

CIRCOR INTERNATIONAL INC  
Form 10-Q  
August 02, 2012

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 July 1, 2012.

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 001-14962

CIRCOR INTERNATIONAL, INC.  
(Exact name of registrant as specified in its charter)

Delaware  
(State or Other Jurisdiction of  
Incorporation or Organization) 04-3477276  
(I.R.S. Employer  
Identification No.)

c/o CIRCOR, Inc.  
30 Corporate Drive, Suite 200, Burlington, MA  
(Address of principal executive offices) 01803-4238  
(781) 270-1200  
(Zip Code)  
(Registrant's telephone number, including area code)

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

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

Large accelerated filer  Accelerated filer   
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

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As of July 27, 2012, there were 17,405,140 shares of the Registrant's Common Stock, par value \$0.01 per share, outstanding.

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PART I FINANCIAL INFORMATION.  
 ITEM 1. FINANCIAL STATEMENTS  
 CIRCOR INTERNATIONAL, INC.  
 CONSOLIDATED BALANCE SHEETS  
 (In thousands, except per share data)

	July 1, 2012 (Unaudited)	December 31, 2011
<b>ASSETS</b>		
<b>CURRENT ASSETS:</b>		
Cash and cash equivalents	\$41,414	\$54,855
Short-term investments	98	99
Trade accounts receivable, less allowance for doubtful accounts of \$1,231 and \$1,127, respectively	160,012	156,075
Inventories	206,247	203,777
Prepaid expenses and other current assets	15,498	12,376
Deferred income tax asset	15,623	16,320
Assets held for sale	542	542
<b>Total Current Assets</b>	<b>439,434</b>	<b>444,044</b>
<b>PROPERTY, PLANT AND EQUIPMENT, NET</b>	<b>105,252</b>	<b>104,434</b>
<b>OTHER ASSETS:</b>		
Goodwill	76,285	77,829
Intangibles, net	55,974	58,442
Deferred income tax asset	25,381	27,949
Other assets	10,051	9,825
<b>TOTAL ASSETS</b>	<b>\$712,377</b>	<b>\$722,523</b>
<b>LIABILITIES AND SHAREHOLDERS' EQUITY</b>		
<b>CURRENT LIABILITIES:</b>		
Accounts payable	\$93,625	\$92,493
Accrued expenses and other current liabilities	55,269	63,386
Accrued compensation and benefits	22,154	24,328
Asbestos liability	0	1,000
Income taxes payable	3,018	5,553
Notes payable and current portion of long-term debt	6,366	8,796
<b>Total Current Liabilities</b>	<b>180,432</b>	<b>195,556</b>
<b>LONG-TERM DEBT, NET OF CURRENT PORTION</b>	<b>89,522</b>	<b>96,327</b>
<b>DEFERRED INCOME TAXES</b>	<b>10,618</b>	<b>11,284</b>
<b>OTHER NON-CURRENT LIABILITIES</b>	<b>33,848</b>	<b>35,271</b>
<b>CONTINGENCIES AND COMMITMENTS (See Note 10)</b>		
<b>SHAREHOLDERS' EQUITY:</b>		
Preferred stock, \$0.01 par value; 1,000,000 shares authorized; no shares issued and outstanding	0	0
Common stock, \$0.01 par value; 29,000,000 shares authorized; 17,405,140 and 17,268,212 shares issued and outstanding at July 1, 2012 and December 31, 2011, respectively	174	173
Additional paid-in capital	260,556	258,209
Retained earnings	148,765	130,373
Accumulated other comprehensive loss	(11,538)	(4,670)
<b>Total Shareholders' Equity</b>	<b>397,957</b>	<b>384,085</b>

TOTAL LIABILITIES AND SHAREHOLDERS' EQUITY	\$712,377	\$722,523
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The accompanying notes are an integral part of these unaudited consolidated financial statements.

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CIRCOR INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF INCOME  
(In thousands, except per share data)  
(Unaudited)

	Three Months Ended		Six Months Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Net revenues	\$219,862	\$191,908	\$434,142	\$395,278
Cost of revenues	156,046	137,302	311,714	284,444
<b>GROSS PROFIT</b>	<b>63,816</b>	<b>54,606</b>	<b>122,428</b>	<b>110,834</b>
Selling, general and administrative expenses	45,337	42,180	90,249	84,635
Leslie asbestos and bankruptcy (recoveries) charges, net	0	(124)	0	877
<b>OPERATING INCOME</b>	<b>18,479</b>	<b>12,550</b>	<b>32,179</b>	<b>25,322</b>
Other (income) expense:				
Interest income	(78)	(54)	(161)	(97)
Interest expense	1,095	1,286	2,259	2,102
Other, net	184	560	322	1,476
<b>TOTAL OTHER EXPENSE</b>	<b>1,201</b>	<b>1,792</b>	<b>2,420</b>	<b>3,481</b>
<b>INCOME BEFORE INCOME TAXES</b>	<b>17,278</b>	<b>10,758</b>	<b>29,759</b>	<b>21,841</b>
Provision for income taxes	6,142	3,261	10,038	6,439
<b>NET INCOME</b>	<b>\$11,136</b>	<b>\$7,497</b>	<b>\$19,721</b>	<b>\$15,402</b>
Earnings per common share:				
Basic	\$0.64	\$0.43	\$1.14	\$0.90
Diluted	\$0.64	\$0.43	\$1.13	\$0.88
Weighted average number of common shares outstanding:				
Basic	17,422	17,251	17,369	17,206
Diluted	17,451	17,434	17,421	17,406
Dividends paid per common share	\$0.0375	\$0.0375	\$0.075	\$0.075

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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CIRCOR INTERNATIONAL, INC.

## STATEMENTS OF CONSOLIDATED COMPREHENSIVE (LOSS) INCOME

(In thousands)

(Unaudited)

	Three Months Ended		Six Months Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Net income	\$11,136	\$7,497	\$19,721	\$15,402
Other comprehensive (loss) income, net of tax:				
Foreign currency translation adjustments	(12,548	) 3,523	(6,867	) 12,972
Other comprehensive (loss) income	(12,548	) 3,523	(6,867	) 12,972
COMPREHENSIVE (LOSS) INCOME	\$(1,412	) \$11,020	\$12,854	\$28,374

The accompanying notes are an integral part of these unaudited consolidated financial statements.

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CIRCOR INTERNATIONAL, INC.  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(In thousands)  
(Unaudited)

	Six Months Ended	
	July 1, 2012	July 3, 2011
<b>OPERATING ACTIVITIES</b>		
Net income	\$19,721	\$15,402
Adjustments to reconcile net income to net cash provided by (used in) operating activities:		
Depreciation	7,833	7,496
Amortization	1,887	2,196
Payment for Leslie bankruptcy settlement	(1,000)	(76,625)
Compensation expense of share-based plans	2,317	1,960
Tax effect of share-based compensation	499	(637)
Loss (gain) on disposal of property, plant and equipment	133	(39)
Changes in operating assets and liabilities, net of effects from business acquisitions:		
Trade accounts receivable	(6,312)	(5,790)
Inventories	(5,340)	(34,236)
Prepaid expenses and other assets	(1,408)	(5,836)
Accounts payable, accrued expenses and other liabilities	(9,559)	26,853
Net cash provided by (used in) operating activities	8,771	(69,256)
<b>INVESTING ACTIVITIES</b>		
Additions to property, plant and equipment	(10,783)	(7,463)
Proceeds from the sale of property, plant and equipment	31	50
Purchase of investments	0	(2)
Business acquisitions, net of cash acquired	0	(20,221)
Net cash used in investing activities	(10,752)	(27,636)
<b>FINANCING ACTIVITIES</b>		
Proceeds from long-term debt	108,943	201,087
Payments of long-term debt	(117,944)	(101,994)
Debt issuance costs	0	(2,001)
Dividends paid	(1,331)	(1,325)
Proceeds from the exercise of stock options	94	476
Tax effect of share-based compensation	(499)	637
Net cash (used in) provided by financing activities	(10,737)	96,880
Effect of exchange rate changes on cash and cash equivalents	(723)	2,562
<b>(DECREASE) INCREASE IN CASH AND CASH EQUIVALENTS</b>	<b>(13,441)</b>	<b>2,550</b>
Cash and cash equivalents at beginning of period	54,855	45,752
<b>CASH AND CASH EQUIVALENTS AT END OF PERIOD</b>	<b>\$41,414</b>	<b>\$48,302</b>
<b>Supplemental Cash Flow Information:</b>		
Cash paid during the six months for:		
Income taxes	\$9,673	\$4,600
Interest	\$1,842	\$1,678

The accompanying notes are an integral part of these unaudited consolidated financial statements.



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CIRCOR INTERNATIONAL, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(Unaudited)

(1) Basis of Presentation

The accompanying unaudited, consolidated financial statements have been prepared according to the rules and regulations of the United States Securities and Exchange Commission (“SEC”) and, in the opinion of management, reflect all adjustments, which include normal recurring adjustments, necessary for a fair presentation of the consolidated balance sheets, consolidated statements of operations and consolidated statements of cash flows of CIRCOR International, Inc. (“CIRCOR”, the “Company”, “us”, “we” or “our”) for the periods presented. We prepare our interim financial information using the same accounting principles as we use for our annual audited financial statements. Certain information and note disclosures normally included in the annual audited financial statements have been condensed or omitted in accordance with prescribed SEC rules. We believe that the disclosures made in our consolidated financial statements and the accompanying notes are adequate to make the information presented not misleading.

The consolidated balance sheet at December 31, 2011 is as reported in our audited financial statements as of that date. Our accounting policies are described in the notes to our December 31, 2011 financial statements, which were included in our Annual Report filed on Form 10-K. We recommend that the financial statements included in this Quarterly Report on Form 10-Q be read in conjunction with the financial statements and notes included in our Annual Report filed on Form 10-K for the year ended December 31, 2011.

We operate and report financial information using a 52-week fiscal year ending December 31. The data periods contained within our Quarterly Reports on Form 10-Q reflect the results of operations for the 13-week, 26-week and 39-week periods which generally end on the Sunday nearest the calendar quarter-end date. Operating results for the three and six months ended July 1, 2012 are not necessarily indicative of the results that may be expected for the year ending December 31, 2012.

Reclassifications

Certain items in the prior period financial statements have been reclassified to conform to currently reported presentations.

(2) Summary of Significant Accounting Policies

The significant accounting policies used in preparation of these condensed consolidated financial statements for the three and six months ended July 1, 2012 are consistent with those discussed in Note 2 to the consolidated financial statements in our Annual Report on Form 10-K for the year ended December 31, 2011. There were no new accounting pronouncements adopted during the three and six months ended July 1, 2012 that had a material impact on our financial statements.

