

EASTERN CO  
Form 10-K  
March 11, 2010  
UNITED STATES SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

**FORM 10-K**

**(Mark One)**

**ANNUAL REPORT PURSUANT TO SECTION 13 or 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**  
For the Fiscal Year ended January 2, 2010

**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 0-599**

**THE EASTERN COMPANY**

(Exact name of registrant as specified in its charter)

**Connecticut**

(State or other jurisdiction of  
incorporation or organization)

**06-0330020**

(IRS Employer  
Identification No.)

**112 Bridge Street, Naugatuck, Connecticut**

(Address of principal executive offices)

**06770**

(Zip Code)

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

Securities registered pursuant to Section 12(b) of the Act: **None**

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

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**Common Stock No Par Value**

(Title of Class)

Indicate by check mark if the registrant is a well known seasoned issuer, as defined in Rule 405 of the Securities Act.

Yes o No **x**

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Act.

Yes o No **x**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days.

Yes **x** No o

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

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K (§229.405 of this chapter) is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. **x**

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

Large accelerated filer o

Accelerated filer **x**

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

Smaller reporting company o

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b2 of the Act).

Yes o No **x**

As of July 4, 2009, the last day of registrant's most recently completed second fiscal quarter, the aggregate market value of the voting stock held by non-affiliates of the registrant was \$86,190,198 (based on the closing sales price of the registrant's common stock on the last trading date prior to that date). Shares of the registrant's common stock held by each officer and director and shares held in trust by the pension plans of the Company have been excluded in that such persons may be deemed to be affiliates. This determination of affiliate status is not necessarily a conclusive determination for other purposes.

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As of February 27, 2010, 6,065,169 shares of the registrant's common stock, no par value per share, were issued and outstanding.

**DOCUMENTS INCORPORATED BY REFERENCE**

Portions of the annual proxy statement dated March 17, 2010 are incorporated by reference into Part III.

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The Eastern Company

Form 10-K

FOR THE FISCAL YEAR ENDED JANUARY 2, 2010

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SAFE HARBOR STATEMENT

UNDER THE PRIVATE SECURITIES

LITIGATION REFORM ACT OF 1995

This Annual Report on Form 10-K contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. Such statements reflect the Company's current expectations regarding its products, its markets and its future financial and operating performance. These statements, however, are subject to risks and uncertainties that may cause the Company's actual results in future periods to differ materially from those expected. Such risks and uncertainties include, but are not limited to, unanticipated slowdowns in the Company's major markets, changing customer preferences, lack of success of new products, loss of customers, competition, increased raw material prices, problems associated with foreign sourcing of parts and products, worldwide conditions and foreign currency fluctuations that may affect results of operations, and other factors discussed from time to time in the Company's filings with the Securities and Exchange Commission. The Company is not obligated to update or revise the aforementioned statements for those new developments.

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**PART I**

**ITEM 1 BUSINESS**

**(a) General Development of Business**

The Eastern Company (the Company) was incorporated under the laws of the State of Connecticut in October, 1912, succeeding a co-partnership established in October, 1858.

The business of the Company is the manufacture and sale of industrial hardware, security products and metal products from four U.S. operations and six wholly-owned foreign subsidiaries. The Company maintains nine physical locations.

**RECENT DEVELOPMENTS**

Effective January 11, 2008 the Company acquired certain assets from Auto-Vehicle Parts Company that included a certain product line owned by one of its divisions, the F.A. Neider Company (Neider). Neider produces the footman loop products, or strap fasteners, which are used to fasten straps, traps, tools, and cargo to a vehicle, container, or trailer. Neider manufactures footman loops used in the following markets: military, aerospace, service body, and trailer. The footman loop product line was integrated into the Company's Industrial Hardware segment. The cost of the Neider acquisition was \$128,325, inclusive of transaction costs. The acquisition was accounted for using the purchase method. The acquired business is included in the consolidated operating results of the Company from the date of acquisition. Neither the actual results nor the pro forma effects of these acquisitions are material to the Company's financial statements.

During the third quarter of 2006, the Company received orders from a military contractor for component parts used in retro-fitting Humvees as part of the military's up-armor program to provide additional troop protection. These component parts were shipped from September 2006 through the early part of the second quarter of 2007. This program resulted in approximately \$39 million in total sales for the Industrial Hardware segment of the Company during the period from September 2006 to April 2007, when the shipments were completed.

**(b) Financial Information about Industry Segments**

Financial information about industry segments is included in Note 11 to the Company's financial statements, included at Item 8 of this Annual Report on Form 10-K.

**(c) Narrative Description of Business**

The Company operates in three business segments: Industrial Hardware, Security Products and Metal Products.

## **Industrial Hardware**

The Industrial Hardware segment consists of Eberhard Manufacturing, Eberhard Hardware Manufacturing Ltd., Canadian Commercial Vehicles Corporation, Eastern Industrial Ltd. and Sesamee Mexicana, S.A. de C.V. The units design, manufacture and market a diverse product line of industrial and vehicular hardware throughout North America. The segment's locks, latches, hinges, handles, lightweight honeycomb composite structures and related hardware can be found on tractor-trailer trucks, moving vans, off-road construction and farming equipment, school buses, military vehicles and recreational boats. They are also used on pickup trucks, sport utility vehicles and fire and rescue vehicles. In addition, the segment manufactures a wide selection of fasteners and other closure devices used to secure access doors on various types of industrial equipment such as metal cabinets, machinery housings and electronic instruments. Eastern Industrial expands the range of offerings of this segment to include plastic injection molding.

Typical products include passenger restraint locks, slam and draw latches, dead bolt latches, compression latches, cam-type vehicular locks, hinges, tool box locks, light-weight sleeper boxes for Class 8 trucks and school bus door closure hardware. The products are sold directly to original equipment manufacturers and to distributors through a distribution channel consisting of in-house salesmen and outside sales representatives. Sales and customer service efforts are concentrated through in-house sales personnel where greater representation of our diverse product lines can be promoted across a variety of markets.

The Industrial Hardware segment sells its products to a diverse array of markets, such as the truck, bus and automotive industries as well as to the industrial equipment, military and marine sectors. Although service, quality and price are major criteria for servicing these markets, the continued introduction of new or improved product designs and the acquisition of synergistic product lines are vital for maintaining and increasing market share.



## Security Products

The Security Products segment, made up of Greenwald Industries, Illinois Lock Company/CCL Security Products/Royal Lock, World Lock Company Ltd. and World Security Industries Ltd., is a leading manufacturer of security products. This segment manufactures electronic and mechanical locking devices, both keyed and keyless, for the computer, electronics, vending and gaming industries. The segment also supplies its products to the luggage, furniture, laboratory equipment and commercial laundry industries. Greenwald manufactures and markets coin acceptors and other coin security products used primarily in the commercial laundry markets, as well as hardware and accessories for the appliance industry. In addition, the segment provides a new level of security for the access control, municipal parking and vending markets through the use of smart card technology.

Greenwald's products include timers, drop meters, coin chutes, money boxes, meter cases, smart cards, value transfer stations, smart card readers, card management software, access control units, oven door latches, oven door switches and smoke eliminators. Illinois Lock Company/CCL Security Products/Royal Lock sales include cabinet locks, cam locks, electric switch locks, tubular key locks and combination padlocks. Many of the products are sold under the names SEARCHALERT<sup>®</sup>, PRESTOSEAL<sup>®</sup>, DUO, X-STAT<sup>®</sup>, EXCALIBUR<sup>®</sup>, WARLOCK<sup>®</sup>, LITE LOCK<sup>®</sup>, SESAMEE<sup>®</sup>, BIG TAG<sup>®</sup>, PRESTOLOCK<sup>®</sup> and HUSKI<sup>®</sup>. These products are sold to original equipment manufacturers, distributors, route operators, and locksmiths via in-house salesmen and outside sales representatives. Sales efforts are concentrated through national and regional sales personnel where greater representation of our diverse product lines can be promoted across a variety of markets.

The Security Products segment continuously seeks new markets where it can offer competitive pricing and provide customers with engineered solutions for their security needs.

## Metal Products

The Metal Products segment, based at the Company's Frazer & Jones facility, is the largest and most efficient producer of expansion shells for use in supporting the roofs of underground mines. This segment also manufactures specialty malleable and ductile iron castings.

Typical products include mine roof support anchors, couplers for railroad braking systems, adjustable clamps for construction and fittings for electrical installations. Mine roof support anchors are sold to distributors and directly to mines, while specialty castings are sold to original equipment manufacturers.

Rising oil and natural gas prices have resulted in continued demand for coal, which has led to increased demand for our highly engineered proprietary mine roof support products produced by this segment of the Company.

## General

Raw materials and outside services were readily available from domestic sources for all of the Company's segments during 2009 and are expected to be readily available in 2010 and the foreseeable future. The Company also obtains materials from Asian affiliated and nonaffiliated sources. The Company has not experienced any significant problems obtaining material from its Asian sources in 2009 and does not expect any

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such problems in 2010. In 2008, the Company experienced price increases for zinc, brass and stainless steel, used mainly in the Industrial Hardware and Security Products segments, as well as scrap iron used in the Metal Products segment. These higher prices had a negative impact on gross margin in 2008. The Company experienced fairly stable raw material prices in 2009. The Company expects raw material prices to increase as demand for raw materials increases with improvements in the world economy. These raw material cost increases could negatively impact the Company's gross margin if raw material prices increase too rapidly for the Company to react or the Company is not able to increase selling prices to its customers to recover these increased costs.

Patent protection for the various product lines within the Company is limited, but is sufficient to protect the Company's competitive positions. Foreign sales and license agreements are not significant.

None of the Company's business segments are seasonal.

The Company, across all its business segments, has increased its emphasis on sales and customer service by fulfilling the rapid delivery requirements of our customers. As a result, investments in additional inventories are made on a selective basis.

Customer lists for all business segments are broad-based geographically and by markets, and sales are generally not highly concentrated by customer. However, due to the military Humvee retro-fit contract, one customer in the Industrial Hardware

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Segment accounted for approximately 14% of total sales in 2007. No other customers equaled 10% or more of the Company's consolidated sales for any year presented.

The dollar amount of the backlog of orders received by the Company is believed to be firm as of the fiscal year end January 2, 2010 at \$17,780,000, as compared to \$18,936,000 at January 3, 2009. The primary reasons for the decrease from 2008 to 2009 are the timing of orders received from customers and changes in customer ordering habits, such as not issuing blanket purchase orders due to the continuing uncertain economic conditions.

The Company encounters competition in all of its business segments. The Company has been successful in dealing with this competition by offering high quality diversified products with the flexibility of meeting customer needs on a timely basis. This is accomplished by effectively using internal engineering resources and cost effective manufacturing capabilities, expanding product lines through product development and acquisitions, and maintaining sufficient inventory for fast turnaround of customer orders. However, imports from Asia and Latin America with favorable currency exchange rates and low cost labor have created additional competitive pressures. The Company currently utilizes three wholly-owned subsidiaries in Asia to help offset offshore competition.

Research and development expenditures in 2009 were \$1,331,000 and represented approximately 1% of gross revenues. In 2008 and 2007 they were \$1,293,000 and \$1,439,000, respectively. The research costs are primarily attributable to the Greenwald Industries and Eberhard Mfg. divisions. Greenwald performs ongoing research, in both the mechanical and smart card product lines, which is necessary in order to remain competitive and to continue to provide technologically advanced smart card systems. Eberhard develops new products for the various markets they serve based on changing customer requirements to remain competitive. Other research projects include the development of various locks, and transportation and industrial hardware products.

The Company does not anticipate that compliance with federal, state or local environmental laws or regulations will have a material effect on the Company's capital expenditures, earnings or competitive position.

The average number of employees in 2009 was 597.

### **(d) Financial Information about Geographic Areas**

The Company includes four separate operating divisions located within the United States, two wholly-owned Canadian subsidiaries (one located in Tillsonburg, Ontario, Canada, and one in Kelowna, British Columbia, Canada), a wholly-owned Taiwanese subsidiary located in Taipei, Taiwan, a wholly-owned subsidiary in Hong Kong, a wholly-owned subsidiary in Shanghai, China, and a wholly-owned subsidiary in Lerma, Mexico.

Individually, the Canadian, Taiwanese, Hong Kong, Chinese and Mexican subsidiaries' revenue and assets are not significant. Substantially all other revenues are derived from customers located in the United States.

Financial information about foreign and domestic operations' revenues and identifiable assets is included in Note 1 to the Company's financial statements, included at Item 8 of this Annual Report on Form 10-K. Information about risks attendant to the Company's foreign operations is set

forth at Item 1A of this Annual Report on Form 10-K.

**(e) Available Information**

The Company makes available, free of charge through its Internet website at <http://www.easterncompany.com>, its annual report on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and amendments to those reports filed or furnished pursuant to Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as soon as reasonably practicable after such material is electronically filed with or furnished to the Securities and Exchange Commission. The public may read and copy any materials that the Company files with the SEC at the SEC's Public Reference Room, 450 Fifth Street, N.W., Washington, DC 20549 or by calling the SEC at 1-800-SEC-0330. The Company's reports filed with, or furnished to, the SEC are also available on the SEC's website at [www.sec.gov](http://www.sec.gov).

**ITEM 1A            RISK FACTORS**

In addition to the other information contained in this Form 10-K and the exhibits hereto and the Company's other filings with the SEC, the following risk factors should be considered carefully in evaluating the Company's business. The Company's business, financial condition or results of operation could be materially adversely affected by any of these risks or additional

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risks not presently known to the Company, or by risks the Company currently deems immaterial which may also adversely affect its business, financial condition, or results of operations, such as: changes in the economy, including changes in inflation, tax rates and interest rates; risk associated with possible disruption in the Company's operations due to terrorism and other manmade or natural disasters; future regulatory actions, legal issues or environmental matters; loss of, or changes in, executive management; and changes in accounting standards which are adverse to the Company. Also, there can be no assurance that the Company has correctly identified and appropriately assessed all factors affecting its business or that information publicly available with respect to these matters is complete and correct.

### **The Company's business is subject to risks associated with conducting business overseas.**

International operations could be adversely affected by changes in political and economic conditions, trade protection measures, restrictions on repatriation of earnings, differing intellectual property rights, and changes in regulatory requirements that restrict the sales of products or increase costs. Changes in exchange rates between the U.S. dollar and other currencies could result in increases or decreases in earnings, and may adversely affect the value of the Company's assets outside the United States. The Company's operations are also subject to the effects of international trade agreements and regulations. Although generally these trade agreements have positive effects, they can also impose requirements that adversely affect the Company's business, such as setting quotas on product that may be imported from a particular country into the Company's key markets in North America.

The Company's ability to import products in a timely and cost-effective manner may also be affected by conditions at ports or issues that otherwise affect transportation and warehousing providers, such as port and shipping capacity, labor disputes, severe weather or increased homeland security requirements in the United States or other countries. These issues could delay importation of products or require the Company to locate alternative ports or warehousing providers to avoid disruption to customers. These alternatives may not be available on short notice or could result in higher transit costs, which could have an adverse impact on the Company's business, financial conditions or results of operations.

See also **ITEM 7A - QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK** of this Form 10-K.

In addition, the Company's growth strategy involves expanding sales of its products into foreign markets. There is no guarantee that the Company's products will be accepted by foreign customers or how long it may take to develop sales of the Company's products in these foreign markets.

### **Increases in the price or reduced availability of raw materials.**

Raw materials needed to manufacture products are obtained from numerous suppliers. Under normal market conditions, these raw materials are readily available on the open market from a variety of producers. However, from time to time the prices and availability of these raw materials fluctuate, which could impair the Company's ability to procure the required raw materials for its operations or increase the cost of manufacturing its products. If the price of raw materials increases, the Company may be unable to pass these increases on to its customers and could experience reduction to its profit margins. Also, any decrease in the availability of raw materials could impair the Company's ability to meet production requirements in a timely manner.

### **Increased competition in the markets the Company services could impact revenues and earnings.**

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Any change in competition may result in lost market share or reduced prices, which could result in reduced profit margins. This may impair the ability to grow or even maintain current levels of revenues and earnings. While the Company has an extensive customer base, loss of certain customers could adversely affect the Company's business, financial condition or results of operations until such business is replaced, and no assurances can be made that the Company would be able to regain or replace any lost customers.

**The Company is required to evaluate its internal control over financial reporting under Section 404 of the Sarbanes-Oxley Act of 2002.**

The Company is an accelerated filer as defined in Rule 12b-2 under the Securities Exchange Act of 1934, as amended, and is required to comply with Section 404 of the Sarbanes-Oxley Act of 2002. Section 404 requires the Company to include in its report management's assessment of the effectiveness of the Company's internal control over financial reporting as of the end of the fiscal period for which the Company is filing its 10-K. This report must also include disclosure of any material weaknesses

in internal control over financial reporting that the Company has identified. Additionally, the Company's independent registered public accounting firm is required to issue a report on the Company's internal control over financial reporting and their evaluation of the operating effectiveness of the Company's internal control over financial reporting. The Company's assessment requires it to make subjective judgments, and the independent registered public accounting firm may not agree with the Company's assessment. If the Company or its independent registered public accounting firm were unable to complete the assessments within the period prescribed by Section 404 and thus be unable to conclude that the internal control over financial reporting is effective, investors could lose confidence in the Company's reported financial information, which could have an adverse effect on the market price of the Company's common stock or impact the Company's borrowing ability. In addition, changes in operating conditions and changes in compliance with policies and procedures currently in place may result in inadequate internal control over financial reporting in the future.

**The inability to identify or complete acquisitions could limit future growth.**

As part of its growth strategy, the Company continues to pursue acquisitions of complementary products or businesses. The ability to grow through acquisitions depends upon the Company's ability to identify, negotiate, complete and integrate suitable acquisitions. The Company makes certain assumptions based on the information provided by potential acquisition candidates and also conducts due diligence to ensure the information provided is accurate and based on reasonable assumptions. However, the Company may be unable to realize the anticipated benefits from an acquisition or predict accurately how an acquisition will ultimately affect the business, financial condition or results of operations.

**Demand for new products and the inability to develop and introduce new competitive products at favorable profit margins could adversely affect the Company's performance and prospects for future growth, and the Company would not be positioned to maintain current levels of revenues and earnings.**

The uncertainties associated with developing and introducing new products, such as the market demands and the costs of development and production, may impede the successful development and introduction of new products. Acceptance of the new products may not meet sales expectations due to several factors, such as the Company's failure to accurately predict market demand or its inability to resolve technical issues in a timely and cost-effective manner. Additionally, the inability to develop new products on a timely basis could result in the loss of business to competitors.

**The Company could be subject to litigation which could have a material impact on the Company's business, financial condition or results of operations.**

From time to time, the Company's operations are parties to or targets of lawsuits, claims, investigations and proceedings, including product liability, personal injury, patent and intellectual property, commercial, contract, environmental and employment matters, which are defended and settled in the ordinary course of business. While the Company is unable to predict the outcome of any of these matters, it does not believe, based upon currently available information, that the resolution of any pending matter will have a material adverse effect on its business, financial condition or results of operations. See ITEM 3 LEGAL PROCEEDINGS in this Form 10-K for a discussion of current litigation.

**The Company could be subject to additional tax liabilities.**

The Company is subject to income tax laws in the United States, its states and municipalities and those of other foreign jurisdictions in which the Company has business operations. These laws are complex and subject to interpretations by the taxpayer and the relevant governmental taxing authorities. Significant judgment and interpretation is required in determining the Company's worldwide provision for income taxes. In the ordinary course of business, transactions arise where the ultimate tax determination is uncertain. Although the Company believes its tax

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estimates are reasonable, the final outcome of tax audits and any related litigation could be materially different from that which is reflected in historical income tax provisions and accruals. Based on the status of a given tax audit or related litigation, a material effect on the Company's income tax provision or net income may result during the period or periods from the initial recognition of a particular matter in the Company's reported financial results to the final closure of that tax audit or settlement of related litigation when the ultimate tax and related cash flow is known with certainty.



