

NATIONAL PRESTO INDUSTRIES INC  
Form 10-Q  
November 07, 2008

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

**FORM 10-Q**

ii

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

For the quarterly period ended: September 28, 2008

or

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

For the transition period from: \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: **1-2451**

**NATIONAL PRESTO INDUSTRIES, INC.**

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

**WISCONSIN**

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

**39-0494170**

*(I.R.S. Employer  
Identification No.)*

**3925 NORTH HASTINGS WAY, EAU CLAIRE, WISCONSIN 54703-3703**

*(Address of Principal Executive Office) (Zip Code)*

**715-839-2121**

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

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

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

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

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

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

There were 6,847,119 shares of the Issuer's Common Stock outstanding as of October 26, 2008.

**PART I FINANCIAL INFORMATION****ITEM 1.****FINANCIAL STATEMENTS****NATIONAL PRESTO INDUSTRIES, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****September 28, 2008 and December 31, 2007****(Unaudited)**

(Dollars in thousands)

	<b>2008</b>	<b>2007</b>
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$ 4,336	\$ 26,715
Marketable securities	115,337	116,559
Accounts receivable, net	69,134	87,918
Inventories:		
Finished goods	\$ 42,914	\$ 31,681
Work in process	36,286	25,831
Raw materials	6,521	85,721
	7,973	65,485
Deferred tax assets	5,725	5,694
Other current assets	731	1,408
Total current assets	280,984	303,779
	93,985	90,391

PROPERTY, PLANT AND  
EQUIPMENT

Less allowance for depreciation	37,674	56,311	31,129	59,262
GOODWILL		11,485		11,485
OTHER ASSETS		150		150
		\$ 348,930		\$ 374,676

The accompanying notes are an integral part of the financial statements.

**NATIONAL PRESTO INDUSTRIES, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS****September 28, 2008 and December 31, 2007****(Unaudited)**

(Dollars in thousands)

	<b>2008</b>	<b>2007</b>
<b>LIABILITIES</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$ 35,832	\$ 40,381
Federal and state income taxes	1,996	5,795
Accrued liabilities	15,924	30,599
Total current liabilities	53,752	76,775
DEFERRED INCOME TAXES	3,290	3,290
<b>COMMITMENTS AND CONTINGENCIES</b>		
 <b>STOCKHOLDERS' EQUITY</b>		
Common stock, \$1 par value:		
Authorized: 12,000,000 shares:		
Issued 7,440,518 shares	\$ 7,441	\$ 7,441
Paid-in capital	1,649	1,496
Retained earnings	301,212	304,246
Accumulated other comprehensive income	119	176
	310,421	313,359
Treasury stock, at cost	18,533	18,748

Total stockholders' equity	291,888	294,611
	\$ 348,930	\$ 374,676

The accompanying notes are an integral part of the financial statements.

## NATIONAL PRESTO INDUSTRIES, INC.

## CONSOLIDATED STATEMENTS OF EARNINGS

Three Months and Nine Months Ended September 28, 2008 and September 30, 2007

(Unaudited)

(In thousands except per share data)

	Three Months Ended		Nine Months Ended	
	2008	2007	2008	2007
Net sales	\$ 113,183	\$ 99,492	\$ 301,853	\$ 276,748
Cost of sales	93,031	81,063	249,539	230,536
Gross profit	20,152	18,429	52,314	46,212
Selling and general expenses	5,290	6,573	15,050	19,647
Operating profit	14,862	11,856	37,264	26,565
Other income	966	1,219	3,269	4,057
Earnings before provision for income taxes	15,828	13,075	40,533	30,622
Income tax provision	5,627	4,363	14,500	9,940
Net earnings	\$ 10,201	\$ 8,712	\$ 26,033	\$ 20,682
Weighted average shares outstanding:				
Basic	6,846	6,837	6,844	6,835
Diluted	6,846	6,837	6,844	6,835
Net earnings per share:				
Basic	\$ 1.49	\$ 1.27	\$ 3.80	\$ 3.03
Diluted	\$ 1.49	\$ 1.27	\$ 3.80	\$ 3.03
Cash dividends declared and paid per common share	\$	\$	\$ 4.25	\$ 3.80

The accompanying notes are an integral part of the financial statements.