(3) Share-Based Compensation

As of July 1, 2012, we have one share-based compensation plan. The Amended and Restated 1999 Stock Option and Incentive Plan (the “1999 Stock Plan”), which was adopted by our Board of Directors and approved by our shareholders, permits the granting of the following types of awards to our officers, other employees and non-employee directors: incentive stock options; non-qualified stock options; deferred stock awards; restricted stock awards; unrestricted stock awards; performance share awards; cash-based awards; stock appreciation rights and dividend equivalent rights. The 1999 Stock Plan provides for the issuance of up to 3,000,000 shares of common stock (subject to adjustment for stock splits and similar events). New options granted under the 1999 Stock Plan could have varying vesting provisions and

exercise periods. Options granted vest in periods ranging from one year to five years and expire ten years after the grant date. Restricted stock units granted generally vest from three years to six years. Vested restricted stock units will be settled in shares of our common stock. As of July 1, 2012, there were 203,200 stock options and 333,048 restricted stock units outstanding. In addition, there were 401,148 shares available for grant under the 1999 Stock Plan as of July 1, 2012. As of July 1, 2012, there were 19,093 outstanding restricted stock units that contain rights to nonforfeitable dividend equivalents and are considered participating securities that are included in our computation of basic and fully diluted earnings per share. There is no difference in the earnings per share amounts between the two class method and the treasury stock method, which is why we continue to use the treasury stock method.

For all of our stock option grants, the fair value of each grant was estimated at the date of grant using the Black-Scholes option pricing model. Black-Scholes utilizes assumptions related to volatility, the risk-free interest rate, the dividend yield and employee exercise behavior. Expected volatilities utilized in the model are based on the historic volatility of the

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Company's stock price. The risk free interest rate is derived from the U.S. Treasury Yield curve in effect at the time of the grant. In the first half of 2012, we granted 68,943 stock options.

The fair value of stock options granted during the six months ended July 1, 2012 of \$14.16 was estimated using the following weighted-average assumptions:

Risk-free interest rate	1.0	%
Expected life (years)	5.8	
Expected stock volatility	47.9	%
Expected dividend yield	0.5	%

We account for Restricted Stock Unit ("RSU") Awards by expensing the weighted average fair value to selling, general and administrative expenses ratably over vesting periods generally ranging from three years to six years. During the six months ended July 1, 2012 and July 3, 2011, we granted 126,552 and 63,372 RSU Awards with approximate fair values of \$33.53 and \$39.00 per RSU Award, respectively.

The CIRCOR Management Stock Purchase Plan, which is a component of the 1999 Stock Plan, provides that eligible employees may elect to receive restricted stock units in lieu of all or a portion of their pre-tax annual incentive bonus and, in some cases, make after-tax contributions in exchange for restricted stock units ("RSU MSPs"). In addition, non-employee directors may elect to receive restricted stock units in lieu of all or a portion of their annual directors' fees. Each RSU MSP represents a right to receive one share of our common stock after a three-year vesting period. RSU MSPs are granted at a discount of 33% from the fair market value of the shares of our common stock on the date of grant. This discount is amortized as compensation expense, to selling, general and administrative expenses, over a four year period. A total of 34,534 and 43,734 RSUs with per unit discount amounts representing fair values of \$10.81 and \$12.87 were granted under the CIRCOR Management Stock Purchase Plan during the six months ended July 1, 2012 and July 3, 2011, respectively.

Compensation expense related to our share-based plans for the six month periods ended July 1, 2012, and July 3, 2011 was \$2.2 million and \$1.9 million, respectively, and was recorded as selling, general and administrative expense. As of July 1, 2012, there was \$8.8 million of total unrecognized compensation costs related to our outstanding share-based compensation arrangements. That cost is expected to be recognized over a weighted average period of 2.8 years.

The weighted average contractual term for stock options outstanding and options exercisable as of July 1, 2012 was 6.7 years and 1.9 years, respectively. The aggregate intrinsic value of stock options exercised during the six months ended July 1, 2012 was \$0.1 million and the aggregate intrinsic value of stock options outstanding and options exercisable as of July 1, 2012 was \$1.0 million and \$0.8 million, respectively.

The aggregate intrinsic value of RSU Awards settled during the six months ended July 1, 2012 was \$3.2 million million and the aggregate intrinsic value of RSU Awards outstanding and RSU Awards vested and deferred as of July 1, 2012 was \$8.4 million and \$0.3 million, respectively.

The aggregate intrinsic value of RSU MSPs settled during the six months ended July 1, 2012 was \$1.8 million and the aggregate intrinsic value of RSU MSPs outstanding and RSU MSPs vested and deferred as of July 1, 2012 was \$1.0 million and \$0.2 million, respectively.

**(4) Inventories**

Inventories consist of the following (In thousands):

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	July 1, 2012	December 31, 2011
Raw materials	\$59,554	\$57,755
Work in process	92,615	96,678
Finished goods	54,078	49,344
	\$206,247	\$203,777

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## (5) Goodwill and Intangible Assets

The following table shows goodwill, by segment, as of July 1, 2012 (In thousands):

	Energy	Aerospace	Flow Technologies	Consolidated Total
Goodwill as of December 31, 2011	\$51,894	\$22,091	\$3,844	\$77,829
Currency translation adjustments	(1,285 )	(63 )	(196 )	(1,544 )
Goodwill as of July 1, 2012	\$50,609	\$22,028	\$3,648	\$76,285

The table below presents gross intangible assets and the related accumulated amortization as of July 1, 2012 (In thousands):

	Gross Carrying Amount	Accumulated Amortization
Patents	\$6,088	\$(5,592 )
Non-amortized intangibles (primarily trademarks and trade names)	29,334	0
Customer relationships	38,053	(15,579 )
Backlog	1,493	(1,340 )
Other	7,390	(3,873 )
Total	\$82,358	\$(26,384 )
Net carrying value of intangible assets	\$55,974	

The table below presents estimated remaining amortization expense for intangible assets recorded as of July 1, 2012 (In thousands):

	2012	2013	2014	2015	2016	After 2016
Estimated amortization expense	\$1,821	\$3,631	\$3,498	\$3,474	\$3,161	\$11,055

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## (6) Segment Information

The following table presents certain reportable segment information (In thousands):

	Energy	Aerospace	Flow Technologies	Corporate / Eliminations	Consolidated Total	
Three Months Ended July 1, 2012						
Net revenues	\$113,527	\$35,896	\$70,439	\$0	\$219,862	
Inter-segment revenues	504	4	202	(710	) 0	
Operating income (loss)	12,580	3,153	9,043	(6,297	) 18,479	
Interest income					(78	)
Interest expense					1,095	
Other expense, net					184	
Income before income taxes					\$17,278	
Identifiable assets	380,496	189,879	192,419	(50,417	) 712,377	
Capital expenditures	1,020	695	3,414	1,532	6,661	
Depreciation and amortization	1,845	1,190	1,373	340	4,748	
Three Months Ended July 3, 2011						
Net revenues	\$81,994	\$36,029	\$73,885	\$0	\$191,908	
Inter-segment revenues	338	9	76	(423	) 0	
Operating income (loss)	4,373	4,021	9,292	(5,136	) 12,550	
Interest income					(54	)
Interest expense					1,286	
Other expense, net					560	
Income before income taxes					\$10,758	
Identifiable assets	360,956	196,598	195,651	(44,008	) 709,197	
Capital expenditures	2,354	1,198	634	584	4,770	
Depreciation and amortization	1,893	1,089	1,537	172	4,691	
Six Months Ended July 1, 2012						
Net revenues	\$222,791	\$73,981	\$137,370	\$0	\$434,142	
Inter-segment revenues	901	30	394	(1,325	) 0	
Operating income (loss)	21,508	7,277	16,630	(13,236	) 32,179	
Interest income					(161	)
Interest expense					2,259	
Other expense, net					322	
Income before income taxes					\$29,759	
Identifiable assets	380,496	189,879	192,419	(50,417	) 712,377	
Capital expenditures	1,750	1,577	5,744	1,712	10,783	
Depreciation and amortization	3,833	2,439	2,804	644	9,720	
Six Months Ended July 3, 2011						
Net revenues	\$181,164	\$68,139	\$145,975	\$0	\$395,278	
Inter-segment revenues	644	10	168	(822	) 0	
Operating income (loss)	10,767	7,747	18,408	(11,600	) 25,322	
Interest income					(97	)
Interest expense					2,102	
Other expense, net					1,476	
Income before income taxes					\$21,841	
Identifiable assets	360,956	196,598	195,651	(44,008	) 709,197	
Capital expenditures	3,412	1,742	1,434	875	7,463	
Depreciation and amortization	3,893	2,432	3,037	330	9,692	

Each reporting segment is individually managed and has separate financial results that are reviewed by our chief operating decision-maker. Each segment contains related products and services particular to that segment. For further discussion of the products included in each segment refer to Note (1) of the consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011.

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In calculating operating income for each reporting segment, substantial administrative expenses incurred at the corporate level for the benefit of other reporting segments were allocated to the segments based upon specific identification of costs, employment related information or net revenues.

Corporate / Eliminations are reported on a net "after allocations" basis. Inter-segment intercompany transactions affecting net operating profit have been eliminated within the respective operating segments.

The operating loss reported in the Corporate / Eliminations column in the preceding table consists primarily of the following corporate expenses: compensation and fringe benefit costs for executive management and other corporate staff; corporate development costs (relating to mergers and acquisitions); human resource development and benefit plan administration expenses; legal, accounting and other professional and consulting fees; facilities, equipment and maintenance costs; and travel and various other administrative costs. The above costs are incurred in the course of furthering the business prospects of the Company and relate to activities such as: implementing strategic business growth opportunities; corporate governance; risk management; treasury; investor relations and shareholder services; regulatory compliance; and stock transfer agent costs.

The total assets for each operating segment have been reported as the Identifiable Assets for that segment, including inter-segment intercompany receivables, payables and investments in other CIRCOR companies. Identifiable assets reported in Corporate / Eliminations include both corporate assets, such as cash, deferred taxes, prepaid and other assets, fixed assets, as well as the elimination of all inter-segment intercompany assets. The elimination of intercompany assets results in negative amounts reported in Corporate / Eliminations for Identifiable Assets for the periods ended July 1, 2012 and July 3, 2011. Corporate Identifiable Assets after elimination of intercompany assets were \$35.6 million and \$40.4 million as of July 1, 2012 and July 3, 2011, respectively.

(7) Earnings Per Common Share (In thousands, except per share amounts):

	Three Months Ended			July 3, 2011		
	July 1, 2012			July 3, 2011		
	Net	Shares	Per Share	Net	Shares	Per Share
	Income		Amount	Income		Amount
Basic Earnings Per Common Share ("EPS")	\$ 11,136	17,422	\$0.64	\$7,497	17,251	\$0.43
Dilutive securities, common stock options	0	29	0.00	0	183	0.00
Diluted EPS	\$ 11,136	17,451	\$0.64	\$7,497	17,434	\$0.43
	Six Months Ended			July 3, 2011		
	July 1, 2012			July 3, 2011		
	Net	Shares	Per Share	Net	Shares	Per Share
	Income		Amount	Income		Amount
Basic EPS	\$19,721	17,369	\$1.14	\$15,402	17,206	\$0.90
Dilutive securities, common stock options	0	52	(0.01)	0	200	(0.02)
Diluted EPS	\$19,721	17,421	\$1.13	\$15,402	17,406	\$0.88

There were 430,860 and 76,096 anti-dilutive stock options and RSUs for the six months ended July 1, 2012 and July 3, 2011, respectively.