**The Company's goodwill or indefinite-lived intangible assets may become impaired, which could require a significant charge to earnings to be recognized.**

Under accounting principles generally accepted in the United States, goodwill and indefinite-lived intangible assets are not amortized but are reviewed for impairment at least annually. Future operating results used in the assumptions, such as sales or profit forecasts, may not materialize, and the Company could be required to record a significant charge to earnings in the financial statements during the period in which any impairment is determined, resulting in an unfavorable impact on our results of operations. Numerous assumptions are used in the evaluation of impairment, and there is no guarantee that the Company's independent registered public accounting firm would reach the same conclusion as the Company or an independent valuation firm, which could result in a disagreement between management and the independent registered public accounting firm.

**The Company may need additional capital in the future, and it may not be available on acceptable terms, if at all.**

From time-to-time, the Company has historically relied on outside financing to fund expanded operations, capital expenditure programs and acquisitions. The Company may require additional capital in the future to fund operations or strategic opportunities. The Company cannot be assured that additional financing will be available on favorable terms, or at all. In addition, the terms of available financing may place limits on the Company's financial and operating flexibility. If the Company is unable to obtain sufficient capital in the future, the Company may not be able to expand or acquire complementary businesses and may not be able to continue to develop new products or otherwise respond to changing business conditions or competitive pressures.

**The Company's stock price is highly volatile due to low float, which is the number of shares of the Company's common stock that are outstanding and available for trading by the public.**

The Company's stock price may change dramatically when buyers seeking to purchase shares of the Company's common stock exceed the shares available on the market, or when there are no buyers to purchase shares of the Company's common stock when shareholders are trying to sell their shares.

**The Company may not be able to reach acceptable terms for contracts negotiated with its labor unions and be subject to work stoppages or disruption of production.**

During 2010, union contracts covering approximately 18% of the total workforce of the Company will expire. The Company has been successful in negotiating new contracts over the years, but cannot guarantee that will continue. Failure to negotiate new union contracts could result in disruption of production, inability to deliver product or a number of unforeseen circumstances, any of which could have an unfavorable material impact on the Company's results of operations or financial statements.

**Deterioration in the creditworthiness of several major customers could have a material impact on the Company's business, financial condition or results of operations.**

Included as a significant asset on the Company's balance sheet is accounts receivable from our customers. If several large customers become insolvent or otherwise unable to pay for products, or become unwilling or unable to make payments in a timely manner, it could have an

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unfavorable material impact on the Company's results of operations or financial statements. Although the Company is not dependent on any one customer, and the Company does not have any customers exceeding 10% of total accounts receivable, deterioration in several large customers at the same time could have an unfavorable material impact on the Company's results of operations or financial statements.

**The Company's operating results may fluctuate, which makes the results of operations difficult to predict and could cause the results to fall short of expectations.**

The Company's operating results may fluctuate as a result of a number of factors, many outside of our control. As a result, comparing the Company's operating results on a period-to-period basis may not be meaningful, and past results should not be relied upon as an indication of future performance. Quarterly, year to date and annual costs and expenses as a percentage of revenue may differ significantly from historical or projected rates. Future operating results may fall below expectations. These types of events could cause the price of the Company's stock to fall.

**New or existing U.S. or foreign laws could subject the Company to claims or otherwise impact the Company's business, financial condition or results of operations.**

The Company is subject to a variety of laws in both the U.S. and foreign countries that are costly to comply with, can result in negative publicity and diversion of management time and effort, and can subject the Company to claims or other remedies.

**ITEM 1B UNRESOLVED STAFF COMMENTS**

None.

**ITEM 2 PROPERTIES**

The corporate office of the Company is located in Naugatuck, Connecticut in a two-story 8,000 square foot administrative building on 3.2 acres of land.

All of the Company's properties are owned or leased and are adequate to satisfy current requirements. All of the Company's properties have the necessary flexibility to cover any long-term expansion requirements.

**The Industrial Hardware Group includes the following:**

The Eberhard Manufacturing Division in Strongsville, Ohio owns 9.6 acres of land and a building containing 138,000 square feet, located in an industrial park. The building is steel frame, one-story, having curtain walls of brick, glass and insulated steel panel. The building has two high bays, one of which houses two units of automated warehousing.

The Eberhard Hardware Manufacturing, Ltd., a wholly-owned Canadian subsidiary in Tillsonburg, Ontario, owns 4.4 acres of land and a building containing 31,000 square feet in an industrial park. The building is steel frame, one-story, having curtain walls of brick, glass and insulated steel panel. It is particularly suited for light fabrication, assembly and warehousing and is adequate for long-term expansion requirements.

The Canadian Commercial Vehicles Corporation, a wholly-owned subsidiary in Kelowna, British Columbia, leases 55,415 square feet of building space located in an industrial park. The building is made from brick and concrete, contains approximately 5,400 square feet of office space on two levels and houses a modern paint booth for finishing our products. The building is protected by a F1 rated fire suppression system and alarmed for fire and security. The current lease expires December 31, 2012 and is renewable.

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The Eastern Industrial Ltd., a wholly-owned subsidiary in Shanghai, China, leases brick and concrete buildings containing approximately 47,500 square feet, located in both industrial and commercial areas. A five-year lease was signed in 2009, which expires on March 31, 2014.

The Sesamee Mexicana subsidiary moved in November 2009 into a leased facility containing approximately 64,250 square feet located in an industrial park in Lerma, Mexico. The current lease expires October 15, 2012 and is renewable. The building is steel framed with concrete block and glass curtain walls.

### **The Security Products Group includes the following:**

The Greenwald Industries Division in Chester, Connecticut owns 26 acres of land and a building containing 120,000 square feet. The building is steel frame, one story, having brick over concrete blocks.

The Illinois Lock Company/CCL Security Products/Royal Lock Division owns 2.5 acres of land and a building containing 44,000 square feet in Wheeling, Illinois. The building is brick and located in an industrial park.

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The World Lock Co. Ltd. subsidiary leases 5,285 square feet located in Taipei, Taiwan. The building is made from brick and concrete and is protected by a fire alarm and sprinklers.

### **The Metal Products Group consists of:**

The Frazer and Jones Division in Solvay, New York owns 17.9 acres of land and buildings containing 205,000 square feet constructed for foundry use. These facilities are well adapted to handle the division's current and future casting requirements.

All owned properties are free and clear of any encumbrances.

### **ITEM 3           LEGAL PROCEEDINGS**

During 2008, the Company reached a settlement relating to an investigation by the U.S. Department of Environmental Protection and N.Y. Department of Environmental Conservation relating to various anonymous complaints regarding its metal castings facility. Settlement payments and remediation costs approximated \$250,000.

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

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

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

**PART II****ITEM 5 MARKET FOR REGISTRANT'S COMMON EQUITY, RELATED STOCKHOLDER MATTERS AND ISSUER PURCHASES OF EQUITY SECURITIES**

The Company's common stock is traded on the NYSE Amex (formerly the American Stock Exchange) (ticker symbol **EML**). The approximate number of record holders of the Company common stock on January 2, 2010 was 525.

High and low stock prices and dividends for the last two years were:

Quarter	2009			Quarter	2008		
	Market Price High	Low	Dividend		Market Price High	Low	Dividend
First	\$12.43	\$8.11	\$.09	First	\$18.55	\$14.51	\$.08
Second	17.48	10.35	.09	Second	20.00	15.00	.08
Third	18.42	15.30	.09	Third	16.10	13.10	.08
Fourth	17.57	11.14	.09	Fourth	13.40	7.88	.09

The Company increased the dividend rate by 12.5% in the fourth quarter of 2008. The Company expects to continue its policy of paying regular cash dividends, although there is no assurance as to future dividends because they are dependent on future earnings, capital requirements, and financial conditions. The payment of dividends is subject to the restrictions of the Company's loan agreement if such payment would result in an event of default. See Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operations, and Note 5 to the Company's financial statements included at Item 8 of this Annual Report on Form 10-K.

The following table sets forth information regarding securities authorized for issuance under the Company's equity compensation plans as of January 2, 2010, including the Company's 1995 and 2000 plans.

**Equity Compensation Plan Information**

Plan category	Number of securities to be issued upon exercise of outstanding options, warrants and rights (a)	Weighted-average exercise price of outstanding options, warrants and rights (b)	Number of securities remaining available for future issuance under equity compensation plans (excluding securities reflected in column (a)) (c)
Equity compensation plans approved by security holders	221,750 <sup>1</sup>	\$10.58	367,500 <sup>2</sup>
Equity compensation plans not approved by security holders	-	-	-
Total	221,750	10.58	367,500

<sup>1</sup> Includes options outstanding under the 1995 and 2000 plans.

<sup>2</sup> Includes shares available for future issuance under the 2000 plan, which expires July 19, 2010 under the

terms of the plan.

Each director who is not an employee of the Company ( Outside Director ) is paid a director s fee for his services at the annual rate of \$24,600. All annual fees paid to non-employee members of the Board of Directors of the Company are paid in common stock of the Company or cash, in accordance with the Directors Fee Program adopted by the shareholders on March 26, 1997 and amended on January 5, 2004. The directors make an annual election, within a reasonable time before their first quarterly payment, to receive their fees in the form of cash, stock or a combination thereof. The election remains in force for one year.

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### Issuer Purchases of Equity Securities

Period	(a) Total Number of Shares Purchased	(b) Average Price Paid per Share	(c) Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	(d) Maximum Number that May Yet Be Purchased Under the Plans or Programs
October 4 - October 31, 2009	-	-	-	-
November 1 - November 28, 2009	12,422	\$15.35	-	-
November 29, 2009 - January 2, 2010	27,638	13.80	-	-
<b>Total</b>	<b>40,060</b>	<b>\$14.28</b>	<b>-</b>	<b>-</b>

The Company does not have any share repurchase plans or programs. The figures shown in the table above are for shares delivered to the Company to exercise stock options.

### Stock Performance Graph

The following graph sets forth the Company's cumulative total shareholder return based upon an initial \$100 investment made on December 31, 2004 (i.e., stock appreciation plus dividends during the past five fiscal years) compared to the Wilshire 5000 Index and the S&P Industrial Machinery Index.

The Company manufactures and markets a broad range of locks, latches, fasteners and other security hardware that meets the diverse security and safety needs of industrial and commercial customers. Consequently, while the S&P Industrial Machinery Index being used for comparison is the standard index most closely related to the Company, it does not completely represent the Company's products or market applications. The Wilshire 5000 is a market index made up of 5,000 publicly-traded companies, including those having both large and small capitalization.

	<b>Dec. 04</b>	<b>Dec. 05</b>	<b>Dec. 06</b>	<b>Dec. 07</b>	<b>Dec. 08</b>	<b>Dec. 09</b>
<b>The Eastern Company</b>	\$100	\$99	\$152	\$145	\$70	\$112
<b>Wilshire 5000</b>	\$100	\$106	\$123	\$130	\$82	\$102
<b>S&amp;P Industrial Machinery</b>	\$100	\$98	\$112	\$136	\$81	\$114

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**ITEM 6 SELECTED FINANCIAL DATA**

	<b>2009</b>	<b>2008</b>	<b>2007</b>	<b>2006</b>	<b>2005</b>
<b>INCOME STATEMENT ITEMS (in thousands)</b>					
Net sales	<b>\$ 112,665</b>	\$ 135,878	\$ 156,281	\$ 138,465	\$ 109,107
Cost of products sold	<b>92,031</b>	110,415	120,343	103,882	84,375
Depreciation and amortization	<b>4,103</b>	4,128	4,370	3,746	3,460
Interest expense	<b>1,728</b>	1,064	1,289	1,098	1,014
Income before income taxes	<b>1,902</b>	6,043	14,845	14,846	7,020
Income taxes	<b>865</b>	1,538	4,765	5,187	2,653
Net income	<b>1,036</b>	4,505	10,081	9,659	4,367
Dividends	<b>2,155</b>	1,938	1,802	1,715	1,600
<b>BALANCE SHEET ITEMS (in thousands)</b>					
Inventories	<b>\$ 24,520</b>	\$ 30,797	\$ 30,491	\$ 28,043	\$ 20,768
Working capital	<b>44,280</b>	48,745	47,028	35,546	31,223
Property, plant and equipment, net	<b>22,974</b>	23,911	25,234	25,816	22,397
Total assets	<b>100,872</b>	106,017	108,352	103,485	81,622
Shareholders' equity	<b>66,597</b>	62,482	70,817	54,391	46,172
Capital expenditures	<b>2,226</b>	2,331	2,868	6,722	1,750
Long-term obligations, less current portion	<b>4,286</b>	11,429	14,383	17,507	12,384
<b>PER SHARE DATA</b>					
Net income per share					
Basic	<b>\$ .17</b>	\$ .77	\$ 1.79	\$ 1.76	\$ .80
Diluted	<b>.17</b>	.73	1.68	1.67	.75
Dividends	<b>.36</b>	.33	.32	.31	.29
Shareholders' equity (Basic)	<b>11.13</b>	10.63	12.58	9.94	8.47
Average shares outstanding:					
Basic	<b>5,985,640</b>	5,875,140	5,631,073	5,474,137	5,455,073
Diluted	<b>6,241,780</b>	6,159,563	5,989,754	5,768,108	5,828,837

The information in the table above reflects a 3-for-2 stock split effective October 2006.

**ITEM 7 MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS****Summary**

Net sales for 2009 decreased 17% to \$112.7 million from \$135.9 million in 2008. Net income for 2009 decreased to \$1.0 million, or \$.17 per diluted share, from \$4.5 million, or \$.73 per diluted share in 2008. Net sales in the Industrial Hardware and Security Products segments decreased approximately 17% and 24%, respectively, in 2009, primarily resulting from the economic slowdown in the many markets we serve. The Metal Products segment sales were comparable in 2009 and 2008, resulting from continued demand for our mine roof support products.

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The following table shows, for the fourth quarter of 2009 and 2008, selected line items from the consolidated statements of income as a percentage of net sales, by segment.

	<b>2009 Fourth Quarter</b>							
	Industrial Hardware		Security Products		Metal Products		Total	
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of products sold	71.6	%	74.9	%	107.4	%	79.2	%
Gross margin	28.4	%	25.1	%	-7.4	%	20.8	%
Selling and administrative expense	14.9	%	18.3	%	8.6	%	15.0	%
Operating profit	13.5	%	6.8	%	-16.0	%	5.8	%
	<b>2008 Fourth Quarter</b>							
	Industrial Hardware		Security Products		Metal Products		Total	
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of products sold	72.7	%	76.8	%	106.1	%	80.3	%
Gross margin	27.3	%	23.2	%	-6.1	%	19.7	%
Selling and administrative expense	14.8	%	18.2	%	8.9	%	14.9	%
Operating profit	12.5	%	5.0	%	-15.0	%	4.8	%

The following table shows the amount of change from the fourth quarter of 2008 to the fourth quarter of 2009 in sales, cost of products sold, gross margin, selling and administrative expenses and operating profit, by segment (dollars in thousands).

	Industrial Hardware		Security Products		Metal Products		Total	
Net sales	\$ (1,706	)	\$ (1,794	)	\$ (796	)	\$ (4,296	)
Volume	-20.1	%	-18.0	%	-16.2	%	-18.6	%
Prices	1.2	%	2.0	%	2.6	%	1.7	%
New Products	<u>7.4</u>	<u>%</u>	<u>0.6</u>	<u>%</u>	=	<u>%</u>	<u>3.6</u>	<u>%</u>
	-11.5	%	-15.4	%	-13.6	%	-13.3	%
Cost of products sold	\$ (1,389	)	\$ (1,563	)	\$ (779	)	\$ (3,731	)
	-12.9	%	-17.4	%	-12.5	%	-14.4	%
Gross margin	\$ (317	)	\$ (231	)	\$ (17	)	\$ (565	)
	-7.9	%	-8.5	%	-4.7	%	-8.9	%
Selling and administrative expenses	\$ (235	)	\$ (314	)	\$ (84	)	\$ (633	)
	-10.8	%	-14.8	%	-16.0	%	-13.1	%
Operating profit	\$ (82	)	\$ 83	)	\$ 67	)	\$ 68	)
	-4.5	%	14.3	%	7.6	%	4.4	%

Net sales in the fourth quarter of 2009 decreased 13% to \$28.0 million from \$32.3 million a year earlier. Net income for the quarter decreased 65% to \$369,000 (or \$.06 per diluted share) from \$1.1 million (or \$.17 per diluted share) a year earlier. The decrease in sales in the fourth quarter from 2008 to 2009 is primarily attributable to the continued economic slowdown in many of the markets served by our Industrial Hardware and Security Products segments and decreases in the contract casting business in the Metal Products segment. The decrease in sales volume of existing products in those segments was partially offset by the introduction of new products and price increases to customers. The decrease in profit in the fourth quarter from 2008 to 2009 is due to the termination of the interest rate swap contract in December 2009, which resulted in a charge to interest expense of \$967,350. See Note 5 to the Company's financial statements included at Item 8 of this Annual Report on Form 10-K.



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Gross margin for the fourth quarter of 2009 decreased 8.9% from the fourth quarter of 2008. The decrease is primarily the result of lower sales volume in the 2009 fourth quarter as a result of the continued economic slowdown which affected many of the markets we serve.

Selling and administrative expenses for the fourth quarter of 2009 decreased 13.1% compared to the prior year quarter. The overall decrease was due to lower payroll and payroll related charges, advertising expense, travel expense and reduced sales commissions as a result of lower sales volume.

### **Authoritative Accounting Guidance**

In December 2007, Financial Accounting Standards Board ( FASB ) issued revised authoritative guidance on disclosures related to Business Combinations. This guidance significantly changed the principles and requirements for how the acquirer of a business recognizes and measures in its financial statements the identifiable assets acquired, the liabilities assumed, and any non-controlling interest in the acquiree. It also provided guidance for recognizing and measuring the goodwill acquired in the business combination and determines what information to disclose to enable users of the financial statements to evaluate the nature and financial effects of the business combination. The Company adopted this guidance effective January 4, 2009. Since this guidance was effective prospectively, except for certain retrospective adjustments to deferred tax balances, its adoption had no impact on the consolidated financial statements of the Company.

In December 2007, the FASB issued authoritative guidance which clarified the classification of noncontrolling interests in consolidated balance sheets and reporting transactions between the reporting entity and holders of noncontrolling interests. Under this guidance, noncontrolling interests are considered equity and reported as an element of consolidated equity. Further, net income encompasses all consolidated subsidiaries with disclosure of the attribution of net income between controlling and noncontrolling interests. The Company adopted this guidance effective January 4, 2009. Since this guidance was effective prospectively, its adoption had no impact on the consolidated financial statements of the Company.

In March 2008, the FASB issued authoritative guidance relating to disclosures about derivative instruments and hedging activities which expanded the disclosure requirements about an entity's derivative instruments and hedging activities. The guidance expanded the disclosure provisions to apply to all entities with derivative instruments. The provisions also apply to related hedged items, bifurcated derivatives, and nonderivative instruments that are designated and qualify as hedging instruments. Entities with instruments must provide more robust qualitative disclosures and expanded quantitative disclosures. Such disclosures generally will need to be presented for every annual and interim reporting period. The Company adopted this guidance effective January 4, 2009. Since this guidance required additional disclosure only, its adoption had no material impact on the consolidated financial statements of the Company.

In April 2008, the FASB issued authoritative guidance relating to the determination of the useful life of intangible assets. This guidance amended the factors that should be considered in developing renewal or extension assumptions used to determine the useful life of a recognized intangible asset. The intent of this guidance was to improve the consistency between the useful life of a recognized intangible asset and the period of expected cash flows used to measure the fair value of the asset in other applicable accounting literature. The Company adopted this guidance effective January 4, 2009. Since this guidance must be applied prospectively, its adoption had no impact on the consolidated financial statements of the Company.

