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ACME UNITED CORP
Form 10-Q
August 07, 2007

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

FORM 10-Q

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

For the quarterly period ended June 30, 2007

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 001-07698

ACME UNITED CORPORATION
(Exact name of registrant as specified in its charter)

CONNECTICUT (State or other jurisdiction of incorporation or organization)	06-0236700 (I.R.S. Employer Identification No.)
60 ROUND HILL ROAD, FAIRFIELD, CONNECTICUT (Address of principal executive offices)	06824 (Zip Code)

Registrant's telephone number, including area code: (203) 254-6060

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

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

Large accelerated filer Accelerated filer Non-accelerated filer

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

As of August 1, 2007 the registrant had outstanding 3,537,283 shares of its \$2.50 par value Common Stock.

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ACME UNITED CORPORATION

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ACME UNITED CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(all dollar amounts in thousands)

	June 30 2007 (unaudited)	December 31 2006 (Note 1)
	-----	-----
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 3,057	\$ 3,838
Accounts receivable, less allowance	18,056	10,852
Inventories:		
Finished goods	16,252	14,709
Work in process	1	63
Raw materials and supplies	827	905
	-----	-----
	17,079	15,677
Prepaid expenses and other current assets	1,013	846
Deferred income taxes	274	274
	-----	-----
Total current assets	39,479	31,487
	-----	-----
Property, plant and equipment:		
Land	163	159
Buildings	2,725	2,778
Machinery and equipment	7,441	7,006

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	10,329	9,943
Less accumulated depreciation	7,823	7,403
	2,506	2,540
Other assets	927	905
Goodwill	89	89
	\$ 43,001	\$ 35,021

See notes to condensed consolidated financial statements.

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ACME UNITED CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS (continued)
(all dollar amounts in thousands)

	June 30 2007 (unaudited)	December 31 2006 (Note 1)
LIABILITIES		
Current liabilities:		
Accounts payable	\$ 4,639	\$ 2,358
Other accrued liabilities	4,309	3,660
Current portion of long-term debt	10	9
	8,958	6,026
Total current liabilities	12,687	10,218
Long-term debt, less current portion	687	645
Other	22,332	16,890
Total liabilities		
STOCKHOLDERS' EQUITY		
Common stock, par value \$2.50:		
authorized 8,000,000 shares;		
issued 4,241,274 shares in 2007		
and 4,192,824 in 2006, including treasury stock	10,602	10,482
Treasury stock, at cost - 703,991 shares in 2007		
and 678,991 in 2006	(5,786)	(5,439)
Additional paid-in capital	3,357	3,014
Retained earnings	12,904	11,015
Accumulated other comprehensive loss:		
Translation adjustment	405	(129)
Minimum pension liability	(812)	(812)
	(408)	(941)
Total stockholders' equity	20,669	18,131
Total liabilities and stockholders' equity	\$ 43,001	\$ 35,021

See notes to condensed consolidated financial statements.

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ACME UNITED CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
 AND COMPREHENSIVE INCOME
 (UNAUDITED)
 (all amounts in thousands, except per share amounts)

	Three Months Ended June 30		
	2007	2006	
Net sales	\$ 18,999	\$ 16,984	\$
Costs and expenses:			
Cost of goods sold	11,020	9,556	
Selling, general and administrative expenses	5,435	4,995	
	16,455	14,551	
Income before non-operating items	2,544	2,433	
Non-operating items:			
Interest expense	156	130	
Other (income) expense, net	41	(38)	
	197	92	
Income before income taxes	2,347	2,341	
Income tax expense	825	835	
Net income	\$ 1,522	\$ 1,506	\$
Basic earnings per share	\$ 0.43	\$ 0.43	\$
Diluted earnings per share	\$ 0.41	\$ 0.40	\$
Weighted average number of common shares outstanding- denominator used for basic per share computations	3,527	3,489	
Weighted average number of dilutive stock options outstanding	171	242	
Denominator used for diluted per share computations	3,698	3,731	
Dividends declared per share	\$ 0.04	\$ 0.03	\$

See notes to condensed consolidated financial statements.