**NATIONAL PRESTO INDUSTRIES, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****Nine Months Ended September 28, 2008 and September 30, 2007****(Unaudited)**

(Dollars in thousands)

	<b>2008</b>	<b>2007</b>
Cash flows from operating activities:		
Net earnings	\$ 26,033	\$ 20,682
Adjustments to reconcile net earnings to net cash provided by (used in) operating activities:		
Provision for depreciation	6,584	6,301
Other	832	166
Changes in:		
Accounts receivable	18,784	5,482
Inventories	(20,236 )	(29,147 )
Other current assets	677	408
Accounts payable and accrued liabilities	(19,224 )	11,083
Federal and state income taxes	(4,424 )	(3,356 )
Net cash provided by operating activities	9,026	11,619
Cash flows from investing activities:		
Marketable securities purchased	(92,324 )	(56,168 )
Marketable securities - maturities and sales	93,458	46,775
Acquisition of property, plant and equipment	(3,664 )	(3,775 )
Acquisition of businesses, net of cash acquired		(6,748 )
Sale of property, plant and equipment	2	200
Net cash used in investing activities	(2,528 )	(19,716 )
Cash flows from financing activities:		
Dividends paid	(29,067 )	(25,958 )
Other	190	41
Net cash used in financing activities	(28,877 )	(25,917 )
Net decrease in cash and cash equivalents	(22,379 )	(34,014 )
Cash and cash equivalents at beginning of period	26,715	46,696
Cash and cash equivalents at end of period	\$ 4,336	\$ 12,682

The accompanying notes are an integral part of the financial statements.

## NATIONAL PRESTO INDUSTRIES, INC., AND SUBSIDIARIES

## NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

## NOTE A EARNINGS PER SHARE

The Company's basic net earnings per share amounts have been computed by dividing net earnings by the weighted average number of outstanding common shares. The Company's diluted net earnings per share is computed by dividing net earnings by the weighted average number of outstanding common shares and common share equivalents relating to stock options, when dilutive.

## NOTE B BUSINESS SEGMENTS

In the following summary, operating profit (loss) represents earnings (loss) before other income, principally interest income and income taxes. The Company's segments operate discretely from each other with no shared manufacturing facilities. Costs associated with corporate activities (such as cash and marketable securities management) and the assets associated with such activities are included within the Housewares/Small Appliances segment for all periods presented.

	(in thousands)			
	Housewares/ Small Appliances	Defense Products	Absorbent Products	Total
<b>Quarter ended September 28, 2008</b>				
External net sales	\$ 31,129	\$ 61,664	\$ 20,390	\$ 113,183
Gross profit (loss)	7,152	13,381	(381 )	20,152
Operating profit (loss)	3,668	11,843	(649 )	14,862
Total assets	199,472	103,952	45,506	348,930
Depreciation	192	815	1,223	2,230
Capital expenditures	161	784	209	1,154
<b>Quarter ended September 30, 2007</b>				
External net sales	\$ 29,735	\$ 53,961	\$ 15,796	\$ 99,492
Gross profit (loss)	6,896	11,834	(301 )	18,429
Operating profit (loss)	3,276	9,104	(524 )	11,856

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Total assets	211,473	89,223	42,412	343,108
Depreciation	190	698	1,236	2,124
Capital expenditures	227	1,389	(263 )	1,353

(in thousands)

	<b>Housewares/ Small Appliances</b>	<b>Defense Products</b>	<b>Absorbent Products</b>	<b>Total</b>
<b>Nine Months ended September 28, 2008</b>				
External net sales	\$ 75,356	\$ 173,208	\$ 53,289	\$ 301,853
Gross profit (loss)	15,987	36,766	(439 )	52,314
Operating profit (loss)	6,636	31,903	(1,275 )	37,264
Total assets	199,472	103,952	45,506	348,930
Depreciation	580	2,356	3,648	6,584
Capital expenditures	370	2,322	972	3,664
<b>Nine Months ended September 30, 2007</b>				
External net sales	\$ 66,895	\$ 162,119	\$ 47,734	\$ 276,748
Gross profit (loss)	14,579	32,853	(1,220 )	46,212
Operating profit (loss)	3,640	24,898	(1,973 )	26,565
Total assets	211,473	89,223	42,412	343,108
Depreciation	575	2,002	3,724	6,301
Capital expenditures	762	2,922	91	3,775

**NATIONAL PRESTO INDUSTRIES, INC., AND SUBSIDIARIES****NOTES TO CONSOLIDATED FINANCIAL STATEMENTS****(Unaudited)****(Continued)****NOTE C PRODUCT WARRANTY**

The Company's Housewares/Small Appliance Segment's products are generally warranted to the original owner to be free from defects in material and workmanship for a period of 1 to 12 years from date of purchase. The Company allows a 60-day over-the-counter initial return privilege through cooperating dealers. The Company services its products through a corporate service repair operation. The Company's service and warranty programs are competitive with those offered by other manufacturers in the industry. The Company determines its product warranty liability based on historical percentages which have remained relatively consistent over the years.