In December 2008, the FASB issued authoritative guidance on employer's disclosures about postretirement benefit plan assets, which requires additional disclosures for assets held by employer pension and other postretirement benefit plans. The required disclosures include information about fair value measurements of plan assets, including the investment policies and strategies for the major categories of plan assets, and significant concentrations of risk within plan assets. This guidance was effective for fiscal years ending after December 15, 2009. Since this guidance provides only disclosure requirements, it did not have a material impact on the consolidated financial statements of the Company.

In May 2009, the FASB issued authoritative guidance on subsequent events, which introduces the concept of financial statements being available to be issued. This guidance will require the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date (that is, whether that date represents the date the financial statements were issued or were available to be issued). For SEC registrants, this date will continue to be the date on which financial statements are filed with the SEC. This guidance was effective for fiscal years and interim periods beginning after June 15, 2009. The adoption of this new guidance had no impact on the consolidated financial statements of the Company. In February 2010, this guidance was effectively reversed for SEC filers because of a potential conflict between the guidance and SEC requirements.

In June 2009, the FASB issued authoritative guidance on consolidation of variable interest entities. The new guidance is intended to improve financial reporting by requiring additional disclosures about a company's involvement in variable interest

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entities. This new guidance is effective for fiscal years and interim periods beginning after November 15, 2009. The Company has not determined the impact, if any, of the adoption of this guidance on the consolidated financial statements of the Company.

In June 2009, the FASB issued The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (the Codification). The Codification is the source for authoritative U.S. Generally Accepted Accounting Principles recognized by the FASB to be applied by non-governmental entities. Rules and interpretive releases of the SEC under the authority of the federal securities laws are also sources of authoritative GAAP for SEC registrants. All other non-grandfathered non-SEC accounting literature not included in the Codification is non-authoritative. The Codification was effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of the Codification had no impact on the consolidated financial statements of the Company.

In August 2009, the FASB issued new accounting guidance to provide clarification on measuring liabilities at fair value when the quoted price in an active market for an identical liability is not available. The new guidance was effective for the first reporting period beginning after August 28, 2009. The adoption of this guidance had no impact on the consolidated financial statements of the Company.

In January 2010, the FASB issued new accounting guidance which requires new disclosures regarding transfers in and out of Level 1 and Level 2 fair value measurements, as well as requiring presentation on a gross basis of information about purchases, sales, issuances and settlements in Level 3 fair value measurements. The guidance also clarifies existing disclosures regarding level of disaggregation, inputs and valuation techniques. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2009. Disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements are effective for fiscal years beginning after December 15, 2010. As this guidance requires only additional disclosure, there should be no impact on the consolidated financial statements of the Company upon adoption.

### **Critical Accounting Policies and Estimates**

The preparation of the financial statements in accordance with accounting principles generally accepted in the United States ( U.S. GAAP ) requires management to make judgments, estimates and assumptions regarding uncertainties that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities, and the reported amounts of revenues and expenses. Areas of uncertainty that require judgments, estimates and assumptions include items such as the accounting for derivatives; environmental matters; the testing of goodwill and other intangible assets for impairment; proceeds on assets to be sold; pensions and other postretirement benefits; and tax matters. Management uses historical experience and all available information to make its estimates and assumptions, but actual results will inevitably differ from the estimates and assumptions that are used to prepare the Company's financial statements at any given time. Despite these inherent limitations, management believes that Management's Discussion and Analysis of Financial Condition and Results of Operations and the financial statements and related footnotes provide a meaningful and fair presentation of the Company.

Management believes that the application of these estimates and assumptions on a consistent basis enables the Company to provide the users of the financial statements with useful and reliable information about the Company's operating results and financial condition.

#### *Allowance for Doubtful Accounts*

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company reviews the collectibility of its receivables on an ongoing basis taking into account a combination of factors. The Company reviews potential problems, such as past due accounts, a bankruptcy filing or deterioration in the customer's financial condition, to ensure the Company is adequately accrued for potential loss. Accounts are considered past due based on when payment was originally due. If a customer's situation changes, such as a bankruptcy or creditworthiness, or there is a change in the current economic climate, the Company may modify its estimate of the allowance for doubtful accounts. The Company will write off accounts receivable after reasonable collection efforts

have been made and the accounts are deemed uncollectible.

*Inventory Reserve*

Inventories are valued at the lower of cost or market. Cost is determined by the last-in, first-out ( LIFO ) method at the Company's U.S. facilities. Accordingly, a LIFO valuation reserve is calculated using the dollar value link chain method.

We review the net realizable value of inventory in detail on an ongoing basis, giving consideration to deterioration, obsolescence and other factors. Based on these assessments, we provide for an inventory reserve in the period in which an impairment is identified. The reserve fluctuates with market conditions, design cycles and other economic factors.

*Goodwill and Other Intangible Assets*

Intangible assets with finite useful lives are amortized generally on a straight-line basis over the periods benefited. Goodwill and other intangible assets with indefinite useful lives are not amortized. Each year during the second quarter, the carrying value of goodwill and other intangible assets with indefinite useful lives is tested for impairment. The Company uses the discounted cash flow method to calculate the fair value of goodwill associated with its reporting units. No impairments of goodwill were deemed to exist. The determination of discounted cash flows is based on the businesses' strategic plans and long-range planning forecasts. The revenue growth rates included in the plans are management's best estimates based on current and forecasted market conditions. Profit margin assumptions are projected by each business based on the current cost structures and anticipated cost reductions. There can be no assurance that operations will achieve the future cash flows reflected in the projections. If different assumptions were used in these plans, the related discounted cash flows used in measuring impairment could be different and an impairment of assets might need to be recorded.

*Pension and Other Postretirement Benefits*

The amounts recognized in the consolidated financial statements related to pension and other postretirement benefits are determined from actuarial valuations. Inherent in these valuations are assumptions about such factors as expected return on plan assets, discount rates at which liabilities could be settled, rate of increase in future compensation levels, mortality rates, and trends in health insurance costs. These assumptions are reviewed annually and updated as required. In accordance with U.S. GAAP, actual results that differ from the assumptions are accumulated and amortized over future periods and, therefore, affect the expense recognized and obligations recorded in future periods.

The discount rate used is based on a single equivalent discount rate derived with the assistance of our actuaries by matching expected future benefit payments in each year to the corresponding spot rates from the Citigroup Pension Liability Yield Curve, comprised of high quality (rated AA or better) corporate bonds. The expected long-term rate of return on assets is also developed with input from the Company's actuarial firms. We consider the Company's historical experience with pension fund asset performance, the current and expected allocation of our plan assets, and expected long-term rates of return. The long-term rate-of-return assumption used for determining net periodic pension expense for 2009 was 8.5%. The Company reviews the long-term rate of return each year. Future actual pension income and expense will depend on future investment performance, changes in future discount rates, and various other factors related to the population of participants in the Company's pension plans.

The Company expects to make cash contributions of approximately \$2.5 million and \$141,000 to its pension plans and postretirement plan, respectively, in 2010.

**RESULTS OF OPERATIONS****Fiscal 2009 Compared to Fiscal 2008**

The following table shows, for 2009 and 2008, selected line items from the consolidated statements of income as a percentage of net sales, by segment.

<b>Industrial Hardware 2009</b>	<b>Security Products</b>	<b>Metal Products</b>	<b>Total</b>
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Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of products sold	75.6	%	78.2	%	103.7	%	81.7	%
Gross margin	24.4	%	21.8	%	-3.7	%	18.3	%
Selling and administrative expense	15.2	%	18.1	%	8.8	%	15.1	%
Operating profit	9.2	%	3.7	%	-12.5	%	3.2	%

**2008**

Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of products sold	77.8	%	77.0	%	102.7	%	81.3	%
Gross margin	22.2	%	23.0	%	-2.7	%	18.7	%
Selling and administrative expense	13.5	%	15.7	%	8.1	%	13.5	%
Operating profit	8.7	%	7.3	%	-10.8	%	5.2	%

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The following table shows the amount of change from 2008 to 2009 in sales, cost of products sold, gross margin, selling and administrative expenses, and operating profit, by segment (dollars in thousands):

	Industrial Hardware		Security Products		Metal Products		Total	
Net sales	\$ (10,086	)	\$ (13,186	)	\$ 59		\$ (23,213)	
Volume	-29.8	%	-29.4	%	-4.9	%	-25.9	%
Prices	0.9	%	4.8	%	2.9	%	2.8	%
New Products	<u>12.1</u>	<u>%</u>	<u>0.7</u>	<u>%</u>	<u>2.3</u>	<u>%</u>	<u>6.0</u>	<u>%</u>
	-16.8	%	-23.9	%	0.3	%	-17.1	%
 Cost of products sold	 \$ (8,979	 )	 \$ (9,661	 )	 \$ 256		 \$ (18,384)	
	-19.2	%	-22.7	%	1.2	%	-16.7	%
 Gross margin	 \$ (1,107	 )	 \$ (3,525	 )	 \$ (197	 )	 \$ (4,829	 )
	-8.3	%	-27.8	%	-34.6	%	-19.0	%
 Selling and administrative expenses	 \$ (488	 )	 \$ (1,033	 )	 \$ 144		 \$ (1,377	 )
	-6.0	%	-11.9	%	8.6	%	-7.5	%
 Operating profit	 \$ (619	 )	 \$ (2,492	 )	 \$ (341	 )	 \$ (3,452	 )
	-11.8	%	-61.8	%	-15.2	%	-49.1	%

### Industrial Hardware Segment

**Net sales** in the Industrial Hardware segment decreased 17% in 2009 from the 2008 level. This decrease was primarily due to reduced sales of existing products to the vehicular markets in 2009 compared to the prior year, while smaller declines were experienced in many of the other markets that use our Industrial Hardware products. New product introductions offset part of the decrease in sales for this segment. All of the new products were internally developed and offered to the many markets we service, including: military, utility truck, vehicular accessories and buses. New products included a lever arm assembly for service bodies, a variety of lightweight composite panels for the marine, transportation, high tech and construction markets, including in the construction of local delivery vans in Mexico where the lighter weight of the vehicles reduces fuel consumption, several new products for the military market including a roof center case assembly, a turret latch and a variety of handles, as well as an assortment of handles and latches used in many of the markets to which we sell.

**Cost of products sold** for the Industrial Hardware segment decreased 19% from 2008 to 2009. The primary reason for this decrease was the lower sales volume in 2009 and lower payroll and payroll related charges compared to the prior year.

**Gross margin** as a percentage of net sales improved from 22% in 2008 to 25% in 2009. The improvement in gross margin was primarily the result of lower raw material costs in 2009 compared to the higher raw material costs in 2008 that the Company was unable to recover from its customers.

**Selling and administrative expenses** decreased 6% from 2008 levels due to decreases in payroll and payroll related charges and lower expenditures for travel.

**Security Products Segment**

**Net sales** in the Security Products segment decreased 24% from 2008 to 2009. The primary reason for the decrease was a decrease in sales volume resulting from the continued economic slowdown in many of the markets served by the Security Products segment, including the travel, coin-op and commercial laundry markets. New products were mainly lock related, such as: a double bitted non-reversible cam lock for the enclosure market and various parts used in the musical instrument accessory market, as well as a variety of other lock products for various markets.

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**Cost of products sold** for the Security Products segment decreased 23% from 2008 to 2009. The decrease in cost of products sold was directly proportionate to the decrease in sales.

**Gross margin** for 2009 at 22% was comparable to the 2008 level of 23% as a percentage of net sales for the Security Products segment.

**Selling and administrative expenses** decreased 12% from the same period a year ago due to a reduction in payroll and payroll related charges and decreased expenses for advertising and sales commissions.

### Metal Products Segment

**Net sales** in the Metal Products segment were comparable for 2009 and 2008. Sales of mine products increased 14% in 2009 compared to 2008. Sales of contract casting products decreased 35% from 2008 levels. In 2009, sales of mine roof supports increased in the U.S. markets, continuing the growth experienced in 2007 and 2008. Sales of new products in 2009 consisted of a crater head for use in underground mining applications.

**Cost of products sold** for the Metal Products segment increased 1% from 2008 to 2009. Cost increases were experienced for raw materials, outside parts and processing, and worker s compensation insurance.

**Gross margin** as a percentage of sales in the Metal Products segment decreased slightly from -3% in 2008 to -4% in 2009. The negative results were primarily caused by excessive scrap and down time due to equipment failures. These operational issues are being addressed through a \$2.5 million capital expenditure program in 2010.

**Selling and administrative expenses** in the Metal Products segment increased 9% from 2008 to 2009, due to increased payroll and payroll related charges.

### Other Items

The following table shows the amount of change from 2008 to 2009 in other items (dollars in thousands):

	<b>Total</b>
Interest expense	\$664 62.5 %
Other income	\$(25 )

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	-33.3 %
Income taxes	\$(673 )
	-43.8 %

**Interest expense** increased from 2008 to 2009 primarily due to the termination of the interest rate swap contract in December 2009. The increase was partially offset by lower interest paid throughout 2009 on the decreased level of debt compared to the prior year.

**Other income** decreased from 2008 to 2009 due to lower interest income earned on cash balances in the Company's cash management program in 2009.

**Income taxes** the effective tax rate increased in 2009 to 45% from the 25% rate in 2008. The increase is primarily the result of a discrete tax item and a change in the mix of U.S and foreign income, as well as a change in the mix of U.S. earnings in states with lower income tax rates.

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**Fiscal 2008 Compared to Fiscal 2007**

The following table shows, for 2008 and 2007, selected line items from the consolidated statements of income as a percentage of net sales, by segment.

	<b>2008</b>							
	<b>Industrial Hardware</b>		<b>Security Products</b>		<b>Metal Products</b>		<b>Total</b>	
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of products sold	77.8	%	77.0	%	102.7	%	81.3	%
Gross margin	22.2	%	23.0	%	-2.7	%	18.7	%
Selling and administrative expense	13.5	%	15.7	%	8.1	%	13.5	%
Operating profit	8.7	%	7.3	%	-10.8	%	5.2	%
	<b>2007</b>							
	<b>Industrial Hardware</b>		<b>Security Products</b>		<b>Metal Products</b>		<b>Total</b>	
Net sales	100.0	%	100.0	%	100.0	%	100.0	%
Cost of products sold	72.5	%	76.8	%	104.3	%	77.0	%
Gross margin	27.5	%	23.2	%	-4.3	%	23.0	%
Selling and administrative expense	11.6	%	14.6	%	12.0	%	12.8	%
Operating profit	15.9	%	8.6	%	-16.3	%	10.2	%

The following table shows the amount of change from 2007 to 2008 in sales, cost of products sold, gross margin, selling and administrative expenses, and operating profit, by segment (dollars in thousands):

	<b>Industrial Hardware</b>		<b>Security Products</b>		<b>Metal Products</b>		<b>Total</b>	
Net sales	\$ (21,561	)	\$ (5,560	)	\$ 6,718		\$ (20,403)	
Volume	-32.2	%	-12.0	%	29.4	%	-18.8	%
Prices	1.2	%	1.7	%	15.1	%	2.6	%
New Products	<u>4.6</u>	<u>%</u>	<u>1.1</u>	<u>%</u>	<u>3.7</u>	<u>%</u>	<u>3.1</u>	<u>%</u>
	-26.4	%	-9.2	%	48.2	%	-13.1	%
Cost of products sold	\$ (12,426	)	\$ (4,185	)	\$ 6,683		\$ (9,928	)
	-21.0	%	-9.0	%	46.0	%	-8.2	%
Gross margin	\$ (9,135	)	\$ (1,375	)	\$ 35		\$ 10,475	
	-40.7	%	-9.8	%	5.7	%	-29.1	%
Selling and administrative expenses	\$ (1,377	)	\$ (201	)	\$ 2		\$ (1,576	)
	-14.5	%	-2.3	%	0.1	%	-7.9	%
Operating profit	\$ (7,758	)	\$ (1,174	)	\$ 33		\$ (8,899	)
	-59.7	%	-22.6	%	1.5	%	-55.9	%



### **Industrial Hardware Segment**

**Net sales** in the Industrial Hardware segment decreased 26.4% in 2008 from the 2007 level. This decrease was primarily due to the 2007 period having benefited from the one-time limited contract to supply latching system components for use in the military's up-armored Humvee program which was completed in April 2007. New product introductions offset part of the decrease in sales for this segment. All of the new products were internally developed and offered to the many markets we service, including: military, utility truck, vehicular accessories and buses. New products included a rear door lock and an out door handle for the bus market, a variety of lightweight composite panels for the marine, transportation, high tech and construction markets, several new products for the military market including a center case kit and a variety of handles, as well as an assortment of handles and latches used in many of the markets to which we sell. Sales volume of existing products was comparable to the prior year in most of the markets serviced by the Industrial Hardware segment. However, decreases in sales volume occurred in the truck accessory, Class 8 truck, service body, and trailer markets, following the general economic decline in the heavy and light truck markets.

**Cost of products sold** for the Industrial Hardware segment decreased 21.0% from 2007 to 2008. The lower manufacturing costs associated with the lower volume of sales was unfavorably impacted by higher costs of raw materials, increases in payroll related charges, maintenance and repair and research and development.

**Gross margin** as a percentage of net sales decreased from 27.5% to 22.2%, driven by higher manufacturing costs which could not be fully recovered through selling price increases due to the competitive nature of many of the products we sell.

**Selling and administrative expenses** decreased 14.5% from 2007 levels due to decreases in payroll and payroll related charges.

### **Security Products Segment**

**Net sales** in the Security Products segment decreased 9.2% from 2007 to 2008. The primary reason for the decrease was a decrease in sales volume resulting from the economic slowdown in many of the markets served by the Security Products segment, including the travel, coin-op and commercial laundry markets. New products were mainly lock related, such as: a wing knob lock with a flip-up cover used in the automotive accessory market and various parts used in the motorcycle market, as well as a variety of other lock products for various markets.

**Cost of products sold** for the Security Products segment decreased 9.0% from 2007 to 2008. The decrease in cost of products sold was directly proportionate to the decrease in sales.

**Gross margin** for 2008 at 23.0% was comparable to 2007 level of 23.2% as a percentage of net sales for the Security Products segment.

**Selling and administrative expenses** decreased 2.3% from the same period a year ago due to a reduction in payroll and payroll related charges.

### **Metal Products Segment**



**Net sales** in the Metal Products segment increased 48.2% from 2007 to 2008. Sales of mine products increased 46% in 2008 compared to 2007. Sales of contract casting products increased 29% from 2007. In 2008, sales of mine roof supports increased in both the U.S. and Canadian markets, continuing the growth experienced in 2007. Shipments of ductile iron castings more than doubled to 2,284 tons in 2008 from 1,058 tons in 2007. Sales of new products in 2008 consisted of a crater head for use in underground mining applications.

**Cost of products sold** for the Metal Products segment increased 46.0% from 2007 to 2008. Cost increases were experienced for raw materials, payroll and payroll related charges, utilities, outside parts and processing, supplies and tools and equipment maintenance.

**Gross margin** in the Metal Products segment improved slightly from -4.3% to -2.8% from 2007 and 2008. The negative results were primarily caused by \$1.5 million in excessive scrap due to equipment failures. Additionally, production down-time resulted in an estimated negative impact of approximately \$500,000. These operational issues are being addressed.

**Selling and administrative expenses** in the Metal Products segment were comparable for 2007 and 2008.

**Other Items**

The following table shows the amount of change from 2007 to 2008 in other items (dollars in thousands):

	<b>Total</b>
Interest expense	\$(225 ) -17.5 %
Other income	\$(171 ) -83.1 %
Income taxes	\$(3,227 ) -67.7 %

**Interest expense** decreased from 2007 to 2008 primarily due to the decreased level of debt.

**Other income** decreased from 2007 to 2008 due to lower interest income earned on cash balances in the Company's cash management program in 2008.

