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FORM 10-Q

SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

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

For the quarterly period ended July 3, 2004

OR

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

For the transition period from ______ to ______

Commission File Number 1-8174

DUCOMMUN INCORPORATED
(Exact name of registrant as specified in its charter)

Delaware	**95-0693330**
(State or other jurisdiction of incorporation or organization)	**I.R.S. Employer Identification No.**

111 W. Ocean Boulevard, Suite 900, Long Beach, California 90802
(Address of principal executive offices) (Zip Code)

(562) 624-0800
(Registrant's telephone number, including area code)

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

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

Indicate by check mark whether the registrant is an accelerated filer (as defined in Rule 12b-2 of the Securities Exchange Act of 1934). Yes ☒ No ☐

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date. As of July 3, 2004, there were outstanding 9,967,463 shares of common stock.

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DUCOMMUN INCORPORATED AND SUBSIDIARIES
CONSOLIDATED BALANCE SHEETS
(In thousands, except share data)

	July 3, 2004	December 31, 2003
Assets		
Current Assets:		
Cash and cash equivalents	$ 266	$ 3,832
Accounts receivable (less allowance for doubtful accounts of $481 and $503)	26,889	26,275
Inventories	46,999	40,003
Deferred income taxes	5,886	6,217
Prepaid income taxes	376	1,593
Other current assets	4,758	4,277
Total Current Assets	85,174	82,197
Property and Equipment, Net	56,984	56,929
Goodwill (Net of Accumulated Amortization of $10,996 and $10,996)	57,201	57,201
Other Assets	1,355	1,714
	$ 200,714	$ 198,041
Liabilities and Shareholders' Equity		
Current Liabilities:		
Current portion of long-term debt	$ 800	$ 2,185
Accounts payable	14,216	14,200
Accrued liabilities	32,654	36,152
Total Current Liabilities	47,670	52,537
Long-Term Debt, Less Current Portion	600	400
Deferred Income Taxes	5,313	5,313
Other Long-Term Liabilities	2,041	2,041
Total Liabilities	55,624	60,291
Commitments and Contingencies		
Shareholders' Equity:		
Common stock — $.01 par value; authorized 35,000,000 shares; issued 9,967,463 shares in 2004 and 9,901,965 shares in 2003	100	99
Additional paid-in capital	39,195	38,394
Retained earnings	107,836	101,298
Accumulated other comprehensive loss	(2,041)	(2,041)
Total Shareholders' Equity	145,090	137,750
	$ 200,714	$ 198,041

See accompanying notes to consolidated financial statements.

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DUCOMMUN INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts)

	For Three Months Ended	
	July 3, 2004	July 5, 2003
Net Sales	$57,383	$56,211
Operating Costs and Expenses:		
Cost of goods sold	43,242	43,282
Selling, general and administrative expenses	7,993	7,105
Total Operating Costs and Expenses	51,235	50,387
Operating Income	6,148	5,824
Interest Expense	(76)	(244)
Income Before Taxes	6,072	5,580
Income Tax Expense	(1,765)	(1,589)
Net Income	$ 4,307	$ 3,991
Earnings Per Share:		
Basic earnings per share:	$ 0.43	$ 0.40
Diluted earnings per share:	$ 0.42	$ 0.40
Weighted Average Number of Common Shares		
Outstanding:		
Basic	9,966	9,874
Diluted	10,191	9,897

See accompanying notes to consolidated financial statements.

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DUCOMMUN INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF INCOME
(In thousands, except per share amounts)

	For Six Months Ended	
	July 3, 2004	July 5, 2003
Net Sales	$ 115,630	$ 111,252
Operating Costs and Expenses:		
Cost of goods sold	91,075	86,310
Selling, general and administrative expenses	14,783	14,088
Total Operating Costs and Expenses	105,858	100,398
Operating Income	9,772	10,854
Interest Expense	(214)	(565)
Income Before Taxes	9,558	10,289
Income Tax Expense	(3,020)	(3,190)
Net Income	$ 6,538	$ 7,099
Earnings Per Share:		
Basic earnings per share:	$ 0.66	$ 0.72
Diluted earnings per share:	$ 0.64	$ 0.72
Weighted Average Number of Common Shares Outstanding:		
Basic	9,943	9,873
Diluted	10,205	9,895

See accompanying notes to consolidated financial statements.

DUCOMMUN INCORPORATED AND SUBSIDIARIES
CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)

	For Six Months Ended	
	July 3, 2004	July 5, 2003
Cash Flows from Operating Activities:		
Net Income	$ 6,538	$ 7,099
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation and amortization	3,738	3,768
Deferred income tax provision	331	89
Income tax benefit related to the exercise of nonqualified stock options	286	7
Recovery of doubtful accounts	(22)	(1)
Loss on sale of assets	33	—
Net (recovery of) provision for warranty reserves	(13)	12
Net provision for (recovery of) contract cost overruns	869	(407)
Changes in Assets and Liabilities:		
Accounts receivable	(592)	(2,586)
Inventories	(6,996)	(2,102)
Other assets	1,095	371
Accounts payable	16	(947)
Accrued and other liabilities	(4,354)	3,466
Net Cash Provided by Operating Activities	929	8,769
Cash Flows from Investing Activities:		
Purchase of Property and Equipment	(3,833)	(2,908)
Proceeds from Sale of Assets	6	—
Net Cash Used in Investing Activities	(3,827)	(2,908)
Cash Flows from Financing Activities:		
Net Borrowings (Repayment) of Long-Term Debt	(1,185)	(5,941)
Net Cash Effect of Exercise Related to Stock Options	517	126
Net Cash Used in Financing Activities	(668)	(5,815)
Net (Decrease) Increase in Cash and Cash Equivalents	