The product warranty liability is included in accounts payable on the balance sheet. During the prior year, certain warranty claims were reclassified and accounted for as sales returns and allowances. The following table shows the changes in product warranty liability for the period:

	<b>(in thousands)</b>	
	<b>2008</b>	<b>2007</b>
Beginning balance January 1	\$ 429	\$ 2,692
Reclassification of certain warranty claims as sales returns and allowances	0	(2,597)
Accruals (reversals) during the period	(177)	340
Payments made under the warranties	(133)	(314)
Balance end of period	\$ 119	\$ 121

**NOTE D DISPOSAL ACTIVITIES**

On October 9, 2006, the Company decided to consolidate its adult incontinence production capabilities in its Absorbent Products segment and, as a result, began the process of relocating its adult incontinence manufacturing equipment from its Marietta, Georgia facility to its Eau Claire, Wisconsin facility. This consolidation, which began during the 4th quarter of 2006, was completed during the 1st quarter of 2007 and served to improve the segment's long-term manufacturing efficiencies. As a result of the consolidation, the Georgia facility has been closed. The

Company issued a W.A.R.N. (Worker Adjustment and Retraining Notification) notice on October 9, 2006. The total cost of the relocation activities was \$950,000, including \$760,000 for the disassembly, transportation, installation of machinery and equipment and other related costs and \$190,000 for one-time termination benefits to affected employees. During the first three quarters of 2007, \$310,000 was incurred for the disassembly, transportation, installation of machinery and equipment and other related costs, and \$180,000 was incurred for one-time termination benefits to affected employees. Expenses related to the above disposal activities are included in Cost of Sales. With the exception of one time termination benefits and capital expenditures related to the shut-down of the Georgia facility, costs are expensed as incurred, consistent with the requirements of SFAS No. 146, Accounting for Costs Associated with Exit or Disposal Activities, as employee services are performed and other associated costs are incurred.

#### NOTE E COMMITMENTS AND CONTINGENCIES

The Company is involved in routine litigation incidental to its business. Management believes the ultimate outcome of this litigation will not have a material effect on the Company's consolidated financial position, liquidity, or results of operations.

#### NOTE F ACCUMULATED OTHER COMPREHENSIVE INCOME

The \$119,000 of accumulated comprehensive income at September 28, 2008 reflects the unrealized gain, net of tax, of available-for-sale marketable security investments. Total comprehensive income net of tax effect was \$10,049,000 and \$8,804,000 for the three-month periods ended September 28, 2008 and September 30, 2007, respectively, and \$25,976,000 and \$20,762,000 for the nine-month periods ended September 28, 2008 and September 30, 2007, respectively.

**NATIONAL PRESTO INDUSTRIES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(Continued)**

**NOTE G ADOPTION OF NEW ACCOUNTING STANDARDS**

*FASB 157*

In September 2006, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards ("SFAS") No. 157, *Fair Value Measurements* ("SFAS 157") which defines fair value, establishes a framework for measuring fair value and requires enhanced disclosures about fair value measurements. SFAS 157 requires companies to disclose the fair value of their financial instruments according to a fair value hierarchy that distinguishes between (a) market participant assumptions developed based on market data obtained from sources independent of the reporting entity (observable inputs) and (b) the reporting entity's own assumptions about market participant assumptions developed based on the best information available in the circumstances (unobservable inputs). SFAS 157 may require companies to provide additional disclosures based on that hierarchy. SFAS 157 was to be effective for financial statements issued for fiscal years beginning after November 15, 2007 and interim periods within those fiscal years. In February 2008, the FASB issued FASB Staff Position No. 157-2, *Effective Date of FASB Statement No. 157*, which delayed for one year the applicability of SFAS 157's fair-value measurements to certain nonfinancial assets and liabilities. The Company adopted SFAS 157 as of January 1, 2008, except as it applies to those nonfinancial assets and liabilities affected by the one-year delay. The financial assets of the Company are primarily comprised of cash equivalents and marketable securities, whose fair value was measured using Level 2 observable inputs. The partial adoption of SFAS 157 did not have a material impact on the Company's consolidated financial position or results of operations. The Company does not expect the adoption of the remaining provisions of SFAS 157 to have a material effect on its consolidated financial statements.

*FSP 157-3*

In October 2008, the FASB issued FASB Staff Position 157-3 *Determining the Fair Value of a Financial Asset When the Market for That Asset Is Not Active* (FSP 157-3). FSP 157-3 clarifies the application of SFAS No. 157 in a market that is not active, and addresses application issues such as the use of internal assumptions when relevant observable data does not exist, the use of observable market information when the market is not active, and the use of market quotes when assessing the relevance of observable and unobservable data. FSP 157-3 is effective for all periods presented in accordance with SFAS No. 157. The adoption of FSP 157-3 did not have a significant impact on the Company's consolidated financial statements.