(8) Financial Instruments

Fair Value



The carrying amounts of cash and cash equivalents, trade receivables and trade payables approximate fair value because of the short maturity of these financial instruments. Short-term investments (principally guaranteed investment certificates) are carried at cost which approximates fair value at the balance sheet date. The fair value of our variable rate debt approximates its carrying amount.

Foreign Currency Exchange Risk

The Company is exposed to certain risks relating to its ongoing business operations including foreign currency exchange

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rate risk and interest rate risk. The Company currently uses derivative instruments to manage foreign currency risk on certain business transactions denominated in foreign currencies. To the extent the underlying transactions hedged are completed, these forward contracts do not subject us to significant risk from exchange rate movements because they offset gains and losses on the related foreign currency denominated transactions. These forward contracts do not qualify as hedging instruments and, therefore, do not qualify for fair value or cash flow hedge treatment. Any unrealized gains and losses on our contracts are recognized as a component of other expense in our consolidated statements of operations.

As of July 1, 2012, we had nine forward contracts with total values as follows (in thousands):

Currency	Number	Contract Amount	
U.S. Dollar/GBP	2	1,500	U.S. Dollars
Euro/GBP	1	291	Euros
Canadian Dollar/Euro	1	7,236	Canadian Dollars
Brazilian Real/Euro	5	12,500	Brazilian Reals

This compares to six forward contracts as of December 31, 2011. The fair value asset of the derivative forward contracts as of July 1, 2012 was approximately \$0.3 million and is included in prepaid expenses and other current assets on our balance sheet. This compares to a fair value asset of approximately \$0.1 million that was included in prepaid expenses and other current assets on our balance sheet as of December 31, 2011. These forward contracts have expiration dates ranging from less than one month to five years from July 1, 2012.

We have determined that the majority of the inputs used to value our foreign currency forward contracts fall within Level 2 of the fair value hierarchy, found under Accounting Standards Codification (“ASC”) Topic 820. The credit valuation adjustments, such as estimates of current credit spreads to evaluate the likelihood of default by us and our counterparties are Level 3 inputs. However, we have assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our foreign currency forward contracts and determined that the credit valuation adjustments are not significant to the overall valuation. As a result, we have determined that our derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

**(9) Guarantees and Indemnification Obligations**

As permitted under Delaware law, we have agreements whereby we indemnify certain of our officers and directors for certain events or occurrences while the officer or director is, or was, serving at our request in such capacity. The term of the indemnification period is for the officer’s or director’s lifetime. The maximum potential amount of future payments we could be required to make under these indemnification agreements is unlimited. However, we have directors’ and officers’ liability insurance policies that limit our exposure for events covered under the policies and should enable us to recover a portion of any future amounts paid. As a result of the coverage under these insurance policies, we believe the estimated fair value of these indemnification agreements based on Level 3 criteria as described under ASC Topic 820 is minimal and, therefore, we have no liabilities recorded from those agreements as of July 1, 2012.

We record provisions for the estimated cost of product warranties, primarily from historical information, at the time product revenue is recognized. While we engage in extensive product quality programs and processes, our warranty obligation is affected by product failure rates, utilization levels, material usage, service delivery costs incurred in correcting a product failure, and supplier warranties on parts delivered to us. Should actual product failure rates, utilization levels, material usage, service delivery costs or supplier warranties on parts differ from our estimates, revisions to the estimated warranty liability would be required.

The following table sets forth information related to our product warranty reserves for the six months ended July 1, 2012 (In thousands):

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Balance beginning December 31, 2011	\$3,104
Provisions	2,859
Claims settled	(1,177 )
Currency translation adjustments	(98 )
Balance ending July 1, 2012	\$4,688

## (10) Contingencies and Commitments

## Asbestos Litigation

## Background

On July 12, 2010 (the “Filing Date”), our subsidiary Leslie Controls, Inc. (“Leslie”) filed a voluntary petition (the “Bankruptcy Filing”) under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the District of Delaware and, simultaneously, filed a pre-negotiated plan of reorganization (as amended, the “Reorganization Plan” or “Plan”) in an effort to permanently resolve Leslie’s exposure to asbestos-related product liability actions. On February 7, 2011, the U.S. Federal District Court for the District of Delaware (the “District Court”) affirmed the Bankruptcy Court’s earlier order confirming Leslie’s Reorganization Plan, thus clearing the way for Leslie to emerge from bankruptcy. On April 28, 2011, pursuant to the terms of the Reorganization Plan, Leslie and CIRCOR contributed \$76.6 million in cash and a \$1.0 million promissory note (the “Note”) to fund the Leslie Controls Asbestos Trust (the “Trust”), and Leslie emerged from Chapter 11 bankruptcy protection. On September 30, 2011, the District Court entered an order for the final decree closing the Chapter 11 case. Under the terms of the Plan, all current and future asbestos related claims against Leslie, as well as all current and future derivative claims against CIRCOR, are now permanently channeled to the Trust. During the three months ended July 1, 2012, Leslie paid off the balance of the Note and, as a result, neither Leslie nor CIRCOR has any remaining financial obligation to the Trust. For a more detailed historical perspective on Leslie’s asbestos related litigation and associated pre-bankruptcy liability accounting, see “Item 3. Legal Proceedings” in our Annual Report on Form 10-K for the Fiscal Year ended December 31, 2010.

## Accounting—Net Leslie Asbestos and Bankruptcy Liability &amp; Financial Statement Impact

As of December 31, 2011, the net Leslie asbestos and bankruptcy liability was \$1.0 million, which represented the remaining payment to the Trust after the initial funding of \$76.6 million was made on April 28, 2011. This remaining \$1.0 million was paid to the Trust in late April 2012.

There were no ongoing costs associated with Leslie’s asbestos litigation for the six months ended July 1, 2012. The \$0.9 million bankruptcy related charges for the six month period ending July 3, 2011 is comprised solely of bankruptcy related professional fees.

(In Thousands)	July 1, 2012	December 31, 2011
Amounts payable to 524(g) trust	\$0	\$1,000
Net Leslie asbestos and bankruptcy liability	\$0	\$1,000

	Three Months Ended		Six Months Ended	
(In Thousands)	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Bankruptcy related (recoveries) costs	\$0	\$(124 )	\$0	\$877
Net pre-tax Leslie asbestos and bankruptcy (recoveries) charges	\$0	\$(124 )	\$0	\$877

## Other Matters

Smaller numbers of asbestos-related claims have also been filed against two of our other subsidiaries—Spence Engineering Company, Inc. (“Spence”), the stock of which we acquired in 1984; and Hoke Incorporated (“Hoke”), the stock of which we acquired in 1998. Due to the nature of the products supplied by these entities, the markets they serve and our historical experience in resolving these claims, we do not believe that asbestos-related claims will have a material adverse effect on the financial condition, results of operations or liquidity of Spence or Hoke, or the

financial condition, consolidated results of operations or liquidity of the Company.

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During the third quarter of 2011, we commenced arbitration proceedings against T.M.W. Corporation (“TMW”), the seller from which we acquired the assets of Castle Precision Industries in August 2010, seeking to recover damages from TMW for breaches of certain representations and warranties made by TMW in the Asset Purchase Agreement dated August 3, 2010 relative to such acquisition. We currently are in the discovery phase of this arbitration and expect the actual hearings to occur late in fiscal 2012 at the earliest. Early in the third quarter of 2012 we also commenced arbitration proceedings against the individuals from whom we purchased Valvulas S.F. Industria e Comercio Ltda. (“SF Valves”) for breaches of certain representations and warranties made in the Stock Purchase Agreement dated February 4, 2011.

**Standby Letters of Credit**

We execute standby letters of credit, which include bid bonds and performance bonds, in the normal course of business to ensure our performance or payments to third parties. The aggregate notional value of these instruments was \$45.1 million at July 1, 2012. Our historical experience with these types of instruments has been good and no claims have been paid in the current or past five fiscal years. We believe that the likelihood of demand for payments relating to the outstanding instruments is remote. These instruments have expiration dates ranging from less than one month to five years from July 1, 2012.

The following table contains information related to standby letters of credit instruments outstanding as of July 1, 2012 (In thousands):

Term Remaining	Maximum Potential Future Payments
0–12 months	\$ 22,569
Greater than 12 months	22,496
Total	\$ 45,065

**(11) Defined Pension Benefit Plans**

We maintain two pension benefit plans, a qualified noncontributory defined benefit plan and a nonqualified, noncontributory defined benefit supplemental plan that provides benefits to certain highly compensated officers and employees. To date, the supplemental plan remains an unfunded plan. These plans include significant pension benefit obligations which are calculated based on actuarial valuations. Key assumptions are made in determining these obligations and related expenses, including expected rates of return on plan assets and discount rates. Benefits are based primarily on years of service and employees’ compensation.

As of July 1, 2006, in connection with a revision to our retirement plan, we froze the pension benefits of our qualified noncontributory plan participants. Under the revised plan, such participants generally do not accrue any additional benefits under the defined benefit plan after July 1, 2006.

During the three and six months ended July 1, 2012, we made cash contributions of \$0.4 million and \$0.8 million, respectively, to our qualified defined benefit pension plan. Additionally, substantially all of our U.S. employees are eligible to participate in a 401(k) savings plan. Under this plan, we make a core contribution and match a specified percentage of employee contributions, subject to certain limitations.

The components of net pension benefit expense are as follows (In thousands):

	Three Months Ended		Six Months Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Service cost-benefits earned	\$52	\$108	\$105	\$215
Interest cost on benefits obligation	513	540	1,027	1,080
Estimated return on assets	(531	) (610	) (1,063	) (1,219
Prior service cost amortization	0	0	0	0
Loss amortization	158	85	316	171
Net periodic cost of defined pension benefit plans	\$192	\$123	\$385	\$247

(12) Income Taxes

As required by the Income Tax Topic of the ASC, at July 1, 2012 and at December 31, 2011, we had \$2.6 million and \$2.4 million of unrecognized tax benefits, respectively, of which \$1.5 million and \$1.4 million, respectively, would affect our

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effective tax rate if recognized in any future period.

We recognize interest and penalties related to uncertain tax positions in income tax expense. As of July 1, 2012, we have approximately \$1.1 million of accrued interest related to uncertain tax positions.

