February 28, 2014, in connection with the funding of the acquisition of ATS, the Company amended its existing credit facility by entering into Amendment No 2. to Third Amended and Restated Credit Agreement. The Company elected to exercise its option to increase the revolving credit commitment. The Credit Agreement now provides for a \$125 million five-year revolving credit facility maturing on June 30, 2018, of which \$58.0 million was drawn to finance the acquisition. As of June 28, 2014, the balance owed on the credit facility was \$36.0 million. On May 5, 2014, the Company entered into Amendment No. 3 to Third Amended and Restated Credit Agreement for the purpose of revising certain definitions under the Credit Agreement.

The credit facility carries an interest rate ranging from 225 basis points to 350 basis points above LIBOR, depending on the Company's leverage ratio as defined in the Credit Agreement. In addition, the Company is required to pay a commitment fee of between 25 basis points and 50 basis points quarterly, on the unused portion of the total revolving credit commitment, also based on the Company's Leverage Ratio.

The credit facility allocates up to \$20 million of the \$125 million revolving credit line for the issuance of letters of credit, including certain existing letters of credit. The credit facility is secured by substantially all of the Company's assets. At June 28, 2014, outstanding letters of credit totaled \$9.1 million. There remains approximately \$79.9 million available under the revolving credit facility on June 28, 2014.

The amended facility temporarily increases the maximum leverage ratio of adjusted EBITDA to funded debt as defined in the agreement to 4.0 to 1.0 for fiscal quarters ending March 31, 2014 and June 30, 2014, 3.75 to 1.0 as of the end of fiscal quarters from September 30, 2014 through March 31, 2015 and 3.5 to 1.0 as of the end of each fiscal quarter subsequent to March 31, 2015 to maturity. There were no changes to the other covenants, interest rates being charged or commitment fees. At June 28, 2014 the leverage as defined in the agreement was 2.20:1.

At June 28, 2014, the Company was in compliance with all of the covenants pursuant to the credit facility.

In the event of voluntary or involuntary bankruptcy of the Company or any subsidiary, all unpaid principal and other amounts owing under the Credit Agreement automatically become due and payable. Other events of default, such as failure to make payments as they become due and breach of financial and other covenants, give the agent the option to declare all such amounts immediately due and payable.

**BACKLOG**

The Company's backlog at June 28, 2014 was \$326.8 million compared with \$214.2 million at December 31, 2013 and \$114.5 million at June 29, 2013.

**CONTRACTUAL OBLIGATIONS AND COMMITMENTS**

The following table represents contractual obligations as of June 28, 2014:

| (In thousands)             | Total      | Payments Due by Period |           |            |            |
|----------------------------|------------|------------------------|-----------|------------|------------|
|                            |            | 2014                   | 2015-2016 | 2017-2018  | After 2018 |
| Long-term Debt             | \$ 245,618 | \$ 9,190               | \$ 35,961 | \$ 190,705 | \$ 9,762   |
| Purchase Obligations       | 53,701     | 44,757                 | 8,807     | 137        |            |
| Interest on Long-term Debt | 42,659     | 4,531                  | 20,120    | 17,197     | 811        |
|                            | 14,900     | 197                    | 782       | 782        | 13,139     |

Supplemental Retirement Plan and Post Retirement  
Obligations

|                                      |                   |                  |                  |                   |                  |
|--------------------------------------|-------------------|------------------|------------------|-------------------|------------------|
| Operating Leases                     | 7,358             | 1,354            | 3,223            | 1,884             | 897              |
| Other Long-term Liabilities          | 6,442             | 5                | 6,116            | 257               | 64               |
| <b>Total Contractual Obligations</b> | <b>\$ 370,678</b> | <b>\$ 60,034</b> | <b>\$ 75,009</b> | <b>\$ 210,962</b> | <b>\$ 24,673</b> |

Notes to Contractual Obligations Table

*Purchase Obligations* Purchase obligations are comprised of the Company's commitments for goods and services in the normal course of business.