*FASB 159*

In February 2007, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 159, *The Fair Value Option for Financial Assets and Liabilities Including an amendment of FASB Statement No. 115* ("SFAS 159"). SFAS 159 expands the use of fair value accounting but does not affect existing standards which require assets or liabilities to be carried at fair value. The objective of SFAS 159 is to improve financial reporting by providing companies with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. Under SFAS 159, a company may elect to use fair value to measure eligible items at specified election dates and report unrealized gains and losses on items for which the fair value option has been elected in earnings at each subsequent reporting date. Eligible items include, but are not limited to, accounts and loans receivable, available-for-sale and held-to-maturity securities, equity method investments, accounts payable, guarantees, issued debt and firm commitments. On January 1, 2008, the Company adopted SFAS 159 and has not elected to use fair value measurement on any assets or liabilities under this statement.

*FASB 141(R)*

In December 2007, the Financial Accounting Standards Board ( FASB ) issued Statement of Financial Accounting Standards No. 141 (revised 2007) *Business Combinations* ("SFAS 141(R)"). SFAS 141(R) retains the fundamental requirements of the original pronouncement requiring that the purchase method be used for all business combinations. SFAS 141(R) defines the acquirer as the entity that obtains control of one or more businesses in the business combination, establishes the acquisition date as the date that the acquirer achieves control and requires the acquirer to recognize the assets acquired, liabilities assumed and any non-controlling interest at their fair values as of the acquisition date. SFAS 141(R) also requires that acquisition-related costs be recognized separately from the acquisition. SFAS 141(R) is effective for fiscal years beginning after December 15, 2008. The Company does not expect the adoption of SFAS 141(R) to have a material impact on its current consolidated financial position and results of operations. However, depending upon the size, nature and complexity of future acquisition transactions, the adoption of SFAS 141(R) could materially impact the Company's consolidated financial statements.



**NATIONAL PRESTO INDUSTRIES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**NOTE G ADOPTION OF NEW ACCOUNTING STANDARDS (CONTINUED)**

*FASB 160*

In December 2007, the FASB issued SFAS No. 160, *Noncontrolling Interests in Consolidated Financial Statements - an amendment of Accounting Research Bulletin No. 51* ("FAS 160"), which establishes accounting and reporting standards for ownership interests in subsidiaries held by parties other than the parent, the amount of consolidated net income attributable to the parent and to the noncontrolling interest, changes in a parent's ownership interest and the valuation of retained noncontrolling equity investments when a subsidiary is deconsolidated. The Statement also establishes reporting requirements that provide sufficient disclosures that clearly identify and distinguish between the interests of the parent and the interests of the noncontrolling owners. FAS 160 is effective as of the beginning of an entity's fiscal year that begins after December 15, 2008. The Company does not have any noncontrolling interests and, accordingly, does not expect the adoption of SFAS No. 160 to have a material impact on the Company's consolidated financial position or results of operations.

*FASB 161*

In March 2008, the FASB issued SFAS 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of SFAS No. 133* to enhance disclosures about an entity's derivative and hedging activities and improve the transparency of financial reporting. Entities will be required to provide enhanced disclosures about (a) how and why derivatives instruments are used, (b) how derivative instruments are accounted for, and (c) how derivative instruments affect the entities financial position, financial performance and cash flows. These disclosures better convey the purpose of derivative use in terms of the risks that the entity is intending to manage by requiring fair value disclosures in a tabular format, providing more information about an entity's liquidity and requiring cross-referencing within the footnotes. SFAS 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early adoption encouraged. The Company does not hold the applicable derivative instruments and does not expect the adoption of SFAS 161 to have a material impact on the Company's consolidated financial position or results of operations.

*FASB 162*

In May 2008, the FASB issued SFAS No. 162, *The Hierarchy of Generally Accepted Accounting Principles*, which identifies the sources of accounting principles and the framework for selecting the principles used in the preparation of financial statements of nongovernmental entities that are presented in conformity with generally accepted accounting principles (GAAP) in the United States of America (the GAAP hierarchy). This Statement is effective November 15, 2008. The Company does not expect the adoption of SFAS 162 to have a material effect on the Company's consolidated financial statements or related disclosures.

NOTE H PENSION PLAN

The Company contributes to a union-sponsored, multi-employer pension plan on behalf of union employees of the Amron division of its AMTEC subsidiary. Contributions are made in accordance with the then current labor agreement with the union. The Company may receive claims for sums in excess of contributions required under the labor agreement for various reasons including legal changes, pension plan assumption changes and the failure or withdrawal of a plan member. Generally, such claims would not be made unless and until the plan were terminated or Amron withdrew from the plan. Such a withdrawal would require both union membership approval and an amendment to the labor agreement with the union.

In August 2008, the plan provided Amron with a Withdrawal Liability Report stating that the cost for Amron to withdraw from the plan during 2008 would be approximately \$239,000. The actual cost to withdraw from the pension plan is not known.