The Company files income tax returns in the U.S. federal jurisdiction and in various state, local and foreign jurisdictions. The Company is no longer subject to examination by the Internal Revenue Service for years prior to 2008 and is no longer subject to examination by the tax authorities in foreign and state jurisdictions prior to 2005. The Company is under examination for income tax filings in various state and foreign jurisdictions.

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

This Quarterly Report on Form 10-Q contains certain statements that are "forward-looking statements" as that term is defined under the Private Securities Litigation Reform Act of 1995 (the "Act") and releases issued by the SEC. The words "may," "hope," "should," "expect," "plan," "anticipate," "intend," "believe," "estimate," "predict," "potential," "continue," and "could" are used to identify forward-looking statements. We believe that it is important to communicate our future expectations to our stockholders, and we, therefore, make forward-looking statements in reliance upon the safe harbor provisions of the Act. However, there may be events in the future that we are not able to accurately predict or control and our actual results may differ materially from the expectations we describe in our forward-looking statements. Forward-looking statements involve known and unknown risks, uncertainties and other factors, which may cause our actual results, performance or achievements to differ materially from anticipated future results, performance or achievements expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, the cyclical and highly competitive nature of some of our end markets which can affect the overall demand for and pricing of our products, changes in the price of and demand for oil and gas in both domestic and international markets, variability of raw material and component pricing, changes in our suppliers' performance, fluctuations in foreign currency exchange rates, our ability to continue operating our manufacturing facilities at efficient levels including our ability to continue to reduce costs, our ability to generate increased cash by reducing our inventories, our prevention of the accumulation of excess inventory, our ability to successfully implement our acquisition strategy, fluctuations in interest rates, our ability to continue to successfully defend product liability actions including asbestos-related claims, as well as the uncertainty associated with the current worldwide economic conditions and the continuing impact on economic and financial conditions in the United States and around the world as a result of terrorist attacks, current Middle Eastern conflicts and related matters. We advise you to read further about certain of these and other risk factors set forth in Part I, Item 1A, "Risk Factors" of our Annual Report filed on Form 10-K for the year ended December 31, 2011, together with subsequent reports we have filed with the SEC on Forms 10-Q and 8-K, which may supplement, modify, supersede, or update those risk factors. We undertake no obligation to publicly update or revise any forward-looking statement, whether as a result of new information, future events or otherwise.

Company Overview

CIRCOR International, Inc. designs, manufactures and markets valves and other highly engineered products and sub-systems used in the energy, aerospace and industrial markets. Within our major product groups, we develop, sell and service a portfolio of fluid-control products, subsystems and technologies that enable us to fulfill our customers' unique fluid-control application needs.

We have organized our reporting structure into three segments: Energy, Aerospace, and Flow Technologies. Our Energy segment primarily serves large international energy projects, short-cycle North American energy markets, and the pipeline transmission equipment and services end-markets. Our Aerospace segment primarily serves the commercial and military aerospace markets. Our Flow Technologies segment serves our broadest variety of end-markets, including power generation, industrial and commercial HVAC/steam, industrial and process markets,



and chemical and refining. The Flow Technologies segment also provides products specifically designed for U.S. and international Navy applications.

We have been enhancing both our domestic and our worldwide operations through the development of the CIRCOR Business System. The CIRCOR Business System is based on lean manufacturing techniques (“Lean”) and is defined by our commitment to attracting, developing and refining the best talent and pursuing continuous improvement in all aspects of our business and operations. The CIRCOR Business System promotes improved shareholder value through the enhancement of core competencies across all of our business units, including continuous improvement, talent acquisition, development and retention, acquisition integration and factory repositioning, global business and supply chain development and product innovation.

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Our primary objective is to enhance shareholder value through profitable growth of our diversified, multi-national company utilizing the CIRCOR Business System. We are working to accomplish this objective by focusing on highly engineered project and product opportunities in key end-markets that have above average growth. These end-markets include the up-stream and mid-stream oil and gas, power generation, process and aerospace markets. In capitalizing on these opportunities, we are using the CIRCOR Business System to excel at:

- Lean Enterprise, Six Sigma and Continuous Improvement;
- Talent Acquisition, Development and Retention;
- Acquisition Integration and Factory Repositioning;
- Global Business and Supply Chain Development;
- Customer Relationship Development; and
- Product Innovation.

Through organic and acquisition-based growth our three to five year objectives are to double the revenue of CIRCOR, gain significant market position increases in our key end-markets and build a global capability in high-growth emerging markets while improving operating margins.

### Basis of Presentation

All significant intercompany balances and transactions have been eliminated in consolidation. Certain prior period financial statement amounts have been reclassified to conform to currently reported presentations. We monitor our business in three segments: Energy, Aerospace and Flow Technologies.

We operate and report financial information using a 52-week fiscal year ending December 31. The data periods contained within our Quarterly Reports on Form 10-Q reflect the results of operations for the 13-week, 26-week and 39-week periods which generally end on the Sunday nearest the calendar quarter-end date.

### Critical Accounting Policies

The following discussion of accounting policies is intended to supplement the section “Summary of Significant Accounting Policies” presented in Note (2) to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011. These policies were selected because they are broadly applicable within our operating units. The expenses and accrued liabilities or allowances related to certain of these policies are initially based on our best estimates at the time of original entry in our accounting records. Adjustments are recorded when our actual experience, or new information concerning our expected experience, differs from underlying initial estimates. These adjustments could be material if our actual or expected experience were to change significantly in a short period of time. We make frequent comparisons of actual experience and expected experience in order to mitigate the likelihood of material adjustments.

There have been no significant changes from the methodology applied by management for critical accounting estimates previously disclosed in our most recent Annual Report on Form 10-K.

### Revenue Recognition

Revenue is recognized when products are delivered, title and risk of loss have passed to the customer, no significant post-delivery obligations remain and collection of the resulting receivable is reasonably assured. We may enter into certain arrangements with multiple deliverables that may include any combination of designing, developing and manufacturing valves and other highly engineered products and sub-systems. Delivery of these products and sub-systems typically occurs within a one to two-year period, although most arrangements have a shorter timeframe for delivery. Revenue is generally allocated ratably to the units of accounting in the arrangement based on their

relative selling prices determined as if the deliverables were sold separately. Shipping and handling costs invoiced to customers are recorded as components of revenues and the associated costs are recorded as cost of revenues. We also have certain long-term arrangements requiring delivery of products or services over extended periods of time and revenue and profits on each arrangement are recognized in accordance with the percentage-of-completion method of accounting.

**Cash, Cash Equivalents, and Short-term Investments**

Cash and cash equivalents consist of amounts on deposit in checking and savings accounts with banks and other financial

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institutions. Short-term investments primarily consist of guaranteed investment certificates which generally have short-term maturities and are carried at cost which generally approximates fair value.

### Allowance for Inventory

We typically analyze our inventory aging and projected future usage on a quarterly basis to assess the adequacy of our inventory allowances. We provide inventory allowances for excess, slow-moving, and obsolete inventories determined primarily by estimates of future demand. The allowance is measured on an item-by-item basis determined based on the difference between the cost of the inventory and estimated market value. The provision for inventory allowance is a component of our cost of revenues. Assumptions about future demand are among the primary factors utilized to estimate market value. At the point of the loss recognition, a new, lower-cost basis for that inventory is established, and subsequent changes in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

Our net inventory balance was \$206.2 million as of July 1, 2012, compared to \$203.8 million as of December 31, 2011. Our inventory allowance as of July 1, 2012 was \$16.3 million, compared with \$17.7 million as of December 31, 2011. Our provision for inventory obsolescence was \$1.7 million and \$1.5 million for the first six months of 2012 and 2011, respectively. For the six months ended July 1, 2012, we have experienced increases in organic revenue and orders compared to the six months ended July 3, 2011. We believe our inventory allowances remain adequate with the net realizable value of our inventory being higher than our current inventory cost.

If there were to be a sudden and significant decrease in demand for our products, significant price reductions, or if there were a higher incidence of inventory obsolescence for any reason, including a change in technology or customer requirements, we could be required to increase our inventory allowances and our gross profit could be adversely affected.

### Penalty Accruals

Some of our customer agreements, primarily in our project related businesses, contain late shipment penalty clauses whereby we are contractually obligated to pay consideration to our customers if we do not meet specified shipment dates. The accrual for estimated penalties is shown as a reduction of revenue and is based on several factors including limited historical customer settlement experience and management's assessment of specific shipment delay information. Accruals related to these potential late shipment penalties as of July 1, 2012, and December 31, 2011 were \$10.0 million and \$9.4 million, respectively. As we conclude performance under these agreements, the actual amount of consideration paid to our customers may vary significantly from the amounts we currently have accrued.

### Acquisition Accounting

In connection with our acquisitions, we assess and formulate a plan related to the future integration of the acquired entity. This process begins during the due diligence phase and is concluded within twelve months of the acquisition. Our methodology for determining the fair values relating to purchase acquisitions is determined through established valuation techniques for industrial manufacturing companies and we utilize third party valuation firms to assist in the valuation of certain tangible and intangible assets.

### Legal Contingencies

We are currently involved in various legal claims and legal proceedings, some of which may involve substantial dollar amounts. Periodically, we review the status of each significant matter and assess our potential financial exposure. If the potential loss from any claim or legal proceeding is considered probable and the amount can be estimated, we accrue a liability for the estimated loss. Significant judgment is required in both the determination of probability and the determination as to whether an exposure can be reasonably estimated. Because of uncertainties related to these matters, accruals are based on the best information available at the time. As additional information becomes available, we reassess the potential liability related to our pending claims and litigation and may revise our estimates. Such

revisions in the estimates of the potential liabilities could have a material adverse effect on our business, results of operations and financial position. For more information related to our outstanding legal proceedings, see “Contingencies and Commitments” in Note 10 of the accompanying unaudited consolidated financial statements as well as “Legal Proceedings” in Part II, Item 1 hereof.

#### Impairment Analysis

As required by ASC Topic 350, “Goodwill and Intangible Assets,” we perform an annual assessment as to whether there was an indication that goodwill and certain intangible assets are impaired. We also perform impairment analyses whenever events and circumstances indicate that goodwill or certain intangibles may be impaired. In assessing the fair value of goodwill, we use our best estimates of future cash flows of operating activities and capital expenditures of the reporting unit, the

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estimated terminal value for each reporting unit and a discount rate based on the weighted average cost of capital.

If our estimates or related projections change in the future due to changes in industry and market conditions, we may be required to record additional impairment charges. The goodwill recorded on the consolidated balance sheet as of July 1, 2012 decreased \$1.5 million to \$76.3 million compared to \$77.8 million as of December 31, 2011 due to foreign currency fluctuations. There were no indicators of impairment as of July 1, 2012.

### Income Taxes

For 2012, we expect an effective income tax rate of approximately 30.0%. Our future effective tax rates could be adversely affected by earnings being lower than anticipated in countries where we have lower statutory rates and vice versa. Changes in the valuation of our deferred tax assets or liabilities, or changes in tax laws or interpretations thereof may also adversely affect our future effective tax rate. In addition, we are subject to the continuous examination of our income tax returns by the Internal Revenue Service and other tax authorities. We regularly assess the likelihood of adverse outcomes resulting from these examinations to determine the adequacy of our provision for income taxes.