*Long-Term Debt* See Part 1 Financial Information, Item 1 Financial Statements, Note 6, Long-Term Debt and Notes Payable included in this report.

*Operating Leases* Operating lease obligations are primarily related to facility leases for our AES, AeroSat, Ballard, DME, Max-Viz, Peco, and foreign operations.

**MARKET RISK**

The Company believes that there have been no material changes in the current year regarding the market risk information for its exposure to currency exchange rates or interest rate fluctuations. Refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2013 for a complete discussion of the Company's market risk.



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***CRITICAL ACCOUNTING POLICIES***

Refer to the Company's annual report on Form 10-K for the year ended December 31, 2013 for a complete discussion of the Company's critical accounting policies.

***RECENT ACCOUNTING PRONOUNCEMENTS***

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes the revenue recognition requirements in ASC 605, Revenue Recognition. This ASU requires revenue recognition to depict the transfer of goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. This ASU also requires additional disclosures about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and assets recognized from costs incurred to obtain or fulfill a contract. This ASU can be applied using one of two prescribed retrospective methods, and no early adoption is permitted. The provisions of this ASU are effective for fiscal years beginning after December 15, 2016 and interim periods within those fiscal years. We are currently evaluating the adoption of this standard on our financial statements.

***FORWARD-LOOKING STATEMENTS***

This Quarterly Report contains certain forward looking statements within the meaning of the Private Securities Litigation Reform Act of 1995 that involves uncertainties and risks. These statements are identified by the use of the may, will, should, believes, expects, expected, intends, plans, projects, estimates, predicts, p anticipates, presume and assume, and words of similar import. Readers are cautioned not to place undue reliance on these forward looking statements as various uncertainties and risks could cause actual results to differ materially from those anticipated in these statements. These uncertainties and risks include the success of the Company with effectively executing its plans; successfully integrating its acquisitions; the timeliness of product deliveries by vendors and other vendor performance issues; changes in demand for our products from the U.S. government and other customers; the acceptance by the market of new products developed; our success in cross-selling products to different customers and markets; changes in government contracts; the state of the commercial and business jet aerospace market; the Company's success at increasing the content on current and new aircraft platforms; the level of aircraft build rates; as well as other general economic conditions and other factors. Certain of these factors, risks and uncertainties are discussed in the sections of this report entitled Risk Factors and Management's Discussion and Analysis of Financial Condition and Results of Operations.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

See Market Risk in Item 2, above.

**Item 4. Controls and Procedures**

- a) The Company's management, with the participation of the Company's Chief Executive Officer and Chief Financial Officer, has evaluated the effectiveness of the Company's disclosure controls and procedures as of June 28, 2014. Based on that evaluation, the Company's Chief Executive Officer and Chief Financial Officer concluded that the Company's disclosure controls and procedures were effective as of June 28, 2014.

- b) Changes in Internal Control over Financial Reporting - There have been no changes in our internal control over financial reporting during the most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II - OTHER INFORMATION**

**Item 1. Legal Proceedings**

The Company is subject to various legal proceedings, claims, and litigation arising in the ordinary course of business. While the outcome of these matters is currently not determinable, we do not expect these matters will have a material adverse effect on our business, financial position, results of operations, or cash flows. However, the results of these matters cannot be predicted with certainty. Should the Company fail to prevail in any legal matter or should several legal matters be resolved against the Company in the same reporting period, then the financial results of that particular reporting period could be materially adversely affected.

We are a defendant in an action filed in the Regional State Court of Mannheim, Germany (Lufthansa Technik AG v. Astronics Advanced Electronics Systems Corp.) relating to an allegation of patent infringement. The damages sought include injunctive relief, as well as monetary damages. We dispute the allegation and are vigorously defending ourselves in this action. We have filed a nullity action with the Federal Patent Court in Munich, Germany, requesting the court to revoke the German part of the European patent that is subject to the claim. In November 2011, the Regional State Court of Mannheim, Germany, issued an interim decision to the effect that the infringement litigation proceedings be stayed until the Federal Patent Court decides on the concurrent nullity action. In February 2014, The Federal Patent Court issued a written judgment upholding the validity of a portion of the patent. This judgment is subject to appeal. However, as a result the judgment proclaimed by The Federal Patent Court the stay of the infringement litigation proceedings is no longer effective. At this time we are unable to provide a reasonable estimate of our potential liability or the potential amount of loss related to this action, if any. If the outcome of this litigation is adverse to us, our results and financial condition could be materially affected.