NOTE I INCOME TAXES

The Company establishes tax reserves in accordance with FASB Interpretation No. 48 - *Accounting for Uncertainty in Income Taxes* (FIN No. 48), which was adopted at the beginning of 2007. The initial application of FIN No. 48 resulted in a net decrease to the Company's consolidated accrued income tax reserve of \$1,062,000, with an offsetting increase to retained earnings. Total unrecognized tax benefits as of September 28, 2008 and December 31, 2007 was \$1,273,000 and \$551,000, respectively, which, if recognized, would affect the Company's effective income tax rate.

**NATIONAL PRESTO INDUSTRIES, INC., AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**(Continued)**

NOTE I INCOME TAXES (CONTINUED)

The following is a reconciliation of the Company's unrecognized tax benefits for the quarter ended September 28, 2008:

Balance at January 1, 2008	\$ 551,000
Additions for tax positions taken related to prior years	722,000
Balance at September 28, 2008	\$ 1,273,000

It is the Company's practice to include interest and penalties in tax expense. The Company accrued interest in the amount of \$231,000 as of September 28, 2008.

The Company is subject to U.S. federal income tax as well as state income taxes in the locations in which it does business. The Company is currently under audit by the Internal Revenue Service for the tax years 2002 through 2006 and by the Wisconsin Department of Revenue for the tax years 2002 through 2005.

The foregoing information for the periods ended September 28, 2008, and September 30, 2007, is unaudited; however, in the opinion of management of the Registrant, it reflects all the adjustments, which were of a normal recurring nature, necessary for a fair statement of the results for the interim periods. The condensed consolidated balance sheet as of December 31, 2007, is summarized from consolidated financial statements, but does not include all the disclosures contained therein and should be read in conjunction with the 2007 annual report on Form 10-K. Interim results for the period are not indicative of those for the year.



**ITEM 2.**

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

Forward-looking statements in this Management's Discussion and Analysis of Financial Condition and Results of Operations, elsewhere in this Form 10-Q, in the Company's 2007 Annual Report to Shareholders, in the Proxy Statement for the annual meeting held May 20, 2008, and in the Company's press releases and oral statements made with the approval of an authorized executive officer are made pursuant to the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. There are certain important factors that could cause results to differ materially from those anticipated by some of the statements made herein. Investors are cautioned that all forward-looking statements involve risks and uncertainty. In addition to the factors discussed herein and in the notes to consolidated financial statements, among the other factors that could cause actual results to differ materially are the following: consumer spending and debt levels; interest rates; continuity of relationships with and purchases by major customers; product mix; the benefit and risk of business acquisitions; competitive pressure on sales and pricing; increases in material, freight/shipping, or production cost which cannot be recouped in product pricing; delays or interruptions in shipping or production from machine issues work or labor disruptions stemming from a unionized work force; changes in government requirements and funding of government contracts, failure of subcontractors or vendors to perform as required by contract; and the efficient start-up and utilization of capital equipment investments. Additional information concerning these and other factors is contained in the Company's Securities and Exchange Commission filings, copies of which are available from the Company without charge.

**Comparison of Third Quarter 2008 and 2007**

Readers are directed to Note B, Business Segments for data on the financial results of the Company's three business segments for the Quarters ended September 28, 2008 and September 30, 2007.

On a consolidated basis, sales increased by \$13,691,000 (14%), gross margins increased by \$1,723,000 (9%), selling and general expense decreased by \$1,283,000 (20%), and other income decreased by \$253,000 (21%). Earnings before the provision for income taxes increased by \$2,753,000 (21%), as did net earnings by \$1,489,000 (17%). Details concerning these changes can be found in the comments by segment below.

Housewares/small appliance net sales increased by \$1,394,000 from \$29,735,000 to \$31,129,000, or 5%. The increase was primarily attributable to price increases, approximately half of which was offset by a reduction in net units shipped. Defense net sales increased by \$7,703,000 from \$53,961,000 to \$61,664,000, or 14%, stemming primarily from an increase in sales related to the US Department of the Army 40mm Systems program. Absorbent products net sales increased by \$4,594,000 from \$15,796,000 to \$20,390,000, or 29%, approximately 90% of which was derived from an increase in unit shipments, with the balance attributable to price increases.

Housewares/small appliance gross profits increased by \$256,000 from \$6,896,000 in the prior quarter to \$7,152,000 in the current quarter. The increase primarily reflected the increase in sales noted above. Defense gross profits increased

\$1,547,000 from \$11,834,000 from the prior year's quarter to \$13,381,000. The increase related to the sales increase noted above. Absorbent products gross profits were a negative \$381,000 in the current quarter versus a negative \$301,000 in the prior period, an unfavorable change of \$80,000, primarily reflecting increased commodity costs, offset by improved efficiency.