**Income taxes** the effective tax rate decreased in 2008 to 25% from the 32% rate in 2007. The decrease is the result of a change in the mix of U.S and foreign income, as well as a change in the mix of U.S. earnings in states with lower income tax rates.

**Liquidity and Sources of Capital**

The Company's financial position remained strong throughout 2009, despite a loss in the first quarter that caused the Company to fail its fixed coverage ratio covenant for the first, second and third quarters. The primary source of the Company's cash is earnings from operating activities adjusted for cash generated from or used for net working capital. The most significant recurring non-cash items included in income are depreciation and amortization expense. Changes in working capital fluctuate with the changes in operating activities. As sales increase, there generally is an increased need for working capital. Since increases in working capital reduce the Company's cash, management attempts to keep the Company's investment in net working capital at a reasonable level by closely monitoring inventory levels (by matching production to expected market demand), keeping tight control over the collection of receivables, and optimizing payment terms on its trade and other payables.

The Company is dependent on the continued demand for its products and subsequent collection of accounts receivable from its customers. The Company serves a broad base of customers and industries with a variety of products. As a result, any fluctuations in demand or payment from a particular industry or customer will not have a material impact on the Company's sales and collection of receivables. Management expects that the Company's foreseeable cash needs for operations, capital expenditures, debt service and dividend payments will continue to be met by the Company's operating cash flows and available credit facility.

**2009      2008      2007**

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Current ratio	3.9	4.8	3.9		
Average days sales in accounts receivable	51	52	52		
Inventory turnover	3.8	3.6	3.9		
Ratio of working capital to sales	39.3	% 35.9	% 30.1	%	
Total debt to shareholders equity	17.2	% 21.9	% 24.7	%	

At January 2, 2010, January 3, 2009, and December 29, 2007, the Company had cash and cash equivalents of \$16.7 million, \$9.0 million and \$8.2 million, respectively, and working capital of \$44.3 million, \$48.7 million and \$47.0 million, respectively.

Net cash provided by operating activities was \$13.3 million in 2009 compared to \$7.6 million in 2008 and \$8.8 million in 2007. The \$5.7 million increase in 2009 is the result of improvements in working capital during the year offset by the lower profitability. The \$1.2 million decrease from 2007 to 2008 was primarily related to the decline in profitability and changes in working capital. During 2009, working capital provided \$7.6 million in cash, most related to a \$6.7 million decline in

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inventory during the period. During 2008, working capital used \$1.4 million in cash. In 2008, a \$1.6 million decline in accounts receivable was offset by a \$1.1 million increase in inventory and a \$1.9 decrease in accounts payable, accrued compensation and other accrued expenses. During 2007, working capital used \$5.5 million in cash. In 2007, changes in inventory, recoverable taxes, accounts payable and other accrued expenses accounted for \$13.3 million of cash usage, while changes in accounts receivable and other long term liabilities provided \$7.7 million in cash.

During 2009, 2008 and 2007 the Company used \$2.2, \$2.4 and \$2.8 million of cash in investing activities, respectively. The entire amount in 2009 was for the purchase of fixed assets. In 2008, the Company made one small acquisition using approximately \$128,000. The balance for 2008 and for 2007 related primarily to the purchase of fixed assets. The Company expects to begin a major equipment upgrade in the Metal Products Group during 2010 and as a result we expect capital expenditures for 2010 to be approximately \$4 million to \$5 million.

Net cash used by financing activities in 2009 totaled \$3.4 million. This consisted of the payment of \$2.2 million in dividends and \$2.2 million of long-term debt. These amounts were offset by the receipt of approximately \$1 million related to the exercise of stock options during the year (\$1.6 million from the sales of common stock, \$200,000 in tax benefits related to the options, and the purchase of approximately \$800,000 in treasury shares). In 2009, 153,421 shares were issued as a result of options being exercised at an average price of approximately \$10.32 per share, and 55,881 shares were purchased for the treasury at an average price of \$14.27 per share. While there is no assurance that the Company will receive additional funds resulting from the exercise of options in 2010, options representing an additional 113,750 shares at an average price of \$9.50 per share are due to expire during 2010 if they are not exercised. Net cash used by financing activities totaled \$4.2 million in 2008, including \$3.8 million paid to reduce the Company's debt, and \$1.9 million paid out as dividends during the year. The Company also received approximately \$1.6 million net related to the exercise of stock options during the year (\$1.9 million from the sales of common stock, \$400,000 in tax benefits related to the options, and the purchase of approximately \$600,000 in treasury shares). In 2008, 196,606 shares were issued as a result of options being exercised at an average price of approximately \$9.47 per share and 42,955 shares were purchased for the treasury at an average price of \$14.21 per share. Net cash used by financing activities in 2007 totaled approximately \$1.1 million. Payments of \$3.1 million in debt and \$1.8 million in dividends were offset by \$2.6 million received from the exercise of stock options and an additional \$1.6 million related to tax benefits derived from these same stock option transactions. In 2007, 339,749 shares were issued as a result of options being exercised at an average price of approximately \$7.54 per share.

The Company leases certain equipment and buildings under cancelable and non-cancelable operating leases expiring at various dates up to five years. Rent expense amounted to approximately \$759,000, \$908,000 and \$882,000 in 2009, 2008 and 2007, respectively.

On September 22, 2006 the Company signed an unsecured loan agreement ( *Loan Agreement* ), which included a \$20,000,000 term loan and a revolving line of credit, with its lender, Bank of America, N.A. The term portion of the loan required quarterly payments of \$714,286 for a period of seven (7) years, maturing on September 22, 2013. Prior to April 21, 2009, the revolving credit portion allowed the Company to borrow up to \$12,000,000 with a maturity date of September 22, 2009. The revolving credit portion had a variable quarterly commitment fee ranging from 0.10% to 0.25% based on operating results. Effective April 21, 2009, the Company agreed to a reduction in the amount available on the revolving credit portion to \$3,000,000. Effective June 19, 2009, the quarterly commitment fee was fixed at 0.5%. There were no outstanding balances under the revolving credit portion at January 2, 2010 or January 3, 2009.

The interest rates on the term and the revolving credit portions of the *Loan Agreement* vary. Prior to June 19, 2009, the interest rates varied based on the LIBOR rate plus a margin spread of 1.0% to 1.65% for the term portion and 1.0% to 1.6% for the revolving credit portion. The margin rate spread was based on operating results calculated on a rolling-four-quarter basis. Effective June 19, 2009, the margin spread was fixed at a rate of 2.25%. The Company may also borrow funds at the lender's prime rate. On January 2, 2010, the interest rate on the term portion of the *Loan Agreement* was approximately 2.54%.

On November 13, 2009, the Company amended its *Loan Agreement* with Bank of America, N.A. The amendment extended the term of the revolving credit portion of the *Loan Agreement* to May 31, 2010 and permanently reduced the amount available to borrow to \$3,000,000. In addition, the margin rate spread was fixed at two and one quarter percent (2.25%); the unused line fee was increased to one half of one percent

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(0.50%); and the fixed coverage ratio covenant was modified such that it will be calculated on a fiscal year to date basis (instead of a rolling four quarter basis) commencing with the second quarter of fiscal 2009, provided that if the Company fails to comply with such fixed coverage ratio covenant for any quarter, then such ratio will be re-calculated to add back the amount of permitted dividends declared and actually paid during the period to meet the required 1.1 to 1.0 ratio, so long as the payment of such dividends does not result in the amount of consolidated cash to be below \$10,000,000 on the date of determination. The testing period will return to a rolling 4 quarter period effective with the end of the first quarter of 2010. The amendment also required the Company to secure all

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of the present and future indebtedness of the Company and its subsidiaries with a continuing first priority security interest in all present and future assets of the Company and its consolidated subsidiaries.

On November 2, 2006, the Company entered into an interest rate swap contract with the lender with an original notional amount of \$20,000,000, which was equal to 100% of the outstanding balance of the term loan on that date. The notional amount began decreasing on a quarterly basis on January 2, 2007 following the principal repayment schedule of the term loan. The Company has a fixed interest rate of 5.25% on the swap contract and paid the difference between the fixed rate and LIBOR when LIBOR was below 5.25% and received interest when the LIBOR rate exceeded 5.25%. This remained in effect until December 22, 2009 when the Company terminated the interest rate swap contract at a cost of \$967,350, which was accounted for as a charge to interest expense. After terminating the contract, the Company commenced a refinancing plan of the Company's outstanding debt.

Subsequent to January 2, 2010, the Company completed the refinancing of all of its debt. On January 29, 2010, the Company signed a new secured Loan Agreement (the "New Loan Agreement") with People's United Bank ("People's") which included a \$5,000,000 term portion and a \$10,000,000 revolving credit portion. The term portion of the loan requires quarterly payments of \$178,571 for a period of seven (7) years, maturing on January 31, 2017. The revolving credit portion has a quarterly commitment fee of one quarter of one percent (0.25%). The proceeds of the term portion along with the Company's available cash were used to retire the remaining portion of the debt with Bank of America, N.A., which on January 29, 2010 totaled \$10,714,286.

Interest on the term portion of the New Loan Agreement is fixed at 4.98%. The interest rate on the revolving credit portion of the New Loan Agreement varies based on the LIBOR rate or People's Prime rate plus a margin spread of 2.25%, with a floor rate of 4.0%.

The Company's loan covenants restrict it from incurring any indebtedness (from any person other than the lender) that exceeds the aggregate sum of \$2.0 million, or that exceeds \$1.0 million in any single transaction, without the express consent of the lender or until the full payment of the current obligation has been made. The loan covenants also prohibit the Company from paying any dividends in the event the payment would result in a default under the terms of the Loan Agreement.

### Tabular Disclosure of Contractual Obligations

The Company's known contractual obligations as of January 2, 2010, are shown below (in thousands):

	<b>Payment due by period</b>				
	<b>Total</b>	<b>Less than 1 Year</b>	<b>1-3 Years</b>	<b>3-5 Years</b>	<b>More than 5 Years</b>
Long-term debt obligations	\$ 11,429	\$ 7,143	\$ 1,429	\$ 1,607	\$ 1,250
Estimated interest on long-term debt	915	181	388	264	82
Operating lease obligations	1,788	592	1,070	126	--
Estimated contributions to pension plans	12,144	328	3,971	3,971	3,874
Estimated post retirement benefits other than pensions	1,341	141	298	329	573
<b>Total</b>	<b>\$ 27,617</b>	<b>\$ 8,385</b>	<b>\$ 7,156</b>	<b>\$ 6,297</b>	<b>\$ 5,779</b>

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The Company paid approximately \$5.7 million of the \$7.1 million of long-term debt obligations due in less than one year, shown in the table above, in connection with the refinancing of the Company's debt on January 29, 2010.

The amounts shown in the above table for estimated contributions to pension plans and estimated postretirement benefits other than pensions are based on the assumptions in Note 10 to the consolidated financial statements, as well as the assumption that participant counts will remain stable.

The Company does not have any non-cancelable open purchase orders.

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During the fourth quarter of Fiscal 2008 a change in the general economy caused a significant tightening of credit by financial institutions. During Fiscal 2009, the Company increased its cash position by approximately \$7.8 million. While the Company used approximately \$5.7 million of this in January 2010 in order to refinance its outstanding debt, the Company believes it has sufficient cash on hand and credit resources available to it to sustain itself through these difficult economic times.

### ITEM 7A            **QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's foreign manufacturing facilities account for approximately 12% of total sales and 15% of total assets. Its U.S. operations buy from and sell to these foreign affiliates, and also make limited sales (approximately 11% of total sales) to nonaffiliated foreign customers. This trade activity could be affected by fluctuations in foreign currency exchange or by weak economic conditions. The Company's currency exposure is concentrated in the Canadian dollar, Mexican peso, New Taiwan dollar, Chinese RMB and Hong Kong dollar. Because of the Company's limited exposure to any single foreign market, any exchange gains or losses have not been material and are not expected to be material in the future. Had the exchange rate as of January 2, 2010 for all of the listed currencies changed by 1%, the total change in reported earnings would have been less than \$5,000. As a result, the Company does not attempt to mitigate its foreign currency exposure through the acquisition of any speculative or leveraged financial instruments. In 2009, a 10% increase/decrease in exchange rates would have resulted in a translation increase/decrease to sales of approximately \$1.2 million, and to equity of approximately \$2.5 million.

On January 29, 2010, subsequent to the date of the financial statements included in Item 8 of this Form 10-K and prior to filing this Form 10-K, the Company eliminated its interest rate risk by refinancing its long-term debt at a fixed rate of 4.98%. See Note 5 to the Company's financial statements included at Item 8 of this Annual Report on Form 10-K.



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**ITEM 8 FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA**

The Eastern Company

Consolidated Balance Sheets

	<b>January 2 2010</b>	<b>January 3 2009</b>
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 16,746,673	\$ 8,967,625
Accounts receivable, less allowances of \$392,000 in 2009 and \$328,000 in 2008	15,326,416	17,021,774
Inventories:		
Raw materials and component parts	7,837,854	7,719,540
Work in process	4,367,851	6,448,593
Finished goods	12,314,584	16,628,746
	<b>24,520,289</b>	<b>30,796,879</b>
Prepaid expenses and other assets	2,037,745	2,366,634
Recoverable income taxes receivable		1,313,628
Deferred income taxes	1,129,898	1,225,723
<b>Total Current Assets</b>	<b>59,761,021</b>	<b>61,692,263</b>
<b>Property, Plant and Equipment</b>		
Land	1,134,743	1,102,385
Buildings	13,790,853	13,751,059
Machinery and equipment	35,413,406	33,574,613
Accumulated depreciation	(27,365,369 )	(24,517,348 )
	<b>22,973,633</b>	<b>23,910,709</b>
<b>Other Assets</b>		
Goodwill	13,869,005	13,700,356
Trademarks	151,341	143,818
Patents, technology and other intangibles net of accumulated amortization	2,796,698	3,415,012
Deferred income taxes	1,283,323	3,154,810
Prepaid pension cost	36,838	
	<b>18,137,205</b>	<b>20,413,996</b>
	<b>\$ 100,871,859</b>	<b>\$ 106,016,968</b>

## Consolidated Balance Sheets

	January 2 2010	January 3 2009
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 5,335,317	\$ 7,081,303
Accrued compensation	1,811,236	1,919,322
Other accrued expenses	1,191,360	1,706,681
Current portion of long-term debt	7,142,858	2,240,202
<b>Total Current Liabilities</b>	<b>15,480,771</b>	<b>12,947,508</b>
<b>Other long-term liabilities</b>	<b>1,077,247</b>	<b>1,614,833</b>
<b>Long-term debt, less current portion</b>	<b>4,285,713</b>	<b>11,428,571</b>
<b>Accrued postretirement benefits</b>	<b>1,341,498</b>	<b>1,062,719</b>
<b>Accrued pension cost</b>	<b>12,089,326</b>	<b>15,311,924</b>
<b>Interest rate swap obligation</b>		<b>1,169,848</b>
<b>Commitments and contingencies (See Note 4)</b>		
<b>Shareholders Equity</b>		
Voting Preferred Stock, no par value:		
Authorized and unissued: 1,000,000 shares		
Nonvoting Preferred Stock, no par value:		
Authorized and unissued: 1,000,000 shares		
Common Stock, no par value:		
Authorized: 50,000,000 shares		
Issued: 8,709,384 shares in 2009 and 8,553,353 shares in 2008		
Treasury Stock: 2,644,215 shares in 2009 and 2,588,334 shares in 2008		
Retained earnings	26,236,477	24,418,916
	(18,375,416 )	(17,578,088 )
	<b>67,558,201</b>	<b>68,676,943</b>
Accumulated other comprehensive income (loss):		
Foreign currency translation	1,696,013	664,990
Unrecognized net pension and postretirement benefit costs, net of taxes	(10,517,971 )	(12,944,539 )
Derivative financial instruments, net of taxes		(756,657 )
	<b>(8,821,958 )</b>	<b>(13,036,206 )</b>
<b>Total Shareholders Equity</b>	<b>66,597,304</b>	<b>62,481,565</b>
	<b>\$ 100,871,859</b>	<b>\$ 106,016,968</b>

See accompanying notes.

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Consolidated Statements of Income

	January 2 2010		Year ended January 3 2009		December 29 2007
<b>Net sales</b>	<b>\$ 112,665,464</b>		\$ 135,878,490		\$ 156,281,083
Cost of products sold	(92,031,078	)	(110,415,392	)	(120,343,196
Gross margin	<b>20,634,386</b>		25,463,098		35,937,887
Selling and administrative expenses	(17,055,610	)	(18,432,700	)	(20,008,851
Operating profit	<b>3,578,776</b>		7,030,398		15,929,036
Interest expense	(1,727,980	)	(1,063,607	)	(1,288,952
Other income	<b>50,733</b>		76,057		205,379
<b>Income before income taxes</b>	<b>1,901,529</b>		6,042,848		14,845,463
Income taxes	<b>865,122</b>		1,538,225		4,764,770
<b>Net income</b>	<b>\$ 1,036,407</b>		\$ 4,504,623		\$ 10,080,693
<b>Earnings per Share:</b>					
Basic	<b>\$ 0.17</b>		\$ 0.77		\$ 1.79
Diluted	<b>\$ 0.17</b>		\$ 0.73		\$ 1.68

See accompanying notes.

Consolidated Statements of Comprehensive Income (Loss)

	January 2 2010		Year ended January 3 2009		December 29 2007
Net income	\$ 1,036,407		\$ 4,504,623		\$ 10,080,693
Other comprehensive income/(loss) -					
Change in foreign currency translation	<b>1,031,023</b>		(1,735,278	)	1,643,816
Change in fair value of derivative financial instruments, net of income tax (expense)/benefit of (\$72,200) in 2009, \$204,866 in 2008 and \$158,343 in 2007	<b>130,298</b>		(387,041	)	(281,185
Reclassification adjustment for termination of derivative financial instrument, net of income tax expense of \$340,991	<b>626,359</b>				
Change in pension and postretirement benefit costs, net of income taxes (expense)/benefit of (\$1,341,658) in 2009, \$5,581,644 in 2008 and (\$1,808,898) in 2007	<b>2,426,568</b>		(10,306,221	)	3,193,078
	<b>4,214,248</b>		(12,428,540	)	4,555,709
Comprehensive income/(loss)	<b>\$ 5,250,655</b>		\$ (7,923,917	)	\$ 14,636,402

See accompanying notes.