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ACME UNITED CORPORATION
 CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
 (UNAUDITED)
 (all amounts in thousands)

Six Months Ended
June 30

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	2007	2006
Operating Activities:		
Net income	\$ 2,172	\$ 2,265
Adjustments to reconcile net income to net cash used by operating activities:		
Depreciation	406	403
Amortization	23	17
Stock compensation expense	184	173
Changes in operating assets and liabilities:		
Accounts receivable	(6,962)	(5,425)
Inventories	(1,201)	(2,327)
Prepaid expenses and other current assets	(155)	(333)
Accounts payable	2,263	1,523
Other accrued liabilities	557	(587)
Total adjustments	(4,885)	(6,556)
Net cash used by operating activities	(2,713)	(4,291)
Investing Activities:		
Purchase of property, plant, and equipment	(337)	(128)
Purchase of patents and trademarks	(45)	(65)
Net cash used by investing activities	(382)	(193)
Financing Activities:		
Net borrowings of long-term debt	2,469	4,665
Proceeds from issuance of common stock	281	51
Dividends to stockholders	(246)	(222)
Purchase of treasury stock	(347)	-
Net cash provided by financing activities	2,157	4,494
Effect of exchange rate changes	159	(33)
Net change in cash and cash equivalents	(781)	(23)
Cash and cash equivalents at beginning of period	3,838	1,076
Cash and cash equivalents at end of period	\$ 3,057	\$ 1,053

See notes to condensed consolidated financial statements

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1 -- Basis of Presentation

In the opinion of management, the accompanying condensed consolidated financial statements include all adjustments necessary to present fairly the financial position, results of operations and cash flows of Acme United Corporation (the "Company"). These adjustments are of a normal, recurring nature. However, the financial statements do not include all of the disclosures normally required by

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accounting principles generally accepted in the United States of America or those normally made in the Company's Annual Report on Form 10-K. Please refer to the Company's Annual Report on Form 10-K for the year ended December 31, 2006 for such disclosures. The condensed consolidated balance sheet as of December 31, 2006 was derived from the audited consolidated balance sheet as of that date. The results of operations for interim periods are not necessarily indicative of the results to be expected for the full year. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations and financial statements and notes thereto, included in the Company's 2006 Annual Report on Form 10-K.

Note 2 -- Contingencies

The Company is involved from time to time in disputes and other litigation in the ordinary course of business and may encounter other contingencies, which may include environmental and other matters. The Company presently believes that none of these matters, individually or in the aggregate, would be likely to have a material adverse impact on financial position, results of operations or liquidity.

Note 3 -- Pension

Components of net periodic pension cost are as follows:

	Three Months Ended June 30,		Six
	2007	2006	2
Interest cost	\$ 47,500	\$ 45,948	\$
Service cost	7,500	6,250	
Expected return on plan assets	(57,500)	(62,048)	(
Amortization of prior service costs	2,250	2,138	
Amortization of actuarial gain	22,000	24,408	
	\$ 21,750	\$ 16,696	\$

Note 4 -- Long Term Debt and Shareholders Equity

The Company's revolving loan agreement, as amended, provides for borrowings up to \$15 million with the amounts outstanding to be repaid by June 30, 2009. At June 30, 2007 and December 31, 2006, the Company had outstanding borrowings of \$12,656,570 and \$10,187,245, respectively. Based on the scheduled maturity date, the Company has classified the borrowings at June 30, 2007 as long-term liabilities.

During the first six months of 2007, the Company issued 48,450 shares of common stock with proceeds of \$280,576 upon the exercise of outstanding stock options. During the same period, the Company also repurchased 25,000 shares of common stock for treasury. These shares were purchased at fair market value, with a total cost to the Company of \$346,983.

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Note 5-- Segment Information

The Company reports financial information based on the organization structure used by management for making operating and investment decisions and for assessing performance. The Company's reportable business segments consist of (1) United States; (2) Canada and (3) Europe. The activities of the Company's Asian operating segment are closely linked to those of the U.S. operating segment; accordingly, management reviews the financial results of both segments on a consolidated basis, and the results of the Asian operating segment have been aggregated with the results of the United States operating segment to form one reportable segment called the "United States operating segment". The determination of reportable segments is based on the guidance set forth in SFAS No. 131, "Disclosures about Segments of an Enterprise and Related Information". Each reportable segment derives its revenue from the sales of cutting devices, measuring instruments and safety products for school, office, home and industrial use.

The chief operating decision maker evaluates the performance of each operating segment based on segment revenues and operating income. Segment amounts are presented after converting to U.S. dollars and consolidating eliminations.