Housewares/small appliance segment selling and general expenses were essentially flat. Defense segment selling and general expenses decreased by \$1,192,000, reflecting in largest part the absence of performance based accruals pertaining to the four-year earn-out of the Spectra Technologies, LLC purchase price and an incentive program for key executives to promote the rapid growth of the defense segment. Absorbent segment selling and general expenses were essentially unchanged.

The above items were responsible for the change in operating profit.

Other income decreased \$253,000, due primarily to lower interest income resulting from decreased yields on a decreased level of investments, reflecting the use of more funds to support operations.

Earnings before provision for income taxes increased \$2,753,000 from \$13,075,000 to \$15,828,000. The provision for income taxes increased from \$4,363,000 to \$5,627,000, which resulted in an effective income tax rate increase from 33% to 36% as a result of increased earnings subject to income. Net earnings increased \$1,489,000 from \$8,712,000 to \$10,201,000, or 17%.

### Comparison of First Nine Months 2008 and 2007

Readers are directed to Note B, Business Segments for data on the financial results of the Company's three business segments for the Nine Months ended September 28, 2008 and September 30, 2007.

On a consolidated basis, sales increased by \$25,105,000 (9%), gross margins increased by \$6,102,000 (13%), selling and general expense decreased by \$4,597,000 (23%), and other income decreased by \$788,000 (19%). Earnings before the provision for income taxes increased by \$9,911,000 (32%), as did net earnings by \$5,351,000 (26%). Details concerning these changes can be found in the comments by segment below.

Housewares/small appliance net sales increased by \$8,461,000 from \$66,895,000 to \$75,356,000, approximately 75% of which reflected pricing increases, with the balance attributable to an increase in recorded net units shipped.

Defense net sales increased by \$11,089,000 from \$162,119,000 to \$173,208,000, or 7%, primarily due to increased shipments for the US Department of the Army's 40mm Systems program. Absorbent products net sales increased by \$5,555,000 from \$47,734,000 to \$53,289,000, or 12%, reflecting an increase in unit shipments (approximately 90% of the increase) with the balance attributable to an increase in pricing.

Housewares/small appliance gross profits increased by \$1,408,000 from \$14,579,000 in the prior year's period to \$15,987,000 in the current period. The increase related largely to the increase in sales noted above. Defense gross profits increased \$3,913,000 from \$32,853,000 from the prior year's period to \$36,766,000. The increase related to the sales increase noted above. Absorbent products gross profits were a negative \$439,000 in the current period versus a negative \$1,220,000 in the prior year's period, an improvement of \$781,000, reflecting improved efficiency, offset by increased commodity costs.

Period to period, housewares/small appliance segment selling and general expenses decreased \$1,588,000. The Company accrues for unexpended selling and advertising costs, primarily for housewares/small appliances, budgeted for the year against each quarter's sales. Selling and advertising charges included in selling expense in each quarter represent that percentage of the annual sales and advertising budget associated with that quarter's shipments.

Revisions to this budget result in periodic changes to the accrued liability for committed selling and advertising expenditures, and approximately \$180,000 of the decrease was attributable to such revisions during the respective periods. The balance of the decrease was primarily due to the absence of \$1,130,000 of professional fees incurred in 2007 attributable to the reaudit of financial statements for 2003 through 2005. The reaudits were necessitated by a chain of events stemming from the investment company case brought by the Securities and Exchange Commission on which the Company ultimately prevailed. Defense segment selling and general expenses decreased by \$3,092,000, reflecting in largest part the absence of performance based accruals pertaining to the four-year earn-out of the Spectra Technologies, LLC purchase price and an incentive program for key executives to promote the rapid growth of the defense segment. Absorbent segment selling and general expenses were essentially unchanged.

The above items were responsible for the change in operating profit.

Other income decreased \$788,000, due primarily to lower interest income resulting from decreased yields on a reduced level of investments, reflecting the fact that more funds were used to support operations.

Earnings before provision for income taxes increased \$9,911,000 from \$30,622,000 to \$40,533,000. The provision for income taxes increased from \$9,940,000 to \$14,500,000, which resulted in an effective income tax rate increase from 32% to 36% as a result of increased earnings subject to income tax and the increase to the FIN 48 tax reserve (see Note I). Net earnings increased \$5,351,000 from \$20,682,000 to \$26,033,000, or 26%.