Other than this proceeding, we are not party to any significant pending legal proceedings that management believes will result in material adverse effect on our financial condition or results of operations.

**Item 1a Risk Factors**

In addition to other information set forth in this report, you should carefully consider the factors discussed in Part 1, Item 1A. Risk Factors, in our Annual Report on Form 10-K for the year ended December 31, 2013, which could materially affect our business, financial condition or results of operations. The risks described in our Annual Report on Form 10-K are not the only risks facing us. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or results of operations.

The Company has a significant concentration of business with three customers, each in excess of 10% of consolidated sales, where a significant reduction in sales to any one of these customers would negatively impact our sales and earnings. Combined sales to these customers were approximately 52.0% and 48.7% of consolidated revenue during the three and six month periods ending June 28, 2014, respectively.

Our Test Systems Segment is highly dependent on winning large contract awards in both the military and commercial markets. Our future revenue stream and profits may be impacted significantly if we are not successful in developing new customers or are not selected for new programs by existing customers.

**Table of Contents****Item 2. Unregistered sales of equity securities and use of proceeds**

(c) The following table summarizes the Company's purchases of its common stock for the quarter ended June 28, 2014:

| Period                              | (a)<br>Total number<br>of shares<br>Purchased(1) | (b)<br>Average<br>Price Paid<br>per<br>Share | (c)<br>Total number of<br>shares Purchased<br>as part of Publicly<br>Announced<br>Plans<br>or<br>Programs | (d)<br>Maximum Number<br>of Shares<br>that May<br>Yet Be<br>Purchased<br>Under the<br>Plans or<br>Programs |
|-------------------------------------|--|--|---|--|
| March 30, 2014 - April 26, 2014 (1) | 844  | \$ 62.68                                     |   |  |
| April 27, 2014 - May 24, 2014       |  |  |   |  |
| May 25, 2014- June 28, 2014 (2)     | 1,257  | \$ 56.48                                     |   |  |
| Total                               | 2,101  | \$ 58.98                                     |   |  |

In connection with the exercise of stock options, we accept, from time to time, delivery of shares to pay the exercise price of stock options.

- (1) On April 3, 2014 we accepted delivery of 844 shares at \$62.68 in connection with the exercise of stock options.
- (2) On May 27, 2014, we accepted delivery of 925 shares at \$55.23 in connection with the exercise of stock options. On June 27, 2014, we accepted delivery of 332 shares at \$59.99 in connection with the exercise of stock options.

**Item 3. Defaults Upon Senior Securities**

None.

**Item 4. Mine Safety Disclosures**

None.

**Item 5. Other Information**

None.

**Item 6. Exhibits**

|               |  |
|---------------|--|
| Exhibit 4.1   | Amendment No. 3 to Third Amended and Restated Credit Agreement   |
| Exhibit 31.1  | Section 302 Certification - Chief Executive Officer  |
| Exhibit 31.2  | Section 302 Certification - Chief Financial Officer  |
| Exhibit 32.   | Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 |
| Exhibit 101.1 | Instance Document  |
| Exhibit 101.2 | Schema Document  |
| Exhibit 101.3 | Calculation Linkbase Document  |
| Exhibit 101.4 | Labels Linkbase Document   |
| Exhibit 101.5 | Presentation Linkbase Document   |
| Exhibit 101.6 | Definition Linkbase Document   |

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**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.

**ASTRONICS CORPORATION**  
(Registrant)

Date: August 5, 2014

By: /s/ David C. Burney  
David C. Burney

Vice President-Finance and Treasurer

(Principal Financial Officer)