Financial data by segment:

(in thousands)

	Three months ended June 30 2007	2006	Six months ended June 30 2007	2006
	-----	-----	-----	-----
Sales to external customers				
United States	\$ 14,642	\$ 13,237	\$ 23,915	\$ 22,91
Canada	2,925	2,388	4,495	3,91
Europe	1,432	1,358	2,829	2,41
	-----	-----	-----	-----
Consolidated	\$ 18,999	\$ 16,984	\$ 31,239	\$ 29,24
	=====	=====	=====	=====
Operating Income				
United States	\$ 2,293	\$ 2,320	\$ 3,595	\$ 3,72
Canada	401	322	458	39
Europe	(151)	(209)	(333)	(39
	-----	-----	-----	-----
Consolidated	\$ 2,543	\$ 2,433	\$ 3,720	\$ 3,72
	=====	=====	=====	=====
	June 30 2007	December 31 2006		
	-----	-----		
Total assets by segment				
United States	\$ 31,150	\$ 24,515		
Canada	7,212	6,286		
Europe	4,639	4,219		
	-----	-----		
Consolidated	\$ 43,001	\$ 35,020		
	=====	=====		

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Note 6 - Stock Based Compensation

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The Company recognizes share-based compensation in accordance with the provisions of Statement of Financial Accounting Standards No. 123R, "Share-Based Payment" ("SFAS 123R"). Share-based compensation expense was \$131,000 and \$107,000 for the quarters ended June 30, 2007 and June 30, 2006, respectively. Share-based compensation expense was \$184,000 and \$173,000 for the six months ended June 30, 2007 and June 30, 2006, respectively. During the three and six months ended June 30, 2007, the Company issued 97,750 options with a weighted average fair value of \$4.96. During the three and six months ended June 30, 2006, the Company issued 28,000 and 50,500 options with a fair value of \$4.05 and \$4.35, respectively. The assumptions used to value option grants for the three and six months ended June 30, 2007 and June 30, 2006 are as follows:

	Three months ended June 30		Six months ended June 30	
	2007	2006	2007	2006
Expected life in years	5	4	5	4
Interest rate	4.51 - 5.18%	4.90%	4.51 - 5.18%	4.32 - 4.90%
Volatility	0.32	0.34	.32	.34
Dividend yield	1.1%	0.80%	1.1%	0.80 - 0.90%

As of June 30, 2007, there was \$663,191 of unrecognized compensation cost related to non-vested share-based payments granted to the Company's employees. The remaining unamortized expense is expected to be recognized over a weighted average period of approximately 3 years.

Note 7 - Comprehensive Income

Comprehensive income for the three and six months ended June 30, 2007 and June 30, 2006 consisted of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2007	2006	2007	2006
Net Income	1,522	1,506	2,172	2,172
Other comprehensive income/(loss) - Foreign currency translation	469	250	532	532
Comprehensive income	<u>\$ 1,992</u>	<u>\$ 1,756</u>	<u>\$ 2,704</u>	<u>\$ 2,704</u>

Note 8 - Income Taxes

The Company adopted the provisions of Financial Accounting Standards Board ("FASB") Interpretation No. 48, "Accounting for Uncertainty in Income Taxes—an interpretation of FASB Statement No. 109" ("FIN 48"), on January 1, 2007. FIN 48 clarifies the accounting for uncertainty in income taxes recognized in an enterprise's financial statements in accordance with FASB Statement 109, "Accounting for Income Taxes", and prescribes a recognition threshold and measurement process for financial statement recognition and measurement of a tax

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position taken or expected to be taken in a tax return. FIN 48 also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

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The Company files income tax returns in the U.S. federal jurisdiction, and various state and foreign jurisdictions. There was no effect on the Company's financial statements from the adoption of FIN 48. The Company's evaluation of FIN 48 was performed for the tax years ended December 31, 2003, 2004, 2005 and 2006, the tax years which remain subject to examination by major tax jurisdictions as of June 30, 2007. The impact on the Company as a result of the adoption of FIN 48 on January 1, 2007 was zero. The Internal Revenue Service (IRS) has completed its exam of the Company's U.S. federal income tax return for 2004 with no recommended changes.

In accordance with the Company's accounting policy, any interest and penalties related to uncertain tax positions are recognized in income tax expense.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

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

Forward-Looking Information

The Company may from time to time make written or oral "forward-looking statements" including statements contained in this report and in other communications by the Company, which are made in good faith by the Company pursuant to the "safe harbor" provisions of the Private Securities Litigation Reform Act of 1995.