### **Liquidity and Capital Resources**

Net cash provided by operating activities was \$9,026,000 during the first nine months of 2008, as compared to \$11,619,000 provided during the first nine months of 2007. The principal factors behind the decrease in cash provided can be found in the changes in the components of working capital within the Consolidated Statement of Cash Flows, combined with the increase in net earnings of \$5,351,000. Of particular note were increases in cash used to pay accrued liabilities and payables that were only partially offset by increases in cash received from collections of the higher levels of receivables at year-end. Inventory was also a factor; although inventory levels as of the third quarter increased from year-end in both years, the increases from year-end 2006 to the third quarter 2007, the first full year of delivery of product under the 40mm Systems contract, was more dramatic than the increase from year-end 2007 to third quarter 2008.

Net cash used by investing activities during the first nine months of 2008 was \$2,528,000, as compared to \$19,716,000 used during the first nine months of 2007. The change in investment activity cash flow is primarily attributable to the increased use in 2008 of proceeds from the sale (which includes tendering cash-like variable rate demand notes) and maturities of marketable securities to fund operating activities, offset by the absence in 2008 of the 2007 earnout payment made in connection with the 2006 acquisition of certain assets of Amron, LLC by the Company's defense segment.



Cash flows from financing activities for the first nine months of 2008 and 2007 primarily differed as a result of the \$.05 and \$.40 per share increases in the regular and extra dividends paid during those periods, respectively.

Working capital increased by \$228,000 to \$227,232,000 at September 28, 2008. The Company's current ratio was 5.2 to 1.0 at September 28, 2008, as compared to 4.0 to 1.0 at December 31, 2007.

As of September 28, 2008, there were approximately \$560,000, \$190,000, and \$60,000 of open equipment/facilities purchase commitments to expand the product lines in the defense, housewares/small appliances, and absorbent products segments, respectively. The Company expects to continue to evaluate acquisition opportunities that align with its business segments and will make further acquisitions as well as continue to make capital investments in these segments if the appropriate return on investment is projected.

The Company has substantial liquidity in the form of cash and short-term maturity marketable securities to meet all of its anticipated capital requirements, to make dividend payments, and to fund growth through acquisitions and other means. The company intends to continue its investment strategy of safety and short-term liquidity throughout its investment holdings. The interest rate environment is a function of national and international monetary policies as well as the growth and inflation rates of the U.S. and foreign economies and is not controllable by the Company.

### **Critical Accounting Policies**

The preparation of the consolidated financial statements in accordance with accounting principles generally accepted in the United States requires management to make certain estimates and assumptions that affect the amount of reported assets and liabilities and disclosure of contingent assets and liabilities at the date of the consolidated financial statements and revenues and expenses during the periods reported. Actual results may differ from those estimates.

The Company reviewed the development and selection of the critical accounting policies and believes the following are the most critical accounting policies that could have an effect on the Company's reported results. These critical accounting policies and estimates have been reviewed with the Audit Committee of the Board of Directors.

#### *Inventories*

New Housewares/Small Appliance product introductions are an important part of the Company's sales to offset the morbidity rate of other Housewares/Small Appliance products and/or the effect of lowered acceptance of seasonal products due to weather conditions. New products entail unusual risks and have occasionally in the past resulted in losses related to obsolete or excess inventory as a result of low or diminishing demand for a product. There were no such obsolescence issues that had a material effect during the current year and, accordingly, the Company did not record a reserve for obsolete product. In the future should product demand issues arise, the Company may incur losses related to the obsolescence of the related inventory. Inventory risk for the Company's other segments is not

deemed to be significant, as products are largely built pursuant to customers' specific orders. The Company's Form 10-Q for the period ended March 30, 2008 referenced several lots of ammunition that were produced to specifications and met ballistic requirements, but were placed on hold. One lot was released and billed at the end of the second quarter. The balance of the lots were released and billed during third quarter 2008.

#### *Product Liability*

The Company is subject to product liability claims in the normal course of business. The Company does carry insurance to limit its product liability claims in excess of a self-insured retention. The self-insured retention and excess coverage vary from policy year to policy year. Moreover, there is typically a limit on all types of insurance coverage. The limits also vary from policy year to policy year. The Company records an accrual for known claims, including an estimate for related legal fees in the Company's consolidated financial statements. It utilizes historical trends and other analysis to assist in determining the appropriate accrual. Currently, there are no known claims that would have a material adverse impact on the Company beyond the reserve levels that have been accrued and recorded on the Company's books. An increase in the number or magnitude of claims could have a material impact on the Company's financial condition and results of operations.

#### *Sales and Returns*

Sales are recorded net of discounts and returns. The latter pertain primarily to warranty returns, returns of seasonal items, and returns of those newly introduced products sold on a guaranteed basis. The calculation of warranty returns is based in large part on historical data, while seasonal and new product returns are primarily developed using customer provided information.

#### **New Accounting Pronouncements**

Please refer to Note G for information related to the effect of adopting new accounting pronouncements on the Company's consolidated financial statements.