The Company has a domestic deferred income tax asset and a net foreign deferred tax asset. With regard to deferred income tax assets, we maintained a total valuation allowance of \$12.8 million at July 1, 2012 and \$10.6 million at December 31, 2011 due to uncertainties related to our ability to utilize certain of these assets, primarily consisting of certain foreign tax credits, foreign and state net operating losses and state tax credits carried forward. The valuation allowance is based on estimates of taxable income in each of the jurisdictions in which we operate and the period over which our deferred tax assets will be recoverable. If market conditions improve and future results of operations exceed our current expectations, our existing tax valuation allowances may be adjusted, resulting in future tax benefits. Alternatively, if market conditions deteriorate or future results of operations are less than expected, future assessments may result in a determination that some or all of the deferred tax assets are not realizable. Consequently, we may need to establish additional tax valuation allowances for all or a portion of the gross deferred tax assets, which may have a material adverse effect on our business, results of operations and financial condition. The Company has had a history of domestic and foreign taxable income, is able to avail itself of federal tax carryback provisions, has future taxable temporary differences and projects future domestic and foreign taxable income. We believe that after considering all of the available objective evidence, it is more likely than not that the results of future operations will generate sufficient taxable income to realize the remaining deferred tax assets.

### Pension Benefits

We maintain two pension benefit plans, a qualified noncontributory defined benefit plan and a nonqualified, noncontributory defined benefit supplemental plan that provides benefits to certain highly compensated officers and employees. To date, the supplemental plan remains an unfunded plan. These plans include significant pension benefit obligations which are calculated based on actuarial valuations. Key assumptions are made in determining these obligations and related expenses, including expected rates of return on plan assets and discount rates. Benefits are based primarily on years of service and employees' compensation.

As of July 1, 2006, in connection with a revision to our retirement plan, we froze the pension benefits of our qualified noncontributory plan participants. Under the revised plan, such participants generally do not accrue any additional benefits under the defined benefit plan after July 1, 2006 and instead receive enhanced benefits associated with our defined contribution 401(k) plan in which substantially all of our U.S. employees are eligible to participate.

During the three and six months ended July 1, 2012, we made cash contributions of \$0.4 million and \$0.8 million, respectively, to our qualified defined benefit pension plan. For the remainder of 2012, we expect to make voluntary cash contributions of approximately \$0.8 million to our qualified defined benefit pension plan, although global capital market and interest rate fluctuations may impact future funding requirements.



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## Results of Operations for the Three Months Ended July 1, 2012 Compared to the Three Months Ended July 3, 2011

The following tables set forth the results of operations, percentage of net revenues and the period-to-period percentage change in certain financial data for the three months ended July 1, 2012 and July 3, 2011:

	Three Months Ended July 1, 2012		Three Months Ended July 3, 2011		% Change		
	(Dollars in thousands)						
Net revenues	\$219,862	100.0	%	\$191,908	100.0	% 14.6	%
Cost of revenues	156,046	71.0	%	137,302	71.5	% 13.7	%
Gross profit	63,816	29.0	%	54,606	28.5	% 16.9	%
Selling, general and administrative expenses	45,337	20.6	%	42,180	22.0	% 7.5	%
Leslie asbestos and bankruptcy recoveries, net	0	0.0	%	(124)	(0.1)	)% (100.0	)%
Operating income	18,479	8.4	%	12,550	6.5	% 47.2	%
Other expense:							
Interest expense, net	1,017	0.5	%	1,232	0.6	% (17.5	)%
Other expense, net	184	0.1	%	560	0.3	% (67.1	)%
Total other expense	1,201	0.5	%	1,792	0.9	% (33.0	)%
Income before income taxes	17,278	7.9	%	10,758	5.6	% 60.6	%
Provision for income taxes	6,142	2.8	%	3,261	1.7	% 88.3	%
Net income	\$11,136	5.1	%	\$7,497	3.9	% 48.5	%

## Net Revenues

Net revenues for the three months ended July 1, 2012 increased by \$28.0 million, or 15%, to \$219.9 million from \$191.9 million for the three months ended July 3, 2011. The change in net revenues for the three months ended July 1, 2012 was attributable to the following:

Segment	Three Months Ended		Total	Acquisitions	Operations	Foreign
	July 1, 2012	July 3, 2011	Change			Exchange
	(In thousands)					
Energy	\$113,527	\$81,994	\$31,533	\$0	\$37,825	\$(6,292)
Aerospace	35,896	36,029	(133)	0	1,272	(1,405)
Flow Technologies	70,439	73,885	(3,446)	0	(1,520)	(1,926)
Total	\$219,862	\$191,908	\$27,954	\$0	\$37,577	\$(9,623)

The Energy segment accounted for 52% of net revenues for the three months ended July 1, 2012 compared to 43% for the three months ended July 3, 2011. The Aerospace segment accounted for 16% of net revenues for the three months ended July 1, 2012 compared to 19% for the three months ended July 3, 2011. The Flow Technologies segment accounted for 32% of net revenues for the three months ended July 1, 2012 compared to 39% for the three months ended July 3, 2011.

Energy segment revenues increased by \$31.5 million, or 38%, for the quarter ended July 1, 2012 compared to the quarter ended July 3, 2011. The increase was primarily driven by \$37.8 million of organic growth across all markets with increases in the short-cycle North American, large international project and pipeline shipments. The increase was partially offset by unfavorable foreign currency fluctuations of \$6.3 million. Energy segment orders increased \$25.0 million to \$128.2 million for the three months ended July 1, 2012 compared to \$103.2 million for the same period in 2011 primarily due to higher international project and North American short-cycle orders placed in the current quarter. Backlog for our Energy segment has decreased \$28.3 million to \$197.4 million as of July 1, 2012 compared to \$225.7



million as of July 3, 2011. The declines in backlog were primarily due to the impact of unfavorable foreign currency fluctuations within our large international project business as well as the ongoing shipments of a large pipeline project booked in 2010. These were partially offset by continued increases in North American short-cycle activities.

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Aerospace segment revenues decreased by \$0.1 million, or less than 1%, for the quarter ended July 1, 2012 compared to the same period in 2011. The decrease was due to unfavorable foreign currency fluctuations of \$1.4 million, partially offset by organic growth of \$1.3 million. Orders for this segment decreased \$4.9 million to \$28.5 million for the three months ended July 1, 2012 compared to \$33.4 million for the same period in 2011. This order decline was primarily due to decreases in both commercial and military landing gear orders. Order backlog increased \$17.5 million to \$150.6 million as of July 1, 2012 compared to \$133.1 million as of July 3, 2011 primarily due to a large multi-year military landing gear order placed in the third quarter of 2011.

Flow Technologies segment revenues decreased by \$3.4 million, or 5%, for the quarter ended July 1, 2012 compared to the same period in 2011. The revenue decrease was due to net organic declines of \$1.5 million and unfavorable foreign currency fluctuations of \$1.9 million. The organic revenue decline was primarily due to lower light emitting diode ("LED") equipment shipments, partially offset by organic growth across most other businesses. This segment's customer orders decreased \$6.2 million to \$70.6 million for the quarter ended July 1, 2012 compared to \$76.8 million for the same period in 2011 primarily due to weakness in the LED equipment market. Order backlog decreased \$8.9 million to \$74.3 million as of July 1, 2012 compared to \$83.2 million as of July 3, 2011, primarily driven by lower LED equipment orders and the shipment of Navy backlog.

Gross Profit

Consolidated gross profit increased \$9.2 million, or 17%, to \$63.8 million for the quarter ended July 1, 2012 compared to \$54.6 million for the quarter ended July 3, 2011. Consolidated gross margin increased 50 basis points to 29.0% for the quarter ended July 1, 2012 from 28.5% for the quarter ended July 3, 2011.

Gross profit for the Energy segment increased \$10.2 million, or 53%, for the quarter ended July 1, 2012 compared to the same period in 2011. The gross profit increase was primarily due to \$10.8 million of organic increases, partially offset by \$0.6 million in unfavorable foreign exchange rates compared to the U.S. dollar. Gross margins improved 250 basis points to 26.0% for the quarter ended July 1, 2012 compared to 23.5% for the same period in 2011. This increase was primarily driven by increased volume and associated leverage and improved large international project pricing, partially offset by expenses in Brazil.

Gross profit for the Aerospace segment decreased \$1.3 million, or 11%, for the quarter ended July 1, 2012 compared to the quarter ended July 3, 2011. This gross profit decrease was primarily due to \$0.8 million from organic declines and unfavorable foreign currency fluctuations of \$0.5 million. Gross margins declined by 360 basis points to 30.4% for the quarter ended July 1, 2012 from 34.0% for the quarter ended July 3, 2011 primarily due to continued large future program expenses including product development and manufacturing capabilities. These declines were partially offset by the increased volume and associated leverage.

Gross profit for the Flow Technologies segment increased \$0.4 million, or 2%, for the quarter ended July 1, 2012 compared to the quarter ended July 3, 2011. Higher organic revenues resulted in an approximate \$1.2 million of higher gross profit, which was partially offset by unfavorable foreign currency fluctuations of \$0.8 million. Gross margins improved 210 basis points to 33.3% for the quarter ended July 1, 2012 from 31.2% for the quarter ended July 3, 2011 primarily due to improved productivity and spending, partially offset by lower volume and associated leverage.

Selling, General and Administrative Expenses

Selling, general and administrative expenses increased \$3.2 million, or 7%, to \$45.3 million for the quarter ended July 1, 2012 compared to \$42.2 million for the three months ended July 3, 2011. Selling, general and administrative expenses as a percentage of revenues decreased 140 basis points to 20.6% for the three months ended July 1, 2012 compared to 22.0% for the three months ended July 3, 2011.

Selling, general and administrative expenses for the Energy segment increased 13%, or \$2.0 million, for the quarter ended July 1, 2012 compared to the same period in 2011. Organic increases, inclusive of higher commissions, increased selling resources and higher personnel-related expenses accounted for \$3.0 million of the total increase. The organic increases were partially offset by \$1.0 million of favorable foreign currency fluctuations.

Selling, general and administrative expenses for the Aerospace segment decreased 6%, or \$0.5 million, for the quarter ended July 1, 2012 compared to the same period in 2011. This decrease included \$0.4 million of foreign currency fluctuations and \$0.1 million organic declines.

Selling, general and administrative expenses for the Flow Technologies segment increased 3%, or \$0.5 million for the

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quarter ended July 1, 2012 compared to the same period in 2011 primarily due to organic increases of \$1.0 million, mainly from growth initiatives. The organic increases were partially offset by favorable foreign currency fluctuations of \$0.5 million.