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Consolidated Statements of Shareholders Equity

	Common Shares	Common Stock	Treasury Shares	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Shareholders Equity
<b>Balances at December 30, 2006</b>	8,012,550	\$ 17,974,115	(2,533,089 )	\$ (16,655,041 )	\$ 58,279,371	\$ (5,207,240 )	\$ 54,391,205
Net income					10,080,693		10,080,693
Cash dividends declared, \$ .32 per share					(1,801,570 )		(1,801,570 )
Currency translation adjustment						1,643,816	1,643,816
Change in pension and postretirement benefit costs, net of tax						3,193,078	3,193,078
Change in derivative financial instrument, net of tax						(281,185 )	(281,185 )
Change in accounting for uncertain tax positions					(295,928 )		(295,928 )
Purchase of Common Stock for treasury			(12,290 )	(312,521 )			(312,521 )
Issuance of Common Stock upon the exercise of stock options	339,749	2,562,997					2,562,997
Tax benefit from exercise of non-qualified stock options and disqualifying dispositions of incentive stock options		1,575,500					1,575,500
Cash payment for fractional shares resulting from exercise of stock options		(20 )					(20 )
Issuance of Common Stock for directors' fees	2,679	61,203					61,203
<b>Balances at December 29, 2007</b>	8,354,978	22,173,795	(2,545,379 )	(16,967,562 )	66,262,566	(651,531 )	70,817,268
Net income					4,504,623		4,504,623
Cash dividends declared, \$ .33 per share					(1,938,172 )		(1,938,172 )
Currency translation adjustment						(1,735,278 )	(1,735,278 )
Change in pension and postretirement benefit costs, net of tax						(10,306,221 )	(10,306,221 )
Change in derivative financial instrument, net of tax						(387,041 )	(387,041 )
Effects of changing pension plan measurement date pursuant to ASC 715, net of tax					(152,074 )	43,865	(108,209 )



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Consolidated Statements of Shareholders Equity *(continued)*

	Common Shares	Common Stock	Treasury Shares	Treasury Stock	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Shareholders Equity
Purchase of Common Stock for treasury			(42,955 )	(610,526 )			(610,526 )
Issuance of Common Stock upon the exercise of stock options	196,606	1,861,486					1,861,486
Tax benefit from exercise of non-qualified stock options and disqualifying dispositions of incentive stock options		355,799					355,799
Cash payment for fractional shares resulting from exercise of stock options		(4 )					(4 )
Issuance of Common Stock for directors' fees	1,769	27,840					27,840
<b>Balances at January 3, 2009</b>	<b>8,553,353</b>	<b>24,418,916</b>	<b>(2,588,334 )</b>	<b>(17,578,088 )</b>	<b>68,676,943 1,036,407</b>	<b>(13,036,206 )</b>	<b>62,481,565 1,036,407</b>
Net income							
Cash dividends declared, \$.36 per share					(2,155,149 )		(2,155,149 )
Currency translation adjustment						1,031,023	1,031,023
Change in pension and postretirement benefit costs, net of tax						2,426,568	2,426,568
Change in derivative financial instrument, net of tax						130,298	130,298
Termination of derivative financial instrument, net of tax						626,359	626,359
Purchase of Common Stock for treasury			(55,881 )	(797,328 )			(797,328 )
Issuance of Common Stock upon the exercise of stock options	153,421	1,584,042					1,584,042
Tax benefit from exercise of non-qualified stock options and disqualifying dispositions of incentive stock options		202,767					202,767
Issuance of Common Stock for directors' fees	2,610	30,752					30,752
<b>Balances at January 2, 2010</b>	<b>8,709,384</b>	<b>\$ 26,236,477</b>	<b>(2,644,215 )</b>	<b>\$ (18,375,416 )</b>	<b>\$ 67,558,201</b>	<b>\$ (8,821,958 )</b>	<b>\$ 66,597,304</b>

See accompanying notes.





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Consolidated Statements of Cash Flows

	January 2 2010	Year ended January 3 2009	December 29 2007
<b>Operating Activities</b>			
Net income	\$ 1,036,407	\$ 4,504,623	\$ 10,080,693
Adjustments to reconcile net income to net cash provided by operating activities:			
Depreciation and amortization	4,103,317	4,128,312	4,369,998
Loss on sale of equipment and other assets	5,644	7,003	65,182
Provision for doubtful accounts	320,716	132,988	45,740
Deferred income taxes	235,788	286,046	(404,618 )
Issuance of Common Stock for directors fees	30,752	27,840	61,203
Changes in operating assets and liabilities:			
Accounts receivable	1,573,393	1,467,368	6,133,976
Inventories	6,671,197	(1,099,265 )	(1,923,947 )
Prepaid expenses and other	361,028	272,933	(462,604 )
Prepaid pension cost	791,059	(130,905 )	(684,514 )
Recoverable taxes receivable	1,313,628	100,288	(1,411,477 )
Other assets	(15,847 )	(111,295 )	(229,858 )
Accounts payable	(1,858,201 )	(911,386 )	(5,190,868 )
Accrued compensation	(127,707 )	(634,707 )	(549,639 )
Other accrued expenses	(1,097,616 )	(426,618 )	(1,139,189 )
<b>Net cash provided by operating activities</b>	<b>13,343,558</b>	<b>7,613,225</b>	<b>8,760,078</b>
<b>Investing Activities</b>			
Purchases of property, plant and equipment	(2,226,025 )	(2,331,341 )	(2,867,829 )
Proceeds from sale of equipment and other assets		13,246	25,120
Business acquisitions		(128,325 )	
<b>Net cash used in investing activities</b>	<b>(2,226,025 )</b>	<b>(2,446,420 )</b>	<b>(2,842,709 )</b>
<b>Financing Activities</b>			
Principal payments on long-term debt	(2,240,202 )	(3,838,029 )	(3,111,907 )
Proceeds from sales of Common Stock	1,584,042	1,861,486	2,562,997
Tax benefit from disqualifying disposition of incentive stock options and exercise of non-qualified stock options	202,767	355,799	1,575,500
Purchases of Common Stock for treasury	(797,328 )	(610,526 )	(312,521 )
Cash payment for fractional shares resulting from exercise of stock options		(4 )	(20 )
Dividends paid	(2,155,149 )	(1,938,172 )	(1,801,570 )
<b>Net cash used in financing activities</b>	<b>(3,405,870 )</b>	<b>(4,169,446 )</b>	<b>(1,087,521 )</b>
<b>Effect of exchange rate changes on cash</b>	<b>67,385</b>	<b>(239,456 )</b>	<b>278,416</b>
<b>Net change in cash and cash equivalents</b>	<b>7,779,048</b>	<b>757,903</b>	<b>5,108,264</b>
Cash and cash equivalents at beginning of year	8,967,625	8,209,722	3,101,458
<b>Cash and cash equivalents at end of year</b>	<b>\$ 16,746,673</b>	<b>\$ 8,967,625</b>	<b>\$ 8,209,722</b>

See accompanying notes.

The Eastern Company

Notes to Consolidated Financial Statements

## **1. DESCRIPTION OF BUSINESS**

The operations of The Eastern Company (the Company) consist of three business segments: industrial hardware, security products, and metal products. The industrial hardware segment produces latching devices for use on industrial equipment and instrumentation as well as a broad line of proprietary hardware designed for truck bodies and other vehicular type equipment. The security products segment manufactures and markets a broad range of locks for traditional general purpose security applications as well as specialized locks for soft luggage, coin-operated vending and gaming equipment, and electric and computer peripheral components. This segment also manufactures and markets coin acceptors and metering systems to secure cash used in the commercial laundry industry and produces cashless payment systems utilizing advanced smart card technology. The metal products segment produces anchoring devices used in supporting the roofs of underground coal mines and specialty products, which serve the construction, automotive and electrical industries.

On August 13, 2008, the Company entered into a joint venture agreement to further develop existing technology for use in the Security Products segment. The joint venture is currently not material to the consolidated financial statements of the Company. The Company's 80% ownership of this joint venture has been consolidated into its financial statements with the remaining 20% ownership accounted for as a minority interest therein, and included in other accrued expenses.

Sales are made to customers primarily in North America.

The consolidated balance sheets reflect the reclassification of debt per the refinancing which occurred in January 2010. See Note 5 Debt.

## **2. ACCOUNTING POLICIES**

### **Estimates and Assumptions**

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

### **Fiscal Year**

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The Company's year ends on the Saturday nearest to December 31. Fiscal 2009 and 2007 were 52 weeks, 2008 was a 53 week year.

### **Principles of Consolidation**

The consolidated financial statements include the accounts of the Company and its subsidiaries, all of which are wholly-owned. All intercompany accounts and transactions are eliminated.

### **Cash Equivalents and Concentrations of Credit Risk**

Highly liquid investments purchased with a maturity of three months or less are considered cash equivalents. The Company has deposits that exceed amounts insured by the Federal Deposit Insurance Corporation (FDIC) up to \$250,000, but the Company does not consider this a significant concentration of credit risk based on the strength of the financial institution.

### **Reclassification**

Certain prior period amounts have been reclassified to conform to the current period presentation. These reclassifications had no effect on previously reported net income.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

## 2. ACCOUNTING POLICIES (continued)

### Foreign Currency Translation

For foreign operations, balance sheet accounts are translated at the current year-end exchange rate; income statement accounts are translated at the average exchange rate for the year. Resulting translation adjustments are made directly to a separate component of shareholders' equity—Accumulated other comprehensive income (loss)—Foreign currency translation. Foreign currency exchange transaction gains and losses are not material in any year.

### Recognition of Revenue and Accounts Receivable

Revenue and accounts receivable are recognized when persuasive evidence of an arrangement exists, the price is fixed and determinable, delivery has occurred, and there is a reasonable assurance of collection of the sales proceeds. The Company obtains written purchase authorizations from its customers for a specified amount of product at a specified price and delivery occurs at the time of shipment. Credit is extended based on an evaluation of each customer's financial condition; collateral is not required. Accounts receivable are recorded net of applicable allowances. No customers exceeded 10% of total accounts receivable at year end 2009 or 2008.

### Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts for estimated losses resulting from the inability of its customers to make required payments. The Company reviews the collectibility of its receivables on an ongoing basis taking into account a combination of factors. The Company reviews potential problems, such as past due accounts, a bankruptcy filing or deterioration in the customer's financial condition, to ensure the Company is adequately accrued for potential loss. Accounts are considered past due based on when payment was originally due. If a customer's situation changes, such as a bankruptcy or creditworthiness, or there is a change in the current economic climate, the Company may modify its estimate of the allowance for doubtful accounts. The Company will write off accounts receivable after reasonable collection efforts have been made and the accounts are deemed uncollectible. Write-offs have been within management's estimates.

### Inventories

Inventories are valued at the lower of cost or market. Cost is determined by the last-in, first-out (LIFO) method in the U.S. (\$17,924,698 for U.S. inventories at January 2, 2010) and by the first-in, first-out (FIFO) method for inventories outside the U.S. (\$6,595,591 for inventories outside the U.S. at January 2, 2010). Current cost exceeds the LIFO carrying value by approximately \$4,725,000 at January 2, 2010 and \$6,212,000 at January 3, 2009. There was no material LIFO quantity liquidation in 2009, 2008 or 2007.

**Property, Plant and Equipment and Related Depreciation**

Property, plant and equipment (including equipment under capital lease) are stated at cost. Depreciation (\$3,387,575 in 2009, \$3,410,538 in 2008 and \$3,770,280 in 2007) is computed generally using the straight-line method based on the following estimated useful lives of the assets: Buildings 10 to 39.5 years; Machinery and equipment 3 to 10 years.

**Goodwill, Intangibles and Impairment of Long-Lived Assets**

Patents are recorded at cost and are amortized using the straight-line method over the lives of the patents. Technology and licenses are recorded at cost and are generally amortized on a straight-line basis over periods ranging from 5 to 17 years. Non-compete agreements and customer relationships are being amortized using the straight-line method over a period of 5 years. Amortization expense in 2009, 2008 and 2007 was \$715,742, \$717,774 and \$599,718, respectively. Total amortization expense for each of the next five years is estimated to be as follows: 2010 - \$648,000; 2011 - \$547,000; 2012 - \$235,000; 2013 - \$220,000; and 2014 - \$220,000. Trademarks are not amortized as their lives are deemed to be indefinite.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

**2. ACCOUNTING POLICIES (continued)**

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

	<b>Industrial Hardware Segment</b>	<b>Security Products Segment</b>	<b>Metal Products Segment</b>	<b>Total</b>	<b>Weighted-Average Amortization Period (Years)</b>
<b>2009 Gross Amount:</b>					
Patents and developed technology	\$ 2,662,125	\$ 995,778	\$ 45,679	\$ 3,703,582	<b>16.0</b>
Customer relationships	45,825	1,921,811		1,967,636	<b>5.0</b>
Non-compete agreements	30,000	90,735		120,735	<b>5.0</b>
Other		128,941		128,941	<b>1.0</b>
<b>Total Gross Intangibles</b>	<b>\$ 2,737,950</b>	<b>\$ 3,137,265</b>	<b>\$ 45,679</b>	<b>\$ 5,920,894</b>	<b>11.6</b>
<b>2009 Accumulated Amortization:</b>					
Patents and developed technology	\$ 1,262,599	\$ 342,109	\$ 41,996	\$ 1,646,704	
Customer relationships	18,330	1,246,219		1,264,549	
Non-compete agreements	12,000	75,943		87,943	
Other		125,000		125,000	
<b>Total Gross Amortization</b>	<b>\$ 1,292,929</b>	<b>\$ 1,789,271</b>	<b>\$ 41,996</b>	<b>\$ 3,124,196</b>	
<b>Net 2009 per Balance Sheet</b>	<b>\$ 1,445,021</b>	<b>\$ 1,347,994</b>	<b>\$ 3,683</b>	<b>\$ 2,796,698</b>	
<b>2008 Gross Amount:</b>					
Patents and developed technology	\$ 2,508,494	\$ 1,039,925	\$ 60,354	\$ 3,608,773	<b>15.8</b>
Customer relationships	45,825	1,921,811		1,967,636	<b>5.0</b>
Non-compete agreements	30,000	90,735		120,735	<b>5.0</b>
Other		128,941		128,941	<b>1.0</b>
<b>Total Gross Intangibles</b>	<b>\$ 2,584,319</b>	<b>\$ 3,181,412</b>	<b>\$ 60,354</b>	<b>\$ 5,826,085</b>	<b>11.3</b>
<b>2008 Accumulated Amortization:</b>					
Patents and developed technology	\$ 1,098,787	\$ 258,295	\$ 53,680	\$ 1,410,762	
Customer relationships	9,165	861,857		871,022	
Non-compete agreements	6,000	67,733		73,733	
Other		55,556		55,556	
<b>Total Gross Amortization</b>	<b>\$ 1,113,952</b>	<b>\$ 1,243,441</b>	<b>\$ 53,680</b>	<b>\$ 2,411,073</b>	
<b>Net 2008 per Balance Sheet</b>	<b>\$ 1,470,367</b>	<b>\$ 1,937,971</b>	<b>\$ 6,674</b>	<b>\$ 3,415,012</b>	

In the event that facts and circumstances indicate that the carrying value of long-lived assets, including definite life intangible assets, may be impaired, an evaluation is performed to determine if a write-down is required. No events or changes in circumstances have occurred to indicate that the carrying amount of such long-lived assets held and used may not be recovered.



The Eastern Company

Notes to Consolidated Financial Statements (continued)

**2. ACCOUNTING POLICIES (continued)**

The Company evaluates the carrying amount of goodwill and trademarks on our balance sheets for possible impairment annually during the second quarter of each year. Goodwill or trademarks would be considered impaired whenever our historical carrying amount exceeds the fair value. Goodwill and trademarks were not impaired in 2009, 2008 or 2007. Should we reach a different conclusion in the future, additional work would be performed to determine the amount of the non-cash impairment charge to be recognized. The maximum future impairment of goodwill or trademarks that could occur is the amount recognized on our balance sheet.

The following is a roll-forward of goodwill for 2009 and 2008:

	<b>Industrial Hardware Segment</b>	<b>Security Products Segment</b>	<b>Metal Products Segment</b>	<b>Total</b>
<b>2009</b>				
Beginning balance	\$ 1,866,540	\$ 11,833,816	\$	\$ 13,700,356
Foreign exchange	168,649			168,649
Ending balance	\$ 2,035,189	\$ 11,833,816	\$	\$ 13,869,005
<b>2008</b>				
Beginning balance	\$ 2,121,792	\$ 11,833,816	\$	\$ 13,955,608
Foreign exchange	(255,252 )			(255,252 )
Ending balance	\$ 1,866,540	\$ 11,833,816	\$	\$ 13,700,356

**Cost of Products Sold**

The Company includes the cost of inventory sold and related costs for the acquisition and distribution of its products in cost of products sold. These costs include inbound freight charges, receiving, inspection, purchasing and warehousing related costs.

**Selling and Administrative Expenses**

All advertising, selling, general consulting, executive salaries, regulatory compliance, audit, legal and professional fees are included in selling and administrative expenses.

**Product Development Costs**

Product development costs, charged to expense as incurred, were \$1,330,729 in 2009, \$1,293,167 in 2008 and \$1,439,044 in 2007.

**Advertising Costs**

The Company expenses advertising costs as incurred. Advertising costs were \$486,598 in 2009, \$560,660 in 2008 and \$540,499 in 2007.

**Income Taxes**

In the first quarter of 2007 the Company adopted provisions of The FASB Accounting Standards Codification ( ASC ) 740 which clarifies the accounting for uncertainty in income taxes recognized in a company s financial statements. These provisions detail how companies should recognize, measure, present and disclose uncertain tax positions that have or are expected to be taken. As such, the financial statements will reflect expected future tax consequences of uncertain tax positions presuming the taxing authorities full knowledge of the position and all relevant facts. See Note 8 Income Taxes.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

## 2. ACCOUNTING POLICIES (continued)

The Company and its U.S. subsidiaries file a consolidated federal income tax return.

Deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

### Earnings per Share

The denominators used in the earnings per share computations follow:

	2009	2008	2007
<b>Basic:</b>			
Weighted average shares outstanding	5,985,640	5,875,140	5,631,073
<b>Diluted:</b>			
Weighted average shares outstanding	5,985,640	5,875,140	5,631,073
Dilutive stock options	256,140	284,423	358,681
Denominator for diluted earnings per share	6,241,780	6,159,563	5,989,754

There were no anti-dilutive stock options in 2009 or 2007. The Company has excluded the effect of 261,750 shares in 2008 from the above dilutive stock options, as their inclusion would be anti-dilutive.

### Derivatives

The Company maintained an interest rate swap agreement until December 2009 to minimize the risk of fluctuations of interest rates on the Company's variable rate term debt. The agreement involved the exchange of amounts based on the London Interbank Offered Rate ( LIBOR ) for amounts based on a fixed interest rate over the life of the agreement, without an exchange of the notional amount upon which the payments are based.

The Company's interest rate swap agreement was accounted for as a cashflow hedge, and, as a result, changes in the fair value of the derivative are recorded as an asset or liability with the offset amount recorded to accumulated other comprehensive income (loss) in shareholders' equity for

2008 and 2007. There have been no losses related to the ineffectiveness of the Company's cashflow hedge in any of the years presented. On December 22, 2009, the Company terminated the interest rate swap contract at a cost of \$967,350 that was accounted for as a charge to interest expense. See Note 5 Debt.

**Stock Based Compensation**

The Company accounts for stock based compensation pursuant to the fair value recognition provisions of ASC 718. No stock options were granted in 2009, 2008 or 2007, and as all options granted prior to January 1, 2006 were fully vested, there was no impact on the financial statements for any year presented.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

## 2. ACCOUNTING POLICIES *(continued)*

### Fair Value of Financial Instruments

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. The company utilizes a fair value hierarchy, which maximizes the use of observable inputs and minimizes the use of unobservable inputs when measuring fair value. The fair value hierarchy has three levels of inputs that may be used to measure fair value:

- Level 1      Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
  
- Level 2      Quoted prices in markets that are not active; or other inputs that are observable, either directly or indirectly, for substantially the full term of the asset or liability.
  
- Level 3      Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable.

The carrying amounts of financial instruments (cash and cash equivalents, accounts receivable, accounts payable, the interest rate swap agreement, and debt) as of January 2, 2010 and January 3, 2009, approximate fair value. Fair value was based on expected cash flows and current market conditions.

### 3. BUSINESS ACQUISITIONS

Effective January 11, 2008 the Company acquired certain assets from Auto-Vehicle Parts Company that included a certain product line owned by one of its divisions, the F.A. Neider Company ( Neider ). Neider produces the footman loop products, or strap fasteners, which are used to fasten straps, traps, tools, and cargo to a vehicle, container, or trailer. Neider manufactures footman loops used in the following markets: military, aerospace, service body, and trailer. The footman loop product line was integrated into the Company's Industrial Hardware segment. The cost of the Neider acquisition was \$128,325, inclusive of transaction costs.