**ITEM 3.**

**QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The Company's interest income on cash equivalents and marketable securities is affected by changes in interest rates in the United States. Cash equivalents include money market funds. Based on the accounting profession's 2005 interpretation of cash equivalents under FASB Statement No. 95, the company's seven-day variable rate demand notes are classified as marketable securities rather than as cash equivalents. The demand notes are highly liquid instruments with interest rates set every 7 days that can be tendered to the trustee or remarketer upon 7 days notice for payment of principal and accrued interest amounts. The 7-day tender feature of these variable rate demand notes is further supported by an irrevocable letter of credit from highly rated U.S. banks. To the extent a bond is not remarketed at par plus accrued interest, the difference is drawn from the bank's letter of credit. The balance of the Company's investments is held primarily in fixed and variable rate municipal bonds with a weighted average life of 1.0 years. Accordingly, changes in interest rates have not had a material effect on the Company, and the Company does not anticipate that future exposure to interest rate market risk will be material. The Company uses sensitivity analysis to determine its exposure to changes in interest rates.

The Company has no history of, and does not anticipate in the future, investing in derivative financial instruments, i.e., instruments whose value changes in response to changes in underlying variables. Most transactions with international customers are entered into in U.S. dollars, precluding the need for foreign currency cash flow hedges. The Company's manufacturing contracts with its foreign suppliers contain provisions to share the impact of fluctuations in the exchange rate between the U.S. dollar and the Hong Kong dollar above and below a fixed range contained in the contracts. All transactions with the foreign suppliers were within the exchange rate range specified in the contracts during 2008 and 2007. There is no similar provision applicable to the Chinese Renminbi (RMB), which until 2005 had been tied to the U.S. Dollar, and has since appreciated dramatically. Further appreciation of the RMB vis-à-vis the U.S. Dollar is not expected to have any material impact on existing orders.

**ITEM 4.**

**CONTROLS AND PROCEDURES**

The Company's management, including the Chief Executive Officer and Chief Financial Officer, have conducted an evaluation of the effectiveness of the design and operation of the Company's disclosure controls and procedures pursuant to Rule 13a-15 under the Securities Exchange Act of 1934 (the "1934 Act") as of September 28, 2008. The Company's Chief Executive Officer and Chief Financial Officer have concluded that the Company's internal control over financial reporting and its disclosure controls and procedures were effective as of that date.

There were no changes in internal controls over financial reporting during the quarter ended September 28, 2008 that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.



**PART II - OTHER INFORMATION**

**ITEM 1.**

**LEGAL PROCEEDINGS**

See Note E in the Notes to Consolidated Financial Statements set forth under Part I - Item 1 above.

**ITEM 2.**

**UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

There were no purchases or sales of securities during the quarter ended September 28, 2008.

**ITEM 6.**

**EXHIBITS**

- |               |   |
|---------------|---|
| Exhibit 3(i)  | Restated Articles of Incorporation - incorporated by reference from Exhibit 3 (i) of the Company's annual report on Form 10-K for the year ended December 31, 2005  |
| Exhibit 3(ii) | By-Laws - incorporated by reference from Exhibit 3 (ii) of the Company's quarterly report on Form 10-Q for the quarter ended October 3, 1999  |
| Exhibit 9     | Voting Trust Agreement - incorporated by reference from Exhibit 9 of the Company's quarterly report on Form 10-Q for the quarter ended July 6, 1997   |
| Exhibit 10.1  | 1988 Stock Option Plan - incorporated by reference from Exhibit 10.1 of the Company's quarterly report on Form 10-Q for the quarter ended July 6, 1997  |
| Exhibit 10.2  | Form of Incentive Stock Option Agreement under the 1988 Stock Option Plan - incorporated by reference from Exhibit 10.2 of the Company's quarterly report on Form 10-Q for the quarter ended July 6, 1997 |
| Exhibit 10.3  | Form of Material Contract for Retired Executive Officer - incorporated by reference from Exhibit 10.3 of the Company's annual report on Form 10-K for the year ended December 31, 2006                    |

- Exhibit 11 Statement regarding computation of per share earnings
- Exhibit 31.1 Certification of the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 31.2 Certification of the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- Exhibit 32.1 Certification of the Chief Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- Exhibit 32.2 Certification of the Chief Financial Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

**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.

**NATIONAL PRESTO INDUSTRIES, INC.**

Date: November 7, 2008

By:

/s/ M. J. COHEN

M. J. Cohen,

Chair of the Board, Chief Executive Officer,

President,

(Principal executive officer)

**National Presto Industries, Inc.**

**Exhibit Index**

<b>Exhibit Number</b>	<b>Exhibit Description</b>
<u>Exhibit 11</u>	Statement regarding computation of per share earnings
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