Corporate, general and administrative expenses increased \$1.2 million to \$6.3 million for the quarter ended July 1, 2012 compared to the same period in 2011. The increase was primarily due to higher professional fees and compensation.

**Leslie Asbestos and Bankruptcy Related Recoveries, Net**

Asbestos and bankruptcy related charges are primarily associated with our Leslie subsidiary in the Flow Technologies segment. There were no ongoing costs associated with Leslie's asbestos litigation for the three months ended July 1, 2012. The \$0.1 million recovery of bankruptcy related costs for the three months ended July 3, 2011 was a result of lower actual costs incurred compared to amounts previously estimated. For more information on asbestos related litigation, see "Contingencies and Commitments" in Note 10 of the accompanying consolidated financial statements as well as "Legal Proceedings" in Part II, Item 1.

**Operating Income**

The change in operating income for the three months ended July 1, 2012 compared to the three months ended July 3, 2011 was as follows:

Segment	Three Months Ended		Total	Acquisitions	Operations	Foreign
	July 1, 2012	July 3, 2011	Change			Exchange
	(Dollars In thousands)					
Energy	\$12,580	\$4,373	\$8,207	\$ 0	\$7,782	\$425
Aerospace	3,153	4,021	(868	) 0	(722	) (146
Flow Technologies	9,043	9,292	(249	) 0	25	(274
Corporate	(6,297	) (5,136	) (1,161	) 0	(1,157	) (4
Total	\$18,479	\$12,550	\$5,929	\$ 0	\$5,928	\$1

Operating income increased 47%, or \$5.9 million, to \$18.5 million for the three months ended July 1, 2012 compared to \$12.6 million for the same period in 2011.

Operating income for the Energy segment increased \$8.2 million, or 188%, to \$12.6 million for the quarter ended July 1, 2012, compared to the same period in 2011. Operating margins improved 580 basis points to 11.1% on a revenue increase of 38%, compared to the first quarter in 2011. The increase in operating income was primarily due to the significant volume increase and the associated leverage in our North American businesses, improved pricing in large international projects and favorable mix, partially offset by expenses in Brazil.

Operating income for the Aerospace segment decreased \$0.9 million, or 22%, to \$3.2 million for the quarter ended July 1, 2012 compared to the same period in 2011. Operating margins declined by 240 basis points to 8.8% for the three months ended July 1, 2012 compared to 11.2% for the same period in 2011. The declines are primarily due to continued large future program expenses including product development and manufacturing capabilities, which were partially offset by favorable product mix and volume.

Operating income for the Flow Technologies segment decreased \$0.2 million, or 3%, to \$9.0 million for the quarter ended July 1, 2012 compared to the same period in 2011. The decline was primarily due to unfavorable foreign currency fluctuations of \$0.3 million. Operating margins improved by 20 basis points to 12.8% for the three months ended July 1, 2012 compared to 12.6% for the same period in 2011 primarily due to favorable product mix, partially offset by expenses associated with growth initiatives.

Corporate operating expenses increased \$1.2 million, or 23%, for the quarter ended July 1, 2012 compared to the same period in 2011, largely due to higher professional fees and compensation.

Interest Expense, Net

Interest expense, net, decreased \$0.2 million for the three months ended July 1, 2012 compared to the three months ended July 3, 2011. This change in interest expense was primarily due to lower interest charges from lower borrowings associated with our revolving credit facility and other borrowings.

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## Other Expense, Net

Other expense, net, was \$0.2 million for the quarter ended July 1, 2012 compared to \$0.6 million in the same period of 2011. The difference of \$0.4 million was largely the result of the remeasurement of foreign currency balances.

## Provision for Taxes

The effective tax rate was 35.5% for the quarter ended July 1, 2012 compared to 30.3% for the same period of 2011. The primary driver of the higher 2012 tax rate was the establishment of a valuation allowance for one of our international subsidiaries that negatively impacted the rate by 13.1%, partially offset by the effect of discrete tax items.

## Net Income

Net income increased \$3.6 million to \$11.1 million for the quarter ended July 1, 2012 compared to \$7.5 million for the same period in 2011. The increase was primarily due to higher operating income, partially offset by an increase in income tax expense.

## Results of Operations for the Six Months Ended July 1, 2012 Compared to the Six Months Ended July 3, 2011

The following tables set forth the results of operations, percentage of net revenues and the period-to-period percentage change in certain financial data for the six months ended July 1, 2012 and July 3, 2011:

	Six Months Ended July 1, 2012		Six Months Ended July 3, 2011		% Change	
	(Dollars in thousands)					
Net revenues	\$434,142	100.0	% \$395,278	100.0	% 9.8	%
Cost of revenues	311,714	71.8	% 284,444	72.0	% 9.6	%
Gross profit	122,428	28.2	% 110,834	28.0	% 10.5	%
Selling, general and administrative expenses	90,249	20.8	% 84,635	21.4	% 6.6	%
Leslie asbestos and bankruptcy charges, net	0	0.0	% 877	0.2	% (100.0)	)%
Operating income	32,179	7.4	% 25,322	6.4	% 27.1	%
Other expense:						
Interest expense, net	2,098	0.5	% 2,005	0.5	% 4.6	%
Other expense, net	322	0.1	% 1,476	0.4	% (78.2)	)%
Total other expense	2,420	0.6	% 3,481	0.9	% (30.5)	)%
Income before income taxes	29,759	6.9	% 21,841	5.5	% 36.3	%
Provision for income taxes	10,038	2.3	% 6,439	1.6	% 55.9	%
Net income	\$19,721	4.5	% \$15,402	3.9	% 28.0	%

## Net Revenues

Net revenues for the six months ended July 1, 2012 increased by \$38.9 million, or 10%, to \$434.1 million from \$395.3 million for the six months ended July 3, 2011. The change in net revenues for the six months ended July 1, 2012 was attributable to the following:

Segment	Six Months Ended		Total	Acquisitions	Operations	Foreign	
	July 1, 2012	July 3, 2011	Change			Exchange	
	(In thousands)						
Energy	\$222,791	\$181,164	\$41,627	\$1,525	\$48,664	\$(8,562)	)
Aerospace	73,981	68,139	5,842	0	7,809	(1,967)	)

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Flow Technologies	137,370	145,975	(8,605	) 0	(5,855	) (2,750	)
Total	\$434,142	\$395,278	\$38,864	\$ 1,525	\$50,618	\$(13,279	)

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The Energy segment accounted for 51% of net revenues for the six months ended July 1, 2012 compared to 46% for the six months ended July 3, 2011. The Aerospace segment accounted for 17% of net revenues for the six months ended July 1, 2012 compared to 17% for the six months ended July 3, 2011. The Flow Technologies segment accounted for 32% of net revenues for the six months ended July 1, 2012 compared to 37% for the six months ended July 3, 2011.

Energy segment revenues increased by \$41.6 million, or 23%, for the six months ended July 1, 2012 compared to the six months ended July 3, 2011. The increase was primarily driven by \$48.7 million of organic growth across all markets with increases in both the short-cycle North American area and in large international project shipments. In addition, this year over year increase was due to \$1.5 million in additional revenue from the first quarter 2011 acquisition of Valvulas S.F. Industria e Comercio Ltda. ("SF Valves") located in Brazil, partially offset by unfavorable foreign currency fluctuations of \$8.6 million. Energy segment orders increased \$46.9 million to \$263.9 million for the six months ended July 1, 2012 compared to \$217.0 million for the same period in 2011 with improvements in both large international projects and North American short-cycle orders.

Aerospace segment revenues increased by \$5.8 million, or 9%, for the six months ended July 1, 2012 compared to the same period in 2011. The increase was due to organic growth of \$7.8 million across most areas with the exception of landing gear, partially offset by unfavorable foreign currency fluctuations of \$2.0 million. Orders for this segment increased \$2.4 million to \$68.7 million for the six months ended July 1, 2012 compared to \$66.3 million for the same period in 2011. This order increase was primarily due to increases in military projects and other programs.

Flow Technologies segment revenues decreased by \$8.6 million, or 6%, for the six months ended July 1, 2012 compared to the same period in 2011. The revenue decrease was due to net organic declines of \$5.9 million and unfavorable foreign currency fluctuations of \$2.7 million. The organic revenue decline was primarily due to lower LED equipment shipments, partially offset by organic growth across most other businesses. This segment's customer orders decreased \$8.3 million to \$143.4 million for the six months ended July 1, 2012 compared to \$151.7 million for the same period in 2011 with improvement in most markets excluding the LED equipment market.

**Gross Profit**

Consolidated gross profit increased \$11.6 million, or 10%, to \$122.4 million for the six months ended July 1, 2012 compared to \$110.8 million for the six months ended July 3, 2011. Consolidated gross margin increased 20 basis points to 28.2% for the six months ended July 1, 2012 from 28.0% for the six months ended July 3, 2011.

Gross profit for the Energy segment increased \$13.5 million, or 33%, for the six months ended July 1, 2012 compared to the same period in 2011. The gross profit increase was primarily due to \$14.2 million of organic increases, partially offset by \$0.8 million in foreign exchange rates compared to the U.S. dollar. Gross margins improved 200 basis points to 24.2% for the six months ended July 1, 2012 compared to 22.2% for the same period in 2011. This increase was primarily driven by increased volume and associated leverage and improved project pricing, partially offset by expenses in Brazil.

Gross profit for the Aerospace segment decreased \$1.0 million, or 4%, for the six months ended July 1, 2012 compared to the six months ended July 3, 2011. This gross profit decrease was primarily due to unfavorable foreign currency fluctuations of \$0.7 million and organic declines of \$0.3 million. Gross margins declined by 410 basis points to 31.0% for the six months ended July 1, 2012 from 35.1% for the six months ended July 3, 2011 primarily due to continued large future program expenses including product development and manufacturing capabilities. These declines were partially offset by the increased military project volume and associated leverage.



Gross profit for the Flow Technologies segment decreased \$1.0 million, or 2%, for the six months ended July 1, 2012 compared to the six months ended July 3, 2011. The decrease was primarily due to unfavorable foreign currency fluctuations of \$1.2 million, partially offset by organic increases of \$0.2 million. Gross margins improved 130 basis points to 33.3% for the six months ended July 1, 2012 from 32.0% for the six months ended July 3, 2011 primarily due to improved productivity and spending, partially offset by lower volume and associated leverage.

#### Selling, General and Administrative Expenses

Selling, general and administrative expenses increased \$5.6 million, or 7%, to \$90.2 million for the six months ended July 1, 2012 compared to \$84.6 million for the six months ended July 3, 2011. Selling, general and administrative expenses as a percentage of revenues decreased 60 basis points to 20.8% for the six months ended July 1, 2012 compared to 21.4% for the six months ended July 3, 2011.