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The above acquisition has been accounted for using the purchase method. The acquired product line is included in the consolidated operating results of the Company from the date of acquisition. There was no goodwill attributable to the acquisition of Neider.

Neither the actual results nor the pro forma effects of the acquisition of the above product line are material to the Company's financial statements.

### 4. CONTINGENCIES

The Company is party to various legal proceedings and claims related to its normal business operations. In the opinion of management, the Company has substantial and meritorious defenses for these claims and proceedings in which it is a defendant, and believes these matters will be ultimately resolved without a material adverse effect on the consolidated financial position, results of operations or liquidity of the Company. The aggregate provision for losses related to contingencies arising in the ordinary course of business was not material to operating results for any year presented.

Reflected in the 2007 Consolidated Statements of Income in Selling and administrative expenses is a contingency reserve for \$250,000 relating to environmental issues at the Frazer & Jones Division. Settlement payments and remediation costs approximated \$250,000 in 2008.

Approximately 42% of the total workforce is subject to negotiated union contracts, and approximately 18% of the total workforce is covered by such agreements that expire during 2010.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

## 5. DEBT

On September 22, 2006 the Company signed an unsecured loan agreement ( *Loan Agreement* ), which included a \$20,000,000 term loan and a revolving line of credit, with its lender, Bank of America, N.A. The term portion of the loan required quarterly payments of \$714,286 for a period of seven (7) years, maturing on September 22, 2013. Prior to April 21, 2009, the revolving credit portion allowed the Company to borrow up to \$12,000,000 with a maturity date of September 22, 2009. The revolving credit portion had a variable quarterly commitment fee ranging from 0.10% to 0.25% based on operating results. Effective April 21, 2009, the Company agreed to a reduction in the amount available on the revolving credit portion to \$3,000,000. Effective June 19, 2009, the quarterly commitment fee was fixed at 0.5%. There were no outstanding balances under the revolving credit portion at January 2, 2010 or January 3, 2009.

The interest rates on the term and the revolving credit portions of the Loan Agreement vary. Prior to June 19, 2009, the interest rates varied based on the LIBOR rate plus a margin spread of 1.0% to 1.65% for the term portion and 1.0% to 1.6% for the revolving credit portion. The margin rate spread was based on operating results calculated on a rolling-four-quarter basis. Effective June 19, 2009, the margin spread was fixed at a rate of 2.25%. The Company may also borrow funds at the lender's prime rate. On January 2, 2010, the interest rate on the term portion of the Loan Agreement was approximately 2.54%.

On November 13, 2009, the Company amended its Loan Agreement with Bank of America, N.A. The amendment extended the term of the revolving credit portion of the Loan Agreement to May 31, 2010 and permanently reduced the amount available to borrow to \$3,000,000. In addition, the margin rate spread was fixed at two and one quarter percent (2.25%); the unused line fee was increased to one half of one percent (0.50%); and the fixed coverage ratio covenant was modified such that it will be calculated on a fiscal year to date basis (instead of a rolling four quarter basis) commencing with the second quarter of fiscal 2009, provided that if the Company fails to comply with such fixed coverage ratio covenant for any quarter, then such ratio will be re-calculated to add back the amount of permitted dividends declared and actually paid during the period to meet the required 1.1 to 1.0 ratio, so long as the payment of such dividends does not result in the amount of consolidated cash to be below \$10,000,000 on the date of determination. The testing period will return to a rolling 4 quarter period effective with the end of the first quarter of 2010. The amendment also required the Company to secure all of the present and future indebtedness of the Company and its subsidiaries with a continuing first priority security interest in all present and future assets of the Company and its consolidated subsidiaries.

On November 2, 2006, the Company entered into an interest rate swap contract with the lender with an original notional amount of \$20,000,000, which was equal to 100% of the outstanding balance of the term loan on that date. The notional amount began decreasing on a quarterly basis on January 2, 2007 following the principal repayment schedule of the term loan. The Company has a fixed interest rate of 5.25% on the swap contract and paid the difference between the fixed rate and LIBOR when LIBOR was below 5.25% and received interest when the LIBOR rate exceeded 5.25%. This remained in effect until December 22, 2009 when the Company terminated the interest rate swap contract at a cost of \$967,350, which was accounted for as a charge to interest expense. After terminating the contract, the Company commenced a refinancing plan of the Company's outstanding debt.

Subsequent to January 2, 2010, the Company completed the refinancing of all of its debt. On January 29, 2010, the Company signed a new secured Loan Agreement (the *New Loan Agreement*) with People's United Bank ( *People's* ) which included a \$5,000,000 term portion and a \$10,000,000 revolving credit portion. The term portion of the loan requires quarterly payments of \$178,571 for a period of seven (7) years, maturing on January 31, 2017. The revolving credit portion has a quarterly commitment fee of one quarter of one percent (0.25%). The proceeds of the term portion along with the Company's available cash were used to retire the remaining portion of the debt with Bank of America, N.A., which on January 29, 2010 totaled \$10,714,286.

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Interest on the term portion of the New Loan Agreement is fixed at 4.98%. The interest rate on the revolving credit portion of the New Loan Agreement varies based on the LIBOR rate or People's Prime rate plus a margin spread of 2.25%, with a floor rate of 4.0%.

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The Eastern Company

Notes to Consolidated Financial Statements (continued)

**5. DEBT (continued)**

As a result of the refinancing in January 2010, the Company reclassified a portion of its long-term debt to current. Debt consists of:

	<b>2009</b>	<b>2008</b>
Term loan	<b>\$ 11,428,571</b>	\$ 13,571,428
Capital lease obligation with interest at 4.99% and payable in monthly installments of \$21,203 through April 2009		83,838
Capital lease obligation with interest at 0% and payable in monthly installments of \$1,915 through July 2009		13,407
	<b>11,428,571</b>	13,668,773
Less current portion	<b>7,142,858</b>	2,240,202
	<b>\$ 4,285,713</b>	\$ 11,428,571

The Company paid interest of \$1,649,607 in 2009, \$1,318,371 in 2008 and \$1,323,246 in 2007.

Collectively, under the covenants of the Loan Agreement and the New Loan Agreement, the Company is required to maintain specified financial ratios and amounts. In addition, the Company has restrictions on, among other things, new capital leases, purchases or redemptions of its capital stock, mergers and divestitures, and new borrowing.

As of January 2, 2010, scheduled annual principal maturities of long-term debt for each of the next five years follow:

2010	\$ 7,142,858
2011	714,286
2012	714,286
2013	714,286
2014	892,857
Thereafter	1,249,998
	<b>\$ 11,428,571</b>

The Company paid approximately \$5.7 million of the \$7.1 million of scheduled annual principal maturities for 2010, shown in the table above, in connection with the refinancing of the Company's debt on January 29, 2010.

All capital leases of the Company matured during Fiscal 2009. On January 3, 2009, building improvements and equipment, with a cost of approximately \$2,069,000, were recorded under capital leases with accumulated amortization of approximately \$978,000.

## 6. STOCK RIGHTS

On July 23, 2008, the Company adopted a new stock rights plan to replace the plan that expired on July 22, 2008. At January 2, 2010, there were 6,065,169 stock rights outstanding under the plan. Each right may be exercised to purchase one share of the Company's common stock at an exercise price of \$80.00, subject to adjustment to prevent dilution.

The rights generally become exercisable ten days after an individual or group acquires 10% or more of the Company's outstanding common stock, or after the commencement or announcement of an offer to acquire 10% or more of the Company's common stock. The stock rights, which do not have voting privileges, expire on July 23, 2018, and may be redeemed by the Company at a price of \$0.01 per right at any time prior to their expiration at the discretion of the Board of Directors. In the event that the Company were acquired in a merger or other business combination transaction, provision shall be made so that each holder of a right shall have the right to receive, upon exercise of the right at its then current exercise price, that number of shares of common stock of the surviving company which at the time of such transaction would have a market value of two times the exercise price of the right.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

**7. STOCK OPTIONS AND AWARDS****Stock Options**

The Company has stock option plans for officers, other key employees, and non-employee directors. At the end of 2009 two plans have shares reserved for future issuance, the 1995 and 2000 plans. Incentive stock options granted under the 1995 and 2000 plans must have exercise prices that are not less than 100% of the fair market value of the stock on the dates the options are granted. Restricted stock awards may also be granted to participants under the 1995 and 2000 plans with restrictions determined by the Compensation Committee of the Company's Board of Directors. Under the 1995 and 2000 plans, non-qualified stock options granted to participants will have exercise prices determined by the Compensation Committee of the Company's Board of Directors. No options or restricted stock were granted in 2009, 2008 or 2007.

As of January 2, 2010, there were 367,500 shares available for future grant under the above noted 2000 plan and there were no shares available for grant under the 1995 plan. As of January 2, 2010, there were 589,250 shares of common stock reserved under all option plans for future issuance.

Information with respect to the Company's stock option plans is summarized below:

	<b>Shares</b>	<b>Weighted Average Exercise Price</b>
Outstanding at December 30, 2006	1,002,750	\$ 9.233
Exercised	(339,750 )	7.544
Outstanding at December 29, 2007	663,000	10.099
Exercised	(196,606 )	9.468
Cancelled	(28,394 )	9.330
Outstanding at January 3, 2009	438,000	10.432
<b>Exercised</b>	<b>(153,421 )</b>	<b>10.325</b>
<b>Cancelled</b>	<b>(62,829 )</b>	<b>10.170</b>
<b>Outstanding at January 2, 2010</b>	<b>221,750</b>	<b>10.581</b>

**Options Outstanding and Exercisable**

Outstanding and Exercisable as of January 2, 2010	Weighted Average Remaining Contractual Life	Weighted Average Exercise Price
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Range of Exercise  
Prices

\$9.46	\$10.20	166,250	1.0	\$	9.579
\$13.58		<u>55,500</u>	5.0		13.580
		221,750	2.0		10.581

At January 2, 2010, outstanding and exercisable options had an intrinsic value of \$640,163. The total intrinsic value of stock options exercised in 2009 was \$683,754.

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Notes to Consolidated Financial Statements (continued)

**8. INCOME TAXES**

Deferred income taxes are provided on temporary differences between the carrying amounts of assets and liabilities for financial reporting purposes and those for income tax reporting purposes. Deferred income tax (assets) liabilities relate to:

	<b>2009</b>	<b>2008</b>	<b>2007</b>
Property, plant and equipment	<b>\$ 3,984,625</b>	\$ 3,775,424	\$ 3,399,329
Intangible assets			
Pensions			240,511
Other			
Total deferred income tax liabilities	<b>3,984,625</b>	3,775,424	3,639,840
Other postretirement benefits	<b>(472,878 )</b>	(375,028 )	(400,555 )
Inventories	<b>(688,253 )</b>	(782,446 )	(804,529 )
Allowance for doubtful accounts	<b>(93,386 )</b>	(79,714 )	(81,352 )
Intangible assets	<b>(409,233 )</b>	(302,576 )	(245,401 )
Accrued compensation	<b>(294,464 )</b>	(348,870 )	(360,540 )
Interest rate swap obligation		(413,190 )	(208,325 )
Pensions	<b>(4,248,502 )</b>	(5,116,289 )	
Tax credits		(557,354 )	(318,176 )
Environmental reserve			(77,679 )
Other	<b>(191,130 )</b>	(180,490 )	(9,181 )
Total deferred income tax assets	<b>(6,397,846 )</b>	(8,155,957 )	(2,505,738 )
Net deferred income tax (assets) liabilities	<b>\$ (2,413,221 )</b>	\$ (4,380,533 )	\$ 1,134,102

Income before income taxes consists of:

	<b>2009</b>	<b>2008</b>	<b>2007</b>
Domestic	<b>\$ 2,274,641</b>	\$ 4,901,283	\$ 13,133,039
Foreign	<b>(373,112 )</b>	1,141,565	1,712,424
	<b>\$ 1,901,529</b>	\$ 6,042,848	\$ 14,845,463

The provision for income taxes follows:

	<b>2009</b>	<b>2008</b>	<b>2007</b>
Current:			
Federal	<b>\$ 505,005</b>	\$ 896,199	\$ 4,537,394
Foreign	<b>(128,177 )</b>	198,634	281,201

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State	<b>252,506</b>	157,346	350,793
Deferred:			
Federal	<b>264,227</b>	352,450	(354,609 )
Foreign			
State	<b>(28,439 )</b>	(66,404 )	(50,009 )
	<b>\$ 865,122</b>	\$ 1,538,225	\$ 4,764,770

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The Eastern Company

Notes to Consolidated Financial Statements (continued)

**8. INCOME TAXES (continued)**

A reconciliation of income taxes computed using the U.S. federal statutory rate to that reflected in operations follows:

	<b>2009</b>		<b>2008</b>		<b>2007</b>		
	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>	<b>Amount</b>	<b>Percent</b>	
Income taxes using U.S. federal statutory rate	<b>\$ 646,520</b>	<b>34</b>	<b>% \$ 2,054,568</b>	<b>34</b>	<b>% \$ 5,047,457</b>	<b>34</b>	<b>%</b>
State income taxes, net of federal benefit	<b>149,893</b>	<b>8</b>	53,898	1	178,834	1	
Impact of foreign subsidiaries on effective tax rate	<b>173,415</b>	<b>9</b>	(379,009)	(6)	(558,068)	(4)	)
Impact of manufacturers deduction on effective tax rate	<b>(68,174)</b>	<b>(4)</b>	(95,620)	(2)	(149,950)	(1)	)
Other net	<b>(36,532)</b>	<b>(2)</b>	(95,612)	(2)	246,497	2	
	<b>\$ 865,122</b>	<b>45</b>	<b>% \$ 1,538,225</b>	<b>25</b>	<b>% \$ 4,764,770</b>	<b>32</b>	<b>%</b>

Total income taxes paid were \$645,976 in 2009, \$1,061,151 in 2008 and \$7,008,300 in 2007.

United States income taxes have been provided on the undistributed earnings of foreign subsidiaries (\$10,983,219 at January 2, 2010) only where necessary because such earnings are intended to be reinvested abroad indefinitely or repatriated only when substantially free of such taxes.

During 2009 and 2008, the Company received tax benefits of \$203,000 and \$356,000, respectively, as a result of the exercise and sale of qualified stock options that resulted in the disqualification of those incentive stock options, and the exercise of non-qualified stock options during the year. The tax benefit associated with the exercise of the qualified and non-qualified stock options has been recorded to common stock.

A reconciliation of the beginning and ending amount of unrecognized tax benefits are as follows:

	<b>2009</b>	<b>2008</b>	<b>2007</b>
Balance at beginning of year	<b>\$ 1,316,240</b>	\$ 1,527,813	\$
Balance recorded at adoption			1,565,014
Increase (decrease) for tax positions taken during a prior period	<b>(3,651)</b>	(37,014)	47,161
Increases for positions taken during the current period	<b>118,786</b>	80,822	384,373
Decreases relating to settlements	<b>(408,000)</b>	(34,595)	(47,161)
Decreases resulting from the expiration of the statute of limitations	<b>(231,835)</b>	(220,786)	(421,574)
Balance at end of year	<b>\$ 791,540</b>	\$ 1,316,240	\$ 1,527,813

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The Company files income tax returns in the U.S. federal jurisdiction, and various states and foreign jurisdictions. With few exceptions, the Company is no longer subject to U.S. federal, state and local income tax examinations by tax authorities for years before 2006 and non-U.S. income tax examinations by tax authorities prior to 2003.

Included in the balance at January 2, 2010, are \$488,317 of unrecognized tax benefits that would affect the annual effective tax rate. In 2009, the Company recognized accrued interest related to unrecognized tax benefits in income tax expense. The Company had approximately \$251,000 of accrued interest at January 2, 2010.

The total amount of unrecognized tax benefits could increase or decrease within the next twelve months for a number of reasons, including the closure of federal, state and foreign tax years by expiration of the statute of limitations and the recognition and measurement considerations under ASC 740. The Company believes that it is reasonably possible that the total amount of unrecognized tax benefits will not increase significantly and will decrease by approximately \$185,000 over the next twelve months related primarily to the earnings of its Hong Kong subsidiary.



The Eastern Company

Notes to Consolidated Financial Statements (continued)

## 9. LEASES

The Company leases certain equipment and buildings under operating lease arrangements. Most leases are for a fixed term and for a fixed amount; additionally, the Company leases certain buildings under operating leases on a month-to-month basis. The Company is not a party to any leases that have step rent provisions, escalation clauses, capital improvement funding or payment increases based on any index or rate.

Future minimum payments under non-cancelable operating leases with initial or remaining terms in excess of one year during each of the next five years follow:

2010	\$ 592,247
2011	580,930
2012	489,175
2013	101,559
2014	24,164
	\$ 1,788,075

Rent expense for all operating leases was \$758,606 in 2009, \$907,617 in 2008 and \$882,162 in 2007. The Company expects future rent expense, including non-cancelable operating leases, leases that are expected to be renewed and buildings leased on a month-to-month basis, for each of the next five years to be in the range of \$800,000 to \$900,000.

## 10. RETIREMENT BENEFIT PLANS

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

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

Effective January 3, 2009, the Company adopted authoritative guidance issued by the Financial Accounting Standards Board ( FASB ) related to measurement of pension and other postretirement benefit plans which requires the Company to measure the assets and obligations of its pension and other postretirement benefit plans as of the balance sheet date. Accordingly, in 2008 the Company was required to record fifteen (15) months of net periodic pension benefit cost in order to adopt the measurement date provision. The total cost was split into two parts, a twelve (12) month portion that was recorded as expense on the income statement, and a three (3) month portion that was recorded as an adjustment to retained earnings.