These forward-looking statements include statements of the Company's plans, objectives, expectations, estimates and intentions, which are subject to change based on various important factors (some of which are beyond the Company's control). The following factors, in addition to others not listed, could cause the Company's actual results to differ materially from those expressed in forward looking statements: the strength of the domestic and local economies in which the Company conducts operations, changes in client needs and consumer spending habits, the impact of competition and technological change on the Company, the Company's ability to manage its growth effectively, including its ability to successfully integrate any business which it might acquire, and currency fluctuations. All forward-looking statements in this report are based upon information available to the Company on the date of this report. The Company undertakes no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events, or otherwise, except as required by law.

Critical Accounting Policies

There have been no material changes to our critical accounting policies and estimates from the information provided in Item 7, Management's Discussion and Analysis of Financial Condition and Results of Operations, included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

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Results of Operations

Net Sales

Consolidated net sales for the three months ended June 30, 2007 were \$18,999,000 compared with \$16,984,000 in the same period in 2006, a 12% increase (11% at constant currency). Consolidated net sales for the six months ended June 30, 2007 were \$31,240,000, compared with \$29,241,000 for the same period in 2006, a 7% increase (6% at constant currency). Net sales for the first six months ended June 30, 2007 in the U.S. operating segment increased 4% primarily due to increased sales of the new iPoint electric pencil sharpener. Sales in Canada increased by 15% (14% in local currency) due to sales of the new iPoint electric pencil sharpeners and other new school products. Sales in Europe increased by 17% (9% in local currency) mainly due to expansion in the office trade channel.

Traditionally, the Company's sales are stronger in the second and third quarters, and weaker in the first and fourth quarters of the fiscal year, due to the seasonal nature of the back-to-school market.

Gross Profit

Gross profit for the three months ended June 30, 2007 was \$7,979,000 (42.0% of net sales) compared to \$7,428,000 (43.7% of net sales) for the same period in 2006. Gross profit for the six months ended June 30, 2007 was \$13,313,000 (42.6% of net sales) compared to \$12,980,000 (44.4% of net sales) in the same period in 2006. The lower margin in the first six months of 2007 as compared to the same period in 2006 is the result of greater sales of lower margin products, increased raw material costs and the appreciation of the Chinese currency.

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Selling, General and Administrative Expenses

Selling, general and administrative ("SG&A") expenses for the three months ended June 30, 2007 were \$5,435,000 (28.6% of net sales) compared with \$4,995,000 (29.4% of net sales) for the same period of 2006, an increase of \$440,000. SG&A expenses for the six months ended June 30, 2007 were \$9,593,000 (30.7% of net sales) compared with \$9,254,000 (31.6% of net sales) in the comparable period of 2006.

Operating Income

Operating income for the three months ended June 30, 2007 was \$2,543,000 compared with \$2,433,000 in the same period of 2006. Operating income for the six months ended June 30, 2007 was \$3,720,000 as compared to \$3,726,000 in the same period of 2006.

Interest Expense

Interest expense for the three months ended June 30, 2007 was \$156,000, compared with \$130,000 for the same period of 2006, a \$26,000 increase. Interest expense for the six months ended June 30, 2007 was \$310,000 as compared to \$255,000 for the same period in 2006, a \$55,000 increase. The increase in interest expense was primarily the result of higher borrowings under the Company's bank revolving credit facility.

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Other (Income) Expense, Net

Net other expense was \$41,000 in the three months ended June 30, 2007 compared to net other income of \$38,000 in the same period of 2006. Net other expense was \$14,000 in the first six months of 2007 compared to net other income of \$114,000 in the first six months of 2006. The change from 2006 is primarily due to lower gains from foreign currency transactions in the first quarter of 2007.

Income Taxes

The effective tax rate in the first six months of 2007 was 36% compared to 37% in the first six months of 2006.

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Financial Condition

Liquidity and Capital Resources

The Company's working capital, current ratio and long-term debt to equity ratio follow:

	June 30, 2007	December 31, 2006
	-----	-----
Working capital	\$ 30,520,173	\$ 25,460,578
Current ratio	4.41	5.22
Long term debt to equity ratio	61.5%	56.3%

During the first six months of 2007, total debt outstanding under the Company's Modified Loan agreement, referred to below, increased by \$2,469,325 compared to total debt at December 31, 2006, principally due to an increase in borrowings for inventory and accounts receivables for the back to school season, partially offset by earnings. As of June 30, 2007, \$12,657,000 was outstanding and \$2,343,000 was available for borrowing under the Modified Loan Agreement.