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Selling, general and administrative expenses for the Energy segment increased 9%, or \$2.8 million for the six months ended July 1, 2012 compared to the same period in 2011. Organic increases, inclusive of higher commissions, increased selling resources and higher personnel-related expenses accounted for \$3.7 million of the total increase. In addition, the SF Valves acquisition in the first quarter of 2011 added \$0.4 million in expenses. These increases were partially offset by \$1.3 million of favorable foreign currency fluctuations.

Selling, general and administrative expenses for the Aerospace segment decreased 3%, or \$0.5 million for the six months ended July 1, 2012 compared to the same period in 2011 primarily due to favorable foreign currency fluctuations of \$0.5 million.

Selling, general and administrative expenses for the Flow Technologies segment increased 5%, or \$1.4 million for the six months ended July 1, 2012 compared to the same period in 2011 primarily due to organic increases of \$2.1 million, mainly from growth initiatives. The organic increases were partially offset by favorable foreign currency fluctuations of \$0.7 million.

Corporate, general and administrative expenses increased \$1.9 million to \$13.2 million for the six months ended July 1, 2012 compared to the same period in 2011. The increase was primarily due to higher professional fees.

**Leslie Asbestos and Bankruptcy Related (Recoveries) Charges, Net**

Asbestos and bankruptcy related charges are primarily associated with our Leslie subsidiary in the Flow Technologies segment. There were no ongoing costs associated with Leslie's asbestos litigation for the six months ended July 1, 2012. The \$0.9 million bankruptcy related charges for the six months ended July 3, 2011 was comprised of bankruptcy related professional fees. For more information on asbestos related litigation, see "Contingencies and Commitments" in Note 10 of the accompanying consolidated financial statements as well as "Legal Proceedings" in Part II, Item 1.

**Operating Income**

The change in operating income for the six months ended July 1, 2012 compared to the six months ended July 3, 2011 was as follows:

Segment	Six Months Ended		Total Change	Acquisitions	Operations	Foreign Exchange
	July 1, 2012	July 3, 2011				
	(Dollars In thousands)					
Energy	\$21,508	\$10,767	\$10,741	\$ (398	) \$10,558	\$581
Aerospace	7,277	7,747	(470	) 0	(250	) (220
Flow Technologies	16,630	18,408	(1,778	) 0	(1,371	) (407
Corporate	(13,236	) (11,600	) (1,636	) 0	(1,630	) (6
Total	\$32,179	\$25,322	\$6,857	\$ (398	) \$7,307	\$(52

Operating income increased 27%, or \$6.9 million, to \$32.2 million for the six months ended July 1, 2012 compared to \$21.8 million for the same period in 2011.

Operating income for our Energy segment increased \$10.7 million, or 100%, to \$21.5 million for the six months ended July 1, 2012, compared to the same period in 2011. Operating margins improved 380 basis points to 9.7% on a revenue increase of 23%, compared to the first six months in 2011. The increase in operating income was primarily due to the significant volume increase and the associated leverage in our North American businesses, improved pricing in large international projects and favorable mix, partially offset by expenses in Brazil.

Operating income for the Aerospace segment decreased \$0.5 million, or 6%, to \$7.3 million for the six months ended July 1, 2012 compared to the same period in 2011. Operating margins declined by 160 basis points to 9.8% compared to the first six months in 2011 primarily due to continued large future program expenses including product development and manufacturing capabilities, which were partially offset by the increased military project volume and associated leverage.

Operating income for the Flow Technologies segment decreased \$1.8 million, or 10%, to \$16.6 million for the six months ended July 1, 2012 compared to the same period in 2011. Operating margins declined by 50 basis points to 12.1% compared to the first six months in 2011 primarily due to lower volume and associated leverage and investment in growth initiatives, partially offset by productivity and lower operating expenses.

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Corporate operating expenses increased \$1.6 million, or 14%, for the six months ended July 1, 2012 compared to the same period in 2011, largely due to higher professional fees.

**Interest Expense, Net**

Interest expense, net, increased \$0.1 million for the six months ended July 1, 2012 compared to the six months ended July 3, 2011. This change in interest expense was primarily due to higher interest charges from higher borrowings associated with our revolving credit facility and other borrowings.

**Other Expense, Net**

Other expense, net, was \$0.3 million for the six months ended July 1, 2012 compared to \$1.5 million in the same period of 2011. The difference of \$1.2 million was largely the result of the remeasurement of foreign currency balances.

**Provision for Taxes**

The effective tax rate was 33.7% for the six months ended July 1, 2012 compared to 29.5% for the same period of 2011. The primary driver of the higher 2012 tax rate was the establishment of a valuation allowance for one of our international subsidiaries that negatively impacted the rate by 7.6%, partially offset by the effect of discrete tax items.

**Net Income**

Net income increased \$4.3 million to \$19.7 million for the six months ended July 1, 2012 compared to \$15.4 million for the same period in 2011. The increase was primarily due to higher operating income, partially offset by an increase in income tax expense.

**Liquidity and Capital Resources**

Our liquidity needs arise primarily from capital investment in machinery, equipment and the improvement of facilities, funding working capital requirements to support business growth initiatives, acquisitions, dividend payments, pension funding obligations and debt service costs. We have historically generated cash from operations and remain in a strong financial position, with resources available for reinvestment in existing businesses, strategic acquisitions and managing our capital structure on a short and long-term basis.

The following table summarizes our cash flow activities for the six months ended July 1, 2012 (In thousands):

**Cash flow provided by (used in):**

Operating activities	\$8,771
Investing activities	(10,752 )
Financing activities	(10,737 )
Effect of exchange rates on cash and cash equivalents	(723 )
Decrease in cash and cash equivalents	\$(13,441 )

During the six months ended July 1, 2012, we generated \$8.8 million in operating activities compared to using \$69.3 million during the same period in 2011. During the six months ended July 1, 2012, we used \$1.0 million to make the final payment to the Leslie Controls Asbestos Trust (the "Trust"). This compares to a use of \$76.6 million for the six months ended July 3, 2011 to initially fund the Trust. In addition, during the six months ended July 1, 2012 we used approximately \$22.6 million in cash from operating assets and liabilities compared to using \$19.0 million during the same period in 2011. During the six months ended July 1, 2012 inventories as well as accounts payable, accrued

expenses and other liabilities were uses of cash of \$5.3 million and \$9.6 million, respectively as compared to the six months ended July 3, 2011 when we used \$34.2 million to acquire inventory and increases in accounts payable, accrued expenses and other liabilities provided \$26.9 million. The operating asset and liability increases were partially offset by higher net income during the six months ended July 1, 2012 compared to the same period in 2011. The \$10.8 million used by investing activities primarily consists of net purchases of capital equipment. Financing activities used \$10.7 million, which included a net \$9.0 million reduction of borrowings and \$1.3 million used to pay dividends to shareholders.

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As of July 1, 2012, total debt was \$95.9 million compared to \$105.1 million at December 31, 2011. Total debt as a percentage of total shareholders' equity was 24.1% as of July 1, 2012 compared to 27.4% as of December 31, 2011.

On May 2, 2011, we entered into a five year unsecured credit agreement ("2011 Credit Agreement") that provides for a \$300.0 million revolving line of credit. The 2011 Credit Agreement includes a \$150.0 million accordion feature for a maximum facility size of \$450.0 million. The 2011 Credit Agreement also allows for additional indebtedness not to exceed \$80 million. We anticipate using the 2011 Credit Agreement to fund potential acquisitions, to support our organic growth initiatives and working capital needs, and for general corporate purposes. As of July 1, 2012, we had borrowings of \$88.4 million outstanding under our credit facility and \$45.1 million was allocated to support outstanding letters of credit.

Certain of our loan agreements contain covenants that require, among other items, maintenance of certain financial ratios and also limit our ability to: enter into secured and unsecured borrowing arrangements; issue dividends to shareholders; acquire and dispose of businesses; invest in capital equipment; transfer assets among domestic and international entities; participate in certain higher yielding long-term investment vehicles; and issue additional shares of our stock. The two primary financial covenants are leverage ratio and interest coverage ratio. We were in compliance with all financial covenants related to our existing debt obligations on July 1, 2012 and we believe it is reasonably likely that we will continue to meet such covenants in the near future.

The ratio of current assets to current liabilities was 2.44:1 as of July 1, 2012 compared to 2.27:1 at December 31, 2011. The increase in the current ratio was primarily due to the payment of short term borrowings, which reduced our current liabilities compared to December 31, 2011. As of July 1, 2012, cash and cash equivalents totaled \$41.4 million, of which approximately \$39.2 million was held in foreign bank accounts. This compares to \$54.9 million of cash and cash equivalents as of December 31, 2011 of which \$51.2 million was held in foreign bank accounts. The cash and cash equivalents located at our foreign subsidiaries may not be repatriated to the United States or other jurisdictions without significant tax implications. We believe that our U.S. based subsidiaries, in the aggregate, will generate positive operating cash flows and in addition we may utilize our 2011 Credit Agreement for U.S. based subsidiary cash needs. As a result, we believe that we will not need to repatriate cash from our foreign subsidiaries with earnings that are indefinitely reinvested.

On November 4, 2010, we filed with the SEC a shelf registration statement on Form S-3 under which we may issue up to \$400 million of securities including debt securities, common stock, preferred stock, warrants to purchase any such securities and units comprised of any such securities (the "Securities"). The registration statement was declared effective by the SEC on December 17, 2010. We may offer these Securities from time to time in amounts, at prices and on terms to be determined at the time of sale. We believe that with this registration statement, we will have greater flexibility to take advantage of financing opportunities, acquisitions and other business opportunities when and if such opportunities arise. Depending on market conditions, we may issue securities under this or future registration statements or in private offerings exempt from registration requirements.

In 2012, we expect to generate positive cash flow from operating activities sufficient to support our capital expenditures and pay dividends of approximately \$2.7 million based on our current dividend practice of paying \$0.15 per share annually. Based on our expected cash flows from operations and contractually available borrowings under our credit facilities, we expect to have sufficient liquidity to fund working capital needs and future growth. We continue to search for strategic acquisitions; a larger acquisition may require additional borrowings and / or the issuance of our common stock.

## Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements other than operating leases and these leases are not reasonably likely to have a current or future effect on our financial condition, changes in financial condition, revenues or expenses, results of operations, liquidity, capital expenditures, or capital resources that is material to investors.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

Interest Rate Sensitivity Risk

As of July 1, 2012, our primary interest rate risk is related to borrowings under our revolving credit facility. The interest rate for our revolving credit facility fluctuates with changes in short-term interest rates. We had \$88.4 million borrowed under our revolving credit facility as of July 1, 2012. Based upon expected levels of borrowings under our credit facility in 2012, an increase in variable interest rates of 100 basis points would have an effect on our annual results of operations and cash flows of approximately \$0.4 million.