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Following is a summary of the net periodic benefit cost recorded in Fiscal 2008:

	15 Months	3 Months	12 Months
Service cost	\$2,324,033	\$446,701	\$1,877,332
Interest cost	3,352,940	667,863	2,685,077
Expected return on plan assets	(4,740,175 )	(948,035 )	(3,792,140 )
Amortization of prior service cost	260,052	52,010	208,042
Amortization of the net loss	82,890	16,578	66,312
Net periodic benefit cost	\$1,279,740	\$235,117	\$1,044,623

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The Eastern Company

Notes to Consolidated Financial Statements (continued)

**10. RETIREMENT BENEFIT PLANS** *(continued)*

Components of the net periodic benefit cost of the Company's pension benefit plans were as follows:

	<b>2009</b>	<b>2008</b>	<b>2007</b>
Service cost	<b>\$2,205,931</b>	\$1,877,332	\$1,758,564
Interest cost	<b>2,829,233</b>	2,685,077	2,481,996
Expected return on plan assets	<b>(4,054,864)</b> )	(3,792,140) )	(3,847,920) )
Amortization of prior service cost	<b>208,043</b>	208,042	81,791
Amortization of the transition obligation			(11,847) )
Amortization of the net loss	<b>2,523,903</b>	66,312	918,116
Net periodic benefit cost	<b>\$3,712,246</b>	\$1,044,623	\$1,380,700

Assumptions used to determine net periodic benefit cost for the Company's pension benefit plans for the fiscal year indicated were as follows:

	<b>2009</b>	<b>2008</b>	<b>2007</b>
Discount rate	<b>5.85%</b>	6.25%	5.8%
Expected return on plan assets	<b>8.5%</b>	8.5%	8.5%
Rate of compensation increase	<b>4.25%</b>	4.25%	4.25%

Components of the net periodic benefit cost of the Company's postretirement benefit plan were as follows:

	<b>2009</b>	<b>2008</b>	<b>2007</b>
Service cost	<b>\$ 135,963</b>	\$127,470	\$111,167
Interest cost	<b>132,513</b>	124,244	128,426
Expected return on plan assets	<b>(61,598)</b> )	(90,203) )	(88,847) )
Amortization of prior service cost	<b>(23,889)</b> )	(23,886) )	(23,866) )
Amortization of the net (gain) loss	<b>(52,568)</b> )	(33,560) )	(17,335) )
Net periodic benefit cost	<b>\$ 130,421</b>	\$104,065	\$109,545

Assumptions used to determine net periodic benefit cost for the Company's postretirement plan for the fiscal year indicated were as follows:

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	<b>2009</b>	<b>2008</b>	<b>2007</b>
Discount rate	<b>5.85%</b>	6.25%	5.8%
Expected return on plan assets	<b>8.5%</b>	8.5%	8.5%

As of the measurement date, the status of the Company's pension benefit plans and postretirement benefit plan was as follows:

	<b>Pension Benefit</b>		<b>Postretirement Benefit</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Benefit obligation at beginning of year	<b>\$ 47,154,975</b>	\$ 44,707,016	<b>\$ 2,190,254</b>	\$ 2,245,344
Change due to availability of final actual assets and census data				(180,343 )
Service cost	<b>2,205,931</b>	2,324,033	<b>135,963</b>	127,470
Interest cost	<b>2,828,090</b>	3,354,083	<b>132,513</b>	124,244
Actuarial (gain)/loss	<b>1,469,762</b>	(378,701 )	<b>131,233</b>	(11,022 )
Benefits paid	<b>(2,121,116 )</b>	(2,851,456 )	<b>(133,911 )</b>	(115,439 )
Benefit obligation at end of year	<b>\$ 51,537,642</b>	\$ 47,154,975	<b>\$ 2,456,052</b>	\$ 2,190,254

The Eastern Company

Notes to Consolidated Financial Statements (continued)

**10. RETIREMENT BENEFIT PLANS (continued)**

	<b>Pension Benefit</b>		<b>Postretirement Benefit</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Fair value of plan assets at beginning of year	\$ 31,843,051	\$ 45,272,679	\$ 1,127,535	\$ 1,134,110
Change due to availability of final actual assets and census data			(74,579 )	(72,901 )
Actual return on plan assets	6,843,175	(11,837,886 )	61,598	66,326
Employer contributions	2,920,044	1,259,714	133,911	115,439
Benefits paid	(2,121,116 )	(2,851,456 )	(133,911 )	(115,439 )
Fair value of plan assets at end of year	\$ 39,485,154	\$ 31,843,051	\$ 1,114,554	\$ 1,127,535

	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Funded Status				
Prepaid benefit cost	\$ 36,838	\$	\$	\$
Accrued benefit liability	(12,089,326 )	(15,311,924 )	(1,341,498 )	(1,062,719 )
Net amount recognized in the balance sheet	\$ (12,052,488 )	\$ (15,311,924 )	\$ (1,341,498 )	\$ (1,062,719 )

Amounts recognized in accumulated other comprehensive income consist of:

	<b>Pension Benefits</b>		<b>Postretirement Benefits</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Net (loss) gain	\$ (14,698,133 )	\$ (19,990,932 )	\$ 405,110	\$ 663,490
Prior service (cost) credit	(2,159,014 )	(916,710 )	207,061	230,950
	\$ (16,857,147 )	\$ (20,907,642 )	\$ 612,171	\$ 894,440

Change in the components of accumulated other comprehensive income consist of:

	<b>Pension Benefit</b>		<b>Postretirement Benefit</b>	
	<b>2009</b>	<b>2008</b>	<b>2009</b>	<b>2008</b>
Balance at beginning of period	\$ (20,907,642 )	\$ (5,051,224 )	\$ 894,440	\$ 857,299
Change due to availability of final actual assets and census data			(74,579 )	107,442
Charged to net periodic benefit cost				
Prior service cost	208,043	208,042	(23,889 )	(23,886 )
Net (gain) loss	2,523,903	66,312	(52,568 )	(33,560 )
Other changes				
Change in measurement date		68,588		
Liability (gains) losses	1,318,549	(16,199,360 )	(131,233 )	(12,855 )
Balance at end of period	\$ (16,857,147 )	\$ (20,907,642 )	\$ 612,171	\$ 894,440

In 2010, the net periodic pension benefit cost will include \$843,154 of net loss and \$204,569 of prior service cost and the net periodic post retirement benefit cost will include \$10,600 of net gain and \$23,900 of prior service credit.



The Eastern Company

Notes to Consolidated Financial Statements (continued)

#### 10. RETIREMENT BENEFIT PLANS (continued)

Assumptions used to determine the projected benefit obligations for the Company's pension benefit plans and postretirement benefit plan for the fiscal year indicated were as follows:

	<b>2009</b>		<b>2008</b>	
Discount rate	<b>5.85</b>	%	6.25	%
Expected return on plan assets	<b>8.5</b>	%	8.5	%
Rate of compensation increase	<b>4.25</b>	%	4.25	%

In 2009 and 2008, the accumulated benefit obligation for all qualified and nonqualified defined benefit pension plans was \$50,818,048 and \$44,589,783, respectively.

Information for the under-funded pension plans with a projected benefit obligation and an accumulated benefit obligation in excess of plan assets:

	<b>2009</b>	<b>2008</b>
Number of plans	<b>5</b>	6
Projected benefit obligation	<b>\$ 49,640,510</b>	\$ 47,154,975
Accumulated benefit obligation	<b>46,456,805</b>	44,589,783
Fair value of plan assets	<b>37,551,184</b>	31,843,051
Net amount recognized in accrued benefit liability	<b>(12,089,326 )</b>	(15,311,924 )

Estimated future benefit payments are \$2.4 million in 2010, \$2.5 million in 2011, \$2.6 million in 2012, \$2.6 million in 2013, \$2.7 million in 2014 and a total of \$15.5 million from 2015 through 2019.

Estimated future benefit payments to participants of the Company's postretirement plan are \$141,000 in 2010, \$147,000 in 2011, \$151,000 in 2012, \$160,000 in 2013, \$169,000 in 2014 and a total of \$944,000 from 2015 through 2019.

The Company expects to make cash contributions to its pension plans of approximately \$2.5 million and to its postretirement plan of approximately \$141,000 in 2010.

We consider a number of factors in determining and selecting assumptions for the overall expected long-term rate of return on plan assets. We consider the historical long-term return experience of our assets, the current and expected allocation of our plan assets, and expected long-term

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rates of return. We derive these expected long-term rates of return with the assistance of our investment advisors and generally base these rates on a 10-year horizon for various asset classes and consider the expected positive impact of active investment management. We base our expected allocation of plan assets on a diversified portfolio consisting of domestic and international equity securities and fixed income securities.

We consider a variety of factors in determining and selecting our assumptions for the discount rate at December 31. We develop a single equivalent discount rate derived with the assistance of our actuaries by matching expected future benefit payments in each year to the corresponding spot rates from the Citigroup Pension Liability Yield Curve, comprised of high quality (rated AA or better) corporate bonds.



The Eastern Company

Notes to Consolidated Financial Statements (continued)

**10. RETIREMENT BENEFIT PLANS (continued)**

The fair values of the company's pension plans assets at January 2, 2010, utilizing the fair value hierarchy discussed in Note 2, follow:

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<u>Cash and Equivalents:</u>				
Common/collective trust funds	\$	\$ 170,377	\$	\$ 170,377
<u>Equities:</u>				
The Eastern Company Common Stock	2,600,370			2,600,370
Common/collective trust funds		19,450,771		19,450,771
<u>Fixed Income:</u>				
Common/collective trust funds		15,524,546		15,524,546
Insurance contracts		1,739,090		1,739,090
Total	\$ 2,600,370	\$ 36,884,784	\$	\$ 39,485,154

The investment portfolio contains a diversified blend of common stocks, bonds, cash equivalents, and other investments, which may reflect varying rates of return. The investments are further diversified within each asset classification. The portfolio diversification provides protection against a single security or class of securities having a disproportionate impact on aggregate performance. The long-term target allocations for plan assets are 65% in equities and 35% in fixed income, although the actual plan asset allocations may be within a range around these targets. The actual asset allocations are reviewed and rebalanced on a periodic basis to maintain the target allocations.

The plans' assets include 193,624 shares and 167,658 shares of the common stock of the Company having a market value of \$2,600,370 and \$1,492,156 at January 2, 2010 and January 3, 2009, respectively. The plans purchased 25,966 and 27,810 shares of common stock of the Company during 2009 and 2008, respectively. Dividends received during 2009 and 2008 on the common stock of the Company were \$69,705 and \$40,171 respectively.

The fair values of the Company's postretirement plan assets at January 2, 2010, utilizing the fair value hierarchy discussed in Note 2, follow:

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
<u>Fixed Income:</u>				
Insurance contracts	\$	\$	\$ 1,114,554	\$ 1,114,554
Total	\$	\$	\$ 1,114,554	\$ 1,114,554

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For measurement purposes relating to the postretirement benefit plan, the life insurance cost trend rate is 1%. The health care cost trend rate for participants retiring after January 1, 1991 is nil; no increase in that rate is expected because of caps placed on benefits. The health care cost trend rate is expected to remain at 4.5% for participants after the year 2000.

A one-percentage-point change in assumed health care cost trend rates would have the following effects on the postretirement benefit plan:

	<b>1-Percentage Point</b>	
	<b>Increase</b>	<b>Decrease</b>
Effect on total of service and interest cost components	\$ 33,950	\$ (27,632 )
Effect on postretirement benefit obligation	\$ 214,494	\$ (197,856 )

The Eastern Company

Notes to Consolidated Financial Statements (continued)

**10. RETIREMENT BENEFIT PLANS (continued)**

U.S. salaried employees and most employees of the Company's Canadian subsidiaries are covered by defined contribution plans.

The Company has a contributory savings plan under Section 401(k) of the Internal Revenue Code covering substantially all U.S. non-union employees. The plan allows participants to make voluntary contributions of up to 100% of their annual compensation on a pretax basis, subject to IRS limitations. The plan provides for contributions by the Company at its discretion. The Company made contributions of \$165,188 in 2009, \$184,303 in 2008 and \$172,889 in 2007.

**11. REPORTABLE SEGMENTS**

The accounting policies of the segments are the same as those described in Note 2. Operating profit is total revenue less operating expenses, excluding interest and miscellaneous non-operating income and expenses. Inter-segment revenue, which is eliminated, is recorded on the same basis as sales to unaffiliated customers. Identifiable assets by reportable segment consist of those directly identified with the segment's operations.

During 2007, one customer accounted for approximately 27% of the revenue of the Industrial Hardware segment and approximately 14% of total revenue. No other customers exceeded 10% of total revenue in 2009, 2008 or 2007.

	2009	2008	2007
<b>Revenue:</b>			
Sales to unaffiliated customers:			
Industrial Hardware	\$ 49,954,491	\$ 60,041,074	\$ 81,601,557
Security Products	41,997,872	55,183,759	60,743,913
Metal Products	20,713,101	20,653,657	13,935,613
	<b>\$ 112,665,464</b>	<b>\$ 135,878,490</b>	<b>\$ 156,281,083</b>
<b>Inter-segment Revenue:</b>			
Industrial Hardware	\$ 215,742	\$ 614,803	\$ 893,752
Security Products	1,327,968	2,964,334	3,209,517
Metal Products	800,477	607,302	748,714
	<b>\$ 2,344,187</b>	<b>\$ 4,186,439</b>	<b>\$ 4,851,983</b>
<b>Income Before Income Taxes and Minority Interest:</b>			
Industrial Hardware	\$ 4,618,072	\$ 5,236,924	\$ 12,994,321
Security Products	1,540,694	4,032,771	5,207,005
Metal Products	(2,579,990 )	(2,239,297 )	(2,272,290 )
Operating Profit	<b>3,578,776</b>	<b>7,030,398</b>	<b>15,929,036</b>

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Interest expense	(1,727,980 )	(1,063,607 )	(1,288,952 )
Other income	50,733	34,747	205,379
	<b>\$ 1,901,529</b>	<b>\$ 6,001,538</b>	<b>\$ 14,845,463</b>

**Geographic Information:**

**Net Sales:**

United States	<b>\$ 99,636,783</b>	\$ 112,171,233	\$ 127,783,200
Foreign	<b>13,028,681</b>	23,707,257	28,497,883
	<b>\$ 112,665,464</b>	<b>\$ 135,878,490</b>	<b>\$ 156,281,083</b>

Foreign sales are primarily to customers in North America.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

**11. REPORTABLE SEGMENTS (continued)**

	2009	2008	2007
<b>Identifiable Assets:</b>			
United States	\$ 85,455,482	\$ 90,479,681	\$ 90,899,082
Foreign	15,416,377	15,537,287	17,452,819
	<b>\$ 100,871,859</b>	<b>\$ 106,016,968</b>	<b>\$ 108,351,901</b>
Industrial Hardware	\$ 25,000,814	\$ 27,744,552	\$ 31,492,875
Security Products	43,812,116	48,155,676	45,783,598
Metal Products	12,555,735	16,185,279	16,586,339
	<b>81,368,665</b>	<b>92,085,507</b>	<b>93,862,812</b>
General corporate	19,503,194	13,931,461	14,489,089
	<b>\$ 100,871,859</b>	<b>\$ 106,016,968</b>	<b>\$ 108,351,901</b>

	2009	2008	2007
<b>Depreciation and Amortization:</b>			
Industrial Hardware	\$ 1,763,500	\$ 1,786,227	\$ 1,898,251
Security Products	1,413,291	1,418,508	1,546,825
Metal Products	926,526	923,577	924,922
	<b>\$ 4,103,317</b>	<b>\$ 4,128,312</b>	<b>\$ 4,369,998</b>
<b>Capital Expenditures:</b>			
Industrial Hardware	\$ 1,307,927	\$ 1,174,762	\$ 1,649,767
Security Products	353,539	406,113	526,710
Metal Products	526,601	633,525	682,810
	<b>2,188,067</b>	<b>2,214,400</b>	<b>2,859,287</b>
Currency translation adjustment	(17,186 )	18,865	(28,941 )
General corporate	55,144	98,076	37,483
	<b>\$ 2,226,025</b>	<b>\$ 2,331,341</b>	<b>\$ 2,867,829</b>

**12. RECENT ACCOUNTING PRONOUNCEMENTS**

In December 2008, the FASB issued authoritative guidance on employer's disclosures about postretirement benefit plan assets, which requires additional disclosures for assets held by employer pension and other postretirement benefit plans. The required disclosures include information about fair value measurements of plan assets, including the investment policies and strategies for the major categories of plan assets, and significant concentrations of risk within plan assets. This guidance was effective for fiscal years ending after December 15, 2009 and provides only disclosure requirements and did not have a material impact on the consolidated financial statements of the Company.

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In May 2009, the FASB issued authoritative guidance on subsequent events, which introduces the concept of financial statements being available to be issued. This guidance will require the disclosure of the date through which an entity has evaluated subsequent events and the basis for that date (that is, whether that date represents the date the financial statements were issued or were available to be issued). For SEC registrants, this date will continue to be the date on which financial statements are filed with the SEC. This guidance was effective for fiscal years and interim periods beginning after June 15, 2009. The adoption of this new guidance had no impact on the consolidated financial statements of the Company. In February 2010, this guidance was effectively reversed for SEC filers because of a potential conflict between the guidance and SEC requirements.

The Eastern Company

Notes to Consolidated Financial Statements (continued)

## **12. RECENT ACCOUNTING PRONOUNCEMENTS (continued)**

In June 2009, the FASB issued authoritative guidance on consolidation of variable interest entities. The new guidance is intended to improve financial reporting by requiring additional disclosures about a company's involvement in variable interest entities. This new guidance is effective for fiscal years and interim periods beginning after November 15, 2009. The Company has not determined the impact, if any, of the adoption of this guidance on the consolidated financial statements of the Company.

In June 2009, the FASB issued, The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles (the Codification). The Codification is the source for authoritative U.S. Generally Accepted Accounting Principles recognized by the FASB to be applied by non-governmental entities. Rules and interpretive releases of the SEC under the authority of the federal securities laws are also sources of authoritative GAAP for SEC registrants. All other non-grandfathered non-SEC accounting literature not included in the Codification is non-authoritative. The Codification was effective for financial statements issued for interim and annual periods ending after September 15, 2009. The adoption of the Codification had no impact on the consolidated financial statements of the Company.

In August 2009, the FASB issued new accounting guidance to provide clarification on measuring liabilities at fair value when the quoted price in an active market for an identical liability is not available. The new guidance was effective for the first reporting period beginning after August 28, 2009. The adoption of this guidance had no impact on the consolidated financial statements of the Company.

In January 2010, the FASB issued new accounting guidance which requires new disclosures regarding transfers in and out of Level 1 and Level 2 fair value measurements, as well as requiring presentation on a gross basis of information about purchases, sales, issuances and settlements in Level 3 fair value measurements. The guidance also clarifies existing disclosures regarding level of disaggregation, inputs and valuation techniques. The new guidance is effective for interim and annual reporting periods beginning after December 15, 2009. Disclosures about purchases, sales, issuances and settlements in the roll forward of activity in Level 3 fair value measurements are effective for fiscal years beginning after December 15, 2010. As this guidance requires only additional disclosure, there should be no impact on the consolidated financial statements of the Company upon adoption.

## **13. FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS**

### **Financial Risk Management Objectives and Policies**

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

### **Credit Risk**

Credit risk is the potential financial loss resulting from the failure of a customer or counterparty to settle its financial and contractual obligations to the Company, as and when they become due. The primary credit risk for the Company is its receivable accounts. The Company has established credit limits for customers and monitors their balances to mitigate its risk of loss. At January 2, 2010 and January 3, 2009, there were no significant concentrations of credit risk. No one customer represented more than 10% of the Company's net trade receivables at January 2, 2010 and January 3, 2009. The maximum exposure to credit risk is primarily represented by the carrying amount of the Company's accounts receivable.

#### **Interest Rate Risk**

Prior to the refinancing completed in January 2010, the Company's exposure to the risk of changes in market interest rates related primarily to the Company's debt which bore interest at variable rates, which approximates market interest rates. While the Company used an interest rate swap to convert all of its Term Loan from variable to fixed rates for most of fiscal 2009, it terminated the swap contract on December 22, 2009. See Note 5 - Debt for additional details concerning the swap contract. The valuation of this swap was determined using the three month LIBOR index.



The Eastern Company

Notes to Consolidated Financial Statements (continued)

**13. FINANCIAL INSTRUMENTS AND FAIR VALUE MEASUREMENTS (continued)****Fair Value Measurements**

Assets and liabilities that require fair value measurement are recorded at fair value using market and income valuation approaches and considering the Company's and counterparty's credit risk. The Company uses the market approach and the income approach to value assets and liabilities as appropriate. There are no assets or liabilities requiring fair value measurement on January 2, 2010.