On March 6, 2006, the Company modified its Revolving Loan Agreement (the "Modified Loan Agreement") with Wachovia Bank. The Modified Loan Agreement amends certain provisions of the original Revolving Loan Agreement. The amendments include an increase in the maximum borrowing amount from \$10 million to \$15 million; an extension of the maturity date of the loan from June 30, 2007 to June 30, 2009; a decrease in the interest rate to LIBOR plus 1% (from LIBOR plus 1.5%), as well as modifications to certain covenant restrictions. Funds borrowed under the Modified Loan Agreement are used for working capital, general operating expenses and certain other purposes.

Cash expected to be generated from operating activities, together with funds available under the Modified Loan Agreement are expected, under current conditions, to be sufficient to finance the Company's planned operations over the next twelve months.

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MANAGEMENT'S DISCUSSION AND ANALYSIS OF

FINANCIAL CONDITION AND RESULTS OF OPERATIONS-Continued

Item 3. Quantitative and Qualitative Disclosure About Market Risk

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There are no material changes in market risks as disclosed in the Company's annual Report on Form 10-K for the year ended December 31, 2006.

Item 4. Controls and Procedures

(a) Evaluation of Internal Controls and Procedures

Our Chief Executive Officer and Chief Financial Officer have reviewed and evaluated the effectiveness of our disclosure controls and procedures, which included inquiries made to certain other of our employees. Based on their evaluation, our Chief Executive Officer and Chief Financial Officer have each concluded that, as of June 30, 2007, our disclosure controls and procedures were effective and sufficient to ensure that we record, process, summarize and report information required to be disclosed by us in our periodic reports filed under the Securities and Exchange Commission's rules and forms.

(b) Changes in Internal Control over Financial Reporting

During the quarter ended June 30, 2007, there were no changes in our internal control over financial reporting that materially affected, or was reasonably likely to materially affect, this control.

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PART II. OTHER INFORMATION

Item 1 -- Legal Proceedings

The Company is involved from time to time in disputes and other litigation in the ordinary course of business, including certain environmental and other matters. The Company presently believes that none of these matters, individually or in the aggregate, would be likely to have a material adverse impact on its financial position, results of operations, or liquidity.

Item 1A - Risk Factors

See Risk Factors set forth in Part I, Item 1A of the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2006.

Item 2 -- Unregistered Sales of Equity Securities and Use of Proceeds

None

Item 3. --Defaults Upon Senior Securities

None

Item 4 -- Submission of Matters to a Vote of Security Holders

The Company's Annual Meeting of shareholders was held on April 23, 2007.

A. The following individuals were elected Directors at the Meeting and comprise the entire Board.

Votes for	Votes against
-----	-----

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Rex Davidson	2,874,446	435,492
Richmond Y. Holden, Jr.	2,920,302	389,636
Walter C. Johnsen	2,813,802	496,136
Susan H. Murphy	2,874,746	435,192
Brian Olschan	2,870,182	439,756
Gary D. Penisten	2,873,325	436,613
Stephen Spinelli, Jr.	2,874,746	435,192
Stevenson E. Ward	2,818,366	491,572

- B. The amendment to the 2005 Non-Employee Director Stock Option Plan was approved with 1,398,255 votes for the proposal, 559,105 votes against and 8,375 votes abstaining.
- C. The Amendment to the Employee Stock Option Plan was approved with 1,487,586 votes for the proposal, 469,674 votes against and 8,475 votes abstaining.

Item 5 -- Other Information

None.

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Item 6 -- Exhibits

Documents filed as part of this report.

Exhibit 31.1 Certification of Walter C. Johnsen pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 31.2 Certification of Paul G. Driscoll pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

Exhibit 32.1 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

Exhibit 32.2 Certification Pursuant to 18 U.S.C. Section 1350, as Adopted Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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SIGNATURES

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

ACME UNITED CORPORATION

By /s/ WALTER C. JOHNSEN

 Walter C. Johnsen
 Chairman of the Board and
 Chief Executive Officer

Dated: August 7, 2007

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By /s/ PAUL G. DRISCOLL

 Paul G. Driscoll
 Vice President and
 Chief Financial Officer

Dated: August 7, 2007

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