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## Foreign Currency Exchange Risk

The Company is exposed to certain risks relating to its ongoing business operations including foreign currency exchange rate risk and interest rate risk. The Company currently uses derivative instruments to manage foreign currency risk on certain business transactions denominated in foreign currencies. To the extent the underlying transactions hedged are completed, these forward contracts do not subject us to significant risk from exchange rate movements because they offset gains and losses on the related foreign currency denominated transactions. These forward contracts do not qualify as hedging instruments and, therefore, do not qualify for fair value or cash flow hedge treatment. Any unrealized gains and losses on our contracts are recognized as a component of other expense in our consolidated statements of operations.

As of July 1, 2012, we had nine forward contracts with total values as follows (in thousands):

Currency	Number	Contract Amount	
U.S. Dollar/GBP	2	1,500	U.S. Dollars
Euro/GBP	1	291	Euros
Canadian Dollar/Euro	1	7,236	Canadian Dollars
Brazilian Real/Euro	5	12,500	Brazilian Reals

This compares to six forward contracts as of December 31, 2011. The fair value asset of the derivative forward contracts as of July 1, 2012 was less than \$0.3 million and is included in prepaid expenses and other current assets on our balance sheet. This compares to a fair value asset of approximately \$0.1 million that was included in prepaid expenses and other current assets on our balance sheet as of December 31, 2011. These forward contracts have expiration dates ranging from less than one month to five years from July 1, 2012.

We have determined that the majority of the inputs used to value our foreign currency forward contracts fall within Level 2 of the fair value hierarchy, found under ASC Topic 820. The credit valuation adjustments, such as estimates of current credit spreads to evaluate the likelihood of default by ourselves and our counterparties are Level 3 inputs. However, we have assessed the significance of the impact of the credit valuation adjustments on the overall valuation of our foreign currency forward contracts and determined that the credit valuation adjustments are not significant to the overall valuation. As a result, we have determined that our derivative valuations in their entirety are classified in Level 2 of the fair value hierarchy.

## ITEM 4. CONTROLS AND PROCEDURES.

## Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our Chief Executive Officer and Chief Financial Officer (our principal executive officer and principal financial officer, respectively), has evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934) as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on this evaluation, our principal executive officer and principal financial officer have concluded that, as of the end of the period covered by this report, the Company's disclosure controls and procedures were designed and were effective to give reasonable assurance that information we disclose in reports that we file or submit under the Securities Exchange Act of 1934 is accumulated and communicated to management, including our principal executive and financial officers, to allow timely decisions regarding disclosure and that such information is recorded, processed, summarized and reported, within the time periods specified in the SEC's rules and forms.

## Changes in Internal Controls Over Financial Reporting



We have made no changes in our internal controls over financial reporting during the quarter ended July 1, 2012 that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION.

ITEM 1. LEGAL PROCEEDINGS.

Asbestos Litigation

Background

On July 12, 2010 (the "Filing Date"), our subsidiary Leslie Controls, Inc. ("Leslie") filed a voluntary petition (the "Bankruptcy Filing") under Chapter 11 of the U.S. Bankruptcy Code in the U.S. Bankruptcy Court for the District of Delaware

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and, simultaneously, filed a pre-negotiated plan of reorganization (as amended, the “Reorganization Plan” or “Plan”) in an effort to permanently resolve Leslie’s exposure to asbestos-related product liability actions. On February 7, 2011, the U.S. Federal District Court for the District of Delaware (the “District Court”) affirmed the Bankruptcy Court’s earlier order confirming Leslie’s Reorganization Plan, thus clearing the way for Leslie to emerge from bankruptcy. On April 28, 2011, pursuant to the terms of the Reorganization Plan, Leslie and CIRCOR contributed \$76.6 million in cash and a \$1.0 million promissory note (the “Note”) to fund the Leslie Controls Asbestos Trust (the “Trust”), and Leslie emerged from Chapter 11 bankruptcy protection. On September 30, 2011, the District Court entered an order for the final decree closing the Chapter 11 case. Under the terms of the Plan, all current and future asbestos related claims against Leslie, as well as all current and future derivative claims against CIRCOR, are now permanently channeled to the Trust. During the three months ended July 1, 2012, Leslie paid off the balance of the Note and, as a result, neither Leslie nor CIRCOR has any remaining financial obligation to the Trust. For a more detailed historical perspective on Leslie’s asbestos related litigation and associated pre-bankruptcy liability accounting, see “Item 3. Legal Proceedings” in our Annual Report on Form 10-K for the Fiscal Year ended December 31, 2010.

Accounting—Net Leslie Asbestos and Bankruptcy Liability & Financial Statement Impact

As of December 31, 2011, the net Leslie asbestos and bankruptcy liability was \$1.0 million, which represented the remaining payment to the Trust after the initial funding of \$76.6 million was made on April 28, 2011. This remaining \$1.0 million was paid to the Trust in late April 2012.

There were no ongoing costs associated with Leslie’s asbestos litigation for the six months ended July 1, 2012. The \$0.9 million bankruptcy related charges for the six month period ending July 3, 2011 is comprised solely of bankruptcy related professional fees.

(In Thousands)	July 1, 2012	December 31, 2011
Amounts payable to 524(g) trust	\$0	\$1,000
Net Leslie asbestos and bankruptcy liability	\$0	\$1,000

(In Thousands)	Three Months Ended		Six Months Ended	
	July 1, 2012	July 3, 2011	July 1, 2012	July 3, 2011
Bankruptcy related (recoveries) costs	\$0	\$(124	) \$0	\$877
Net pre-tax Leslie asbestos and bankruptcy (recoveries) charges	\$0	\$(124	) \$0	\$877

Other Matters

Smaller numbers of asbestos-related claims have also been filed against two of our other subsidiaries—Spence Engineering Company, Inc. (“Spence”), the stock of which we acquired in 1984; and Hoke Incorporated (“Hoke”), the stock of which we acquired in 1998. Due to the nature of the products supplied by these entities, the markets they serve and our historical experience in resolving these claims, we do not believe that asbestos-related claims will have a material adverse effect on the financial condition, results of operations or liquidity of Spence or Hoke, or the financial condition, consolidated results of operations or liquidity of the Company.

During the third quarter of 2011, we commenced arbitration proceedings against T.M.W. Corporation (“TMW”), the seller from which we acquired the assets of Castle Precision Industries in August 2010, seeking to recover damages from TMW for breaches of certain representations and warranties made by TMW in the Asset Purchase Agreement dated August 3, 2010 relative to such acquisition. We currently are in the discovery phase of this arbitration and expect the actual hearings to occur late in fiscal 2012 at the earliest. Early in the third quarter of 2012 we also commenced arbitration proceedings against the individuals from whom we purchased Valvulas S.F. Industria e Comercio Ltda. (“SF Valves”) for breaches of certain representations and warranties made in the Stock Purchase Agreement dated February 4, 2011.



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ITEM 1A. RISK FACTORS.

We have not identified any material changes from the risk factors as previously disclosed in Item 1A to Part I of our Annual Report on Form 10-K for the year ended December 31, 2011.

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

Working Capital Restrictions and Limitations upon Payment of Dividends

Certain of our loan agreements contain covenants that require, among other items, maintenance of certain financial ratios and also limit our ability to: enter into secured and unsecured borrowing arrangements; issue dividends to shareholders; acquire and dispose of businesses; invest in capital equipment; transfer assets among domestic and international entities; participate in certain higher yielding long-term investment vehicles; and issue additional shares of our stock. The two primary financial covenants are leverage ratio and interest coverage ratio. We were in compliance with all covenants related to our existing debt obligations at July 1, 2012 and December 31, 2011. We believe it is reasonably likely that we will continue to meet such covenants in the near future.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES.

None.

ITEM 4. MINE SAFETY DISCLOSURES.

Not applicable.

ITEM 5. OTHER INFORMATION.

None.

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## ITEM 6. EXHIBITS.

Exhibit No.	Description and Location
2	Plan of Acquisition, Reorganization, Arrangement, Liquidation or Succession:
2.1	Distribution Agreement by and between Watts Industries, Inc. and CIRCOR International, Inc., dated as of October 1, 1999, is incorporated herein by reference to Exhibit 2.1 to Amendment No. 2 to CIRCOR International, Inc.'s Registration Statement on Form 10-12B, File No. 000-26961, filed with the Securities and Exchange Commission on October 6, 1999.
3	Articles of Incorporation and By-Laws:
3.1	Amended and Restated Certificate of Incorporation of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 3.1 to CIRCOR International, Inc.'s Form 10-Q, File No. 001-14962, filed with the Securities and Exchange Commission on October 29, 2009.
3.2	Amended and Restated By-Laws of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 3.2 to CIRCOR International, Inc.'s Form 10-K, File No. 001-14962, filed with the Securities and Exchange Commission on February 26, 2009.
3.3	Certificate of Amendment to the Amended and Restated Bylaws of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 3.3 to CIRCOR International, Inc.'s Form 10-K, File No. 001-14962, filed with the Securities and Exchange Commission on February 26, 2009.
3.4	Amended and Restated Certificate of Designations of Series A Junior Participating Cumulative Preferred Stock of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 3.4 to CIRCOR International, Inc.'s Form 10-Q, File No. 001-14962, filed with the Securities and Exchange Commission on October 29, 2009.
4	Instruments Defining the Rights of Security Holders, Including Indentures:
4.1	Specimen certificate representing the Common Stock of CIRCOR International, Inc., is incorporated herein by reference to Exhibit 4.1 to Amendment No. 1 to CIRCOR International, Inc.'s Registration Statement on Form 10-12B, File No. 000-26961, filed with the Securities and Exchange Commission on September 22, 1999.
31.1*	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32**	Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101†	The following financial statements from CIRCOR International, Inc.'s Quarterly Report on Form 10-Q for the quarter ended July 1, 2012, as filed with the Securities and Exchange Commission on August 2, 2012, formatted in XBRL (eXtensible Business Reporting Language), as follows:
	(i) Consolidated Balance Sheets as of July 1, 2012 (unaudited) and December 31, 2011
	(ii) Consolidated Statements of Income for the three and six months ended July 1, 2012 and July 3, 2011 (unaudited)
	(iii) Statements of Consolidated Comprehensive Income for the three and six months ended July 1, 2012 and July 3, 2011 (unaudited)
	(iv) Consolidated Statements of Cash Flows for the six months ended July 1, 2012 and July 3, 2011 (unaudited)
	(v) Notes to the Consolidated Financial Statements (unaudited)
*	Filed with this report.
**	Furnished with this report.
§	Indicates management contract or compensatory plan or arrangement.
†	As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended.



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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.

CIRCOR INTERNATIONAL, INC.

August 2, 2012

/s/ A. WILLIAM HIGGINS  
A. William Higgins  
President and Chief Executive Officer  
Principal Executive Officer

August 2, 2012

/s/ FREDERIC M. BURDITT  
Frederic M. Burditt  
Vice President, Chief Financial Officer  
Principal Financial Officer

August 2, 2012

/s/ JOHN F. KOBER  
John F. Kober  
Vice President, Corporate Controller and Treasurer  
Principal Accounting Officer