**14. SELECTED QUARTERLY FINANCIAL INFORMATION (UNAUDITED)**

Selected quarterly financial information (unaudited) follows:

	<b>First</b>	<b>Second</b>	<b>2009 Third</b>	<b>Fourth</b>	<b>Year</b>
Net sales	\$ 28,432,473	\$ 28,087,629	\$ 28,131,092	\$ 28,014,270	\$ 112,665,464
Gross margin	3,420,085	5,676,766	5,722,051	5,815,484	20,634,386
Selling and administrative expenses	4,388,863	4,103,087	4,371,875	4,191,785	17,055,610
Net (loss)/income	(1,082,530 )	842,382	907,377	369,178	1,036,407
Net (loss)/income per share:					
Basic	\$ (.18 )	\$ .14	\$ .15	\$ .06	\$ .17
Diluted	\$ (.18 )	\$ .13	\$ .15	\$ .06	\$ .17
Weighted average shares outstanding:					
Basic	5,965,751	5,967,826	5,991,345	6,017,708	5,985,640
Diluted	5,965,751	6,268,805	6,206,823	6,177,192	6,241,780

	<b>First</b>	<b>Second</b>	<b>2008 Third</b>	<b>Fourth</b>	<b>Year</b>
Net sales	\$ 32,918,911	\$ 36,098,718	\$ 34,550,899	\$ 32,309,962	\$ 135,878,490
Gross margin	6,764,101	6,871,581	5,446,670	6,380,746	25,463,098
Selling and administrative expenses	4,693,193	4,534,735	4,379,689	4,825,083	18,432,700
Net income	1,206,678	1,354,700	875,041	1,068,204	4,504,623
Net income per share:					
Basic	\$ .21	\$ .23	\$ .15	\$ .18	\$ .77
Diluted	\$ .20	\$ .22	\$ .14	\$ .17	\$ .73

Weighted average shares outstanding:

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Basic	5,811,962	5,835,601	5,881,284	5,964,813	5,875,140
Diluted	6,157,130	6,154,270	6,189,149	6,130,805	6,159,563

Fiscal 2009 consisted of four 13 week quarters totaling 52 weeks for the year. Fiscal 2008 consisted of 13 weeks for the first, second and third quarters, with the fourth quarter being 14 weeks, totaling 53 weeks for the year.

**15. SUBSEQUENT EVENT**

Subsequent to the date of these consolidated financial statements the Company refinanced its debt. See Note 5 Debt.

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Report of Fiondella, Milone and LaSaracina LLP, Independent Registered Public Accounting Firm

The Board of Directors

The Eastern Company

We have audited the accompanying consolidated balance sheet of The Eastern Company (the Company) as of January 2, 2010, and the related consolidated statements of income, comprehensive income (loss), shareholders' equity, and cash flows for the year ended January 2, 2010. Our audit also included the financial statement schedule listed in the Index at Item 15(a)(2). The Company's management is responsible for these financial statements. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of January 2, 2010, and the consolidated results of its operations and its cash flows for the year ended January 2, 2010 in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

We also have audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's internal control over financial reporting as of January 2, 2010, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO), and our report dated March 11, 2010 expressed an unqualified opinion.

/s/ Fiondella, Milone & LaSaracina LLP

Glastonbury, Connecticut

March 11, 2010

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Report of UHY LLP, Independent Registered Public Accounting Firm

The Board of Directors

The Eastern Company

We have audited the accompanying consolidated balance sheet of The Eastern Company (the Company) as of January 3, 2009, and the related consolidated statements of income, comprehensive (loss) income, shareholders' equity, and cash flows for each of the two years in the period ended January 3, 2009. Our audits also included the financial statement schedule listed in the Index at Item 15(a)(2). These financial statements and schedule are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements and schedule based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the consolidated financial position of the Company as of January 3, 2009, and the consolidated results of its operations and its cash flows for each of the two years in the period ended January 3, 2009, in conformity with accounting principles generally accepted in the United States of America. Also in our opinion, the related financial statement schedule, when considered in relation to the basic financial statements taken as a whole, presents fairly, in all material respects, the information set forth therein.

As discussed in Note 10 to the consolidated financial statements, the Company changed the measurement date for its pension benefit plan liability effective January 3, 2009 and, as discussed in Note 8, the Company changed its accounting for uncertain income tax positions effective December 31, 2006, both as required by accounting principles generally accepted in the United States of America.

/s/ UHY LLP

Hartford, Connecticut

March 11, 2009



**ITEM 9                    CHANGES IN AND DISAGREEMENTS WITH ACCOUNTANTS ON ACCOUNTING AND FINANCIAL DISCLOSURE**

For information regarding the change in the Company's independent registered public accounting firm, see the Form 8-K filed on June 12, 2009 and Form 8-K/A filed on June 17, 2009.

**ITEM 9A                 CONTROLS AND PROCEDURES**

*Evaluation of Disclosure Controls and Procedures*

As of the end of the fiscal year ended January 2, 2010, the Company carried out an evaluation, under the supervision and with the participation of the Company's management, including the Chief Executive Officer (the CEO) and Chief Financial Officer (the CFO), of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Exchange Act Rule 240.13a-15. The term "disclosure controls and procedures" means controls and other procedures of a company that are designed to ensure that the information required to be disclosed by the company in the reports it files or submits under the Securities and Exchange Act of 1934 is recorded, processed, summarized and reported within the time periods specified in the Commission's rules and forms. Based upon that evaluation, the CEO and CFO concluded that the Company's current disclosure controls and procedures are effective in timely alerting them to material information relating to the Company and its subsidiaries required to be included in the Company's periodic SEC filings.

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

*Management's Report on Internal Control over Financial Reporting*

The Company's management is responsible for establishing and maintaining adequate internal control over financial reporting, as such term is defined in Exchange Act Rules 240.13a-15(f). Under the supervision and with the participation of our management, including the CEO and CFO, we conducted an evaluation of the effectiveness of our internal control over financial reporting based on the framework in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). Based on our evaluation under the framework in *Internal Control - Integrated Framework*, our management concluded that our internal control over financial reporting was effective as of January 2, 2010.

The independent registered public accounting firm of the Company has issued a report on its assessment of the effectiveness of the Company's internal control over financial reporting as of January 2, 2010. Their report is included below in this Annual Report on Form 10-K.

*Changes in Internal Control over Financial Reporting*

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There were no significant changes in the Company's internal control over financial reporting during the last fiscal quarter that materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

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Report of Fiondella, Milone & LaSaracina LLP, Independent Registered Public Accounting Firm

The Board of Directors

The Eastern Company

We have audited The Eastern Company's (the Company) internal control over financial reporting as of January 2, 2010, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting included in Management's Report on Internal Control over Financial Reporting under Item 9A. Our responsibility is to express an opinion on the company's internal control over financial reporting based on our audit.

We conducted our audit in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether effective internal control over financial reporting was maintained in all material respects. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audit also included performing such other procedures as we considered necessary in the circumstances. We believe that our audit provides a reasonable basis for our opinion.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (1) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (2) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (3) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

In our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of January 2, 2010, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO).

We have also audited, in accordance with the standards of the Public Company Accounting Oversight Board (United States), the Company's consolidated balance sheet and the related consolidated statements of income, comprehensive income (loss), shareholders' equity, and cash flows for the year ended January 2, 2010 and our report dated March 11, 2010 expressed an unqualified opinion.



/s/ Fiondella, Milone & LaSaracina LLP

Glastonbury, Connecticut

March 11, 2010

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**ITEM 9B OTHER INFORMATION**

None.

**PART III**

**ITEM 10 DIRECTORS, EXECUTIVE OFFICERS AND CORPORATE GOVERNANCE**

The Registrant's definitive proxy statement ( Proxy Statement ) for the 2010 Annual Meeting of Shareholders which is incorporated herein by reference will be filed with the SEC pursuant to Regulation 14A not later than 120 days after January 2, 2010.

The information concerning directors is incorporated herein by reference to our Proxy Statement under the captions Item No. 1 Election of Director and Director Compensation in Fiscal 2009 .

The information concerning our executive officers is incorporated herein by reference to our Proxy Statement under the captions Compensation Discussion and Analysis , Compensation Committee Report , Compensation Committee Interlocks and Insider Participation , Executive Compensation , Stock Options , Options Exercised in Fiscal 2009 , Outstanding Equity Awards at Fiscal 2009 Year-End , and Termination of Employment and Change in Control Arrangements . The Registrant's only Executive Officers are Leonard F. Leganza, Chairman, President and Chief Executive Officer, and John L. Sullivan III, Vice President and Chief Financial Officer.

The information concerning our Audit Committee is incorporated herein by reference to our Proxy Statement under the captions Audit Committee Financial Expert , Report of the Audit Committee , The Board of Directors and Committees and Exhibit B The Eastern Company Audit Committee Charter . The Audit Committee Charter is also available on the Company's website <http://www.easterncompany.com> by clicking on Corporate Governance.

The information concerning compliance with Section 16(a) of the Securities Exchange Act is incorporated herein by reference to our Proxy Statement under the caption Section 16(a) Beneficial Ownership Reporting Compliance .

The Company's Board of Directors has adopted a Code of Business Conduct and Ethics that applies to our Chief Executive Officer, Chief Financial Officer, Chief Accounting Officer and the Company's other financial professionals. The Code of Business Conduct and Ethics is available on the Company's website at <http://www.easterncompany.com> by clicking on Corporate Governance.

**ITEM 11 EXECUTIVE COMPENSATION**

Information concerning director and executive compensation is incorporated herein by reference to portions of the Company's Proxy Statement to be filed with the SEC pursuant to Regulation 14A not later than 120 days after January 2, 2010, under the captions Director Compensation in Fiscal 2009 , Compensation Discussion and Analysis , Compensation Committee Report , Compensation Committee Interlocks and Insider Participation , Executive Compensation , Stock Options , Options Exercised in Fiscal 2009 , Outstanding Equity Awards at Fiscal 2009 Year-End and Termination of Employment and Change in Control Arrangements . The Compensation Committee of the Board of Directors operates under the Compensation Committee Charter, which can be found on the Company's website at <http://www.easterncompany.com> by clicking on Corporate Governance.



**ITEM 12 SECURITY OWNERSHIP OF CERTAIN BENEFICIAL OWNERS AND MANAGEMENT AND RELATED STOCKHOLDER MATTERS**

Security ownership of certain beneficial owners and management:

- (a) Information concerning security ownership of certain beneficial owners is incorporated herein by reference to the Proxy Statement to be filed with the SEC pursuant to Regulation 14A not later than 120 days after January 2, 2010, under the caption Security Ownership of Certain Beneficial Shareholders .
- (b) Information concerning security ownership of management is incorporated herein by reference to the Proxy Statement to be filed with the SEC pursuant to Regulation 14A not later than 120 days after January 2, 2010, under the captions Item No. 1 Election of Director , Security Ownership of Certain Beneficial Shareholders , Executive Compensation , Stock Options , Options Exercised in Fiscal 2009 , and Outstanding Equity Awards at Fiscal 2009 Year-End . See also the equity compensation plan information in Item 5 of this Annual Report on Form 10-K.
- (c) Changes in Control  
None.

**ITEM 13 CERTAIN RELATIONSHIPS AND RELATED TRANSACTIONS, AND DIRECTOR INDEPENDENCE**

Information regarding certain relationships and related transactions is incorporated herein by reference to our Proxy Statement to be filed with the SEC pursuant to Regulation 14A not later than 120 days after January 2, 2010 under the caption Policies and Procedures Concerning Related Persons Transactions .

Information regarding director independence is incorporated herein by reference to our Proxy Statement to be filed with the SEC pursuant to Regulation 14A not later than 120 days after January 2, 2010 under the captions Item No.1 Election of Director and The Board of Directors and Committees .

**ITEM 14 PRINCIPAL ACCOUNTING FEES AND SERVICES**

Information concerning principal accountant fees and services are incorporated herein by reference to our Proxy Statement to be filed with the SEC pursuant to Regulation 14A not later than 120 days after January 2, 2010 under the caption Item No. 3 Ratification of Appointment of Independent Registered Public Accounting Firm .

**PART IV**

**ITEM 15 EXHIBITS, FINANCIAL STATEMENT SCHEDULE**

- (a) Documents filed as part of this report:

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(1)	Financial statements		
	Consolidated Balance Sheets	January 2, 2010 and January 3, 2009	28.
	Consolidated Statements of Income	Fiscal years ended January 2, 2010, January 3, 2009 and December 29, 2007	30.
	Consolidated Statements of Comprehensive Income (Loss)	Fiscal years ended January 2, 2010, January 3, 2009 and December 29, 2007	30.
	Consolidated Statements of Shareholders' Equity	Fiscal years ended January 2, 2010, January 3, 2009 and December 29, 2007	31.
	Consolidated Statements of Cash Flows	Fiscal years ended January 2, 2010, January 3, 2009 and December 29, 2007	33.
	Notes to Consolidated Financial Statements		34.

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Report of Fiondella, Milone & LaSaracina LLP, Independent Registered Public

Accounting Firm	54.
Report of UHY LLP, Independent Registered Public Accounting Firm	55.
(2) Financial Statement Schedule Schedule II Valuation and qualifying accounts	61.

Schedules other than that listed above have been omitted because the required information is contained in the financial statements and notes thereto, or because such schedules are not required or applicable.

- (3) Exhibits  
Exhibits are as set forth in the Exhibit Index which appears on pages 63 through 64.

(b) Exhibits Required by Item 601 of Regulation S-K  
Exhibits are as set forth in the Exhibit Index which appears on pages 63 through 64. Also refer to the following Form 8-K s filed by the Company.

Form 8-K filed on March 11, 2009 setting forth the press release reporting the Company s engagement of Morgan Joseph & Co. Inc. as its financial advisor is incorporated herein by reference.

Form 8-K filed on April 22, 2009 setting forth the press release reporting the Company s earnings for the quarter ended April 4, 2009 is incorporated herein by reference.

Form 8-K filed on June 12, 2009 disclosing the change in the Company s Independent Registered Public Accounting Firm from UHY LLP to Fiondella, Milone & LaSaracina LLP is incorporated herein by reference.

Form 8-K/A filed on June 17, 2009 disclosing the change in the Company s Independent Registered Public Accounting Firm from UHY LLP to Fiondella, Milone & LaSaracina LLP is incorporated herein by reference.

Form 8-K filed on June 23, 2009 setting forth the amendment to the Company s loan agreements is incorporated herein by reference.

Form 8-K/A filed on June 24, 2009 setting forth the amendment to the Company s loan agreements is incorporated herein by reference.

Form 8-K filed on July 22, 2009 setting forth the press release reporting the Company s earnings for the quarter ended July 4, 2009 is incorporated herein by reference.

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Form 8-K filed on October 21, 2009 setting forth the press release reporting the Company's earnings for the quarter ended October 3, 2009 is incorporated herein by reference.

Form 8-K filed on October 22, 2009 setting forth an amendment to extend the Employment Agreement with the Company's Chairman is incorporated herein by reference.

Form 8-K filed on November 17, 2009 setting forth the amendment to the Company's loan agreements is incorporated herein by reference.

Form 8-K filed on February 1, 2010 setting forth the change in banking relationship from Bank of America, N.A. to People's United Bank is incorporated herein by reference.

Form 8-K filed on February 9, 2010 setting forth the press release reporting the Company's earnings for the quarter and fiscal year ended January 2, 2010 is incorporated herein by reference.

Form 8-K filed on February 11, 2010 setting forth the 2010 Executive Incentive Program is incorporated herein by reference.

(c) None.

## The Eastern Company and Subsidiaries

## Schedule II Valuation and Qualifying accounts

COL. A	COL. B	COL. C ADDITIONS (1)	(2)	COL. D	COL. E
Description	Balance at Beginning of Period	Charged to Costs and Expenses	Charged to Other Accounts-Describe	Deductions Describe	Balance at End of Period
Fiscal year ended January 2, 2010: Deducted from asset accounts:					
Allowance for doubtful accounts	\$328,000	\$320,716		\$256,716 (a)	\$392,000
Fiscal year ended January 3, 2009: Deducted from asset accounts:					
Allowance for doubtful accounts	\$342,000	\$132,988		\$146,988 (a)	\$328,000
Fiscal year ended December 29, 2007: Deducted from asset accounts:					
Allowance for doubtful accounts	\$319,000	\$ 45,740		\$22,740 (a)	\$342,000

(a) Uncollectible accounts written off, net of recoveries.



**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) 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.

Dated: March 11, 2010

THE EASTERN COMPANY

By /s/ John L. Sullivan III

**John L. Sullivan III**

Vice President and Chief Financial Officer

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the Registrant and in the capacities and on the dates indicated.

/s/ Leonard F. Leganza

March 11, 2010

**Leonard F. Leganza**

Chairman, President  
and Chief Executive Officer

/s/ John L. Sullivan III

March 11, 2010

**John L. Sullivan III**

Vice President and Chief Financial Officer

/s/ Kenneth R. Sapack

March 11, 2010

**Kenneth R. Sapack**

Chief Accounting Officer

/s/ John W. Everets

March 11, 2010

**John W. Everets**

Director

/s/ Charles W. Henry

March 11, 2010

**Charles W. Henry**

Director

/s/ David C. Robinson

March 11, 2010

**David C. Robinson**

Director

/s/ Donald S. Tuttle III

March 11, 2010

**Donald S. Tuttle III**

Director



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### EXHIBIT INDEX

- (3) Restated Certificate of Incorporation dated August 14, 1991 is incorporated by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 28, 1991 and the Registrant's Form 8-K filed on February 13, 1991. Amended and restated bylaws dated July 29, 1996 is incorporated by reference to the Registrant's Form 8-K filed on July 29, 1996.
- (4) Rights Agreement entered into between the Registrant and American Stock Transfer & Trust Company dated as of July 23, 2008 and Letter to all shareholders of the Registrant, dated June 23, 2008 together with Press Release dated June 23, 2008 describing the issuance of a Purchase Rights dividend distribution are incorporated by reference to the Registrant's Form 8-K filed on July 23, 2008.
- (10) (a) The Eastern Company 1995 Executive Stock Incentive Plan effective as of April 26, 1995 incorporated by reference to the Registrant's Form S-8 filed on February 7, 1997.
- (b) The Eastern Company Directors Fee Program effective as of October 1, 1996 incorporated by reference to the Registrant's Form S-8 filed on February 7, 1997, as amended by Amendment No.1 and Amendment No. 2 are incorporated by reference to the Registrant's Form 10-K filed on March 29, 2000 and Amendment No. 3 is incorporated by reference to the Registrant's Form 10-K filed on March 22, 2004.
- (c) The Eastern Company 1997 Directors Stock Option Plan effective as of September 17, 1997 incorporated by reference to the Registrant's Form S-8 filed on May 3, 2004.
- (d) Supplemental Retirement Plan dated September 9, 1998 with Leonard F. Leganza is incorporated by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended January 2, 1999, as amended by amendment incorporated by reference to the Registrant's Current Report on Form 8-K dated December 14, 2007.
- (e) The Eastern Company 2000 Executive Stock Incentive Plan effective July 2000 is incorporated by reference to the Registrant's Annual Report on Form 10-K for the fiscal year ended December 30, 2000.
- (f) Employment Agreement dated February 22, 2005 with Leonard F. Leganza is incorporated by reference to the Registrant's Current Report on Form 8-K dated February 22, 2005, as amended by amendments incorporated by reference to the Registrant's Current Report on Form 8-K dated October 25, 2007, Current Report on Form 8-K dated December 14, 2007, Current Report on Form 8-K dated October 22, 2008 and Current Report on Form 8-K dated October 22, 2009.
- (g) The Eastern Company 2010 Executive Incentive Program is incorporated by reference to the Registrant's Current Report on Form 8-K dated February 11, 2010.
- (14) The Eastern Company Code of Business Conduct and Ethics is incorporated by reference. The Eastern Company Code of Business Conduct and Ethics is available free of charge on the Company's Internet website at <http://www.easterncompany.com> under the section labeled "Corporate Governance".

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(21) List of subsidiaries as follows:

Eberhard Hardware Mfg. Ltd., a private corporation organized under the laws of the Province of Ontario, Canada.

Canadian Commercial Vehicles Corporation, a private corporation organized under the laws of the Province of British Columbia, Canada.

Eastern Industrial Ltd., a private corporation organized under the laws of the Peoples Republic of China.

World Lock Co. Ltd., a private corporation organized under the laws of Taiwan (The Republic of China).

Sesamee Mexicana, Subsidiary, a private corporation organized under the laws of Mexico.

World Security Industries Co. Ltd., a private corporation organized under the laws of Hong Kong.

(23) Consents of independent registered public accounting firms attached hereto on pages 65 and 66.

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

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

(99) Letter to our shareholders from the Annual Report 2010 is attached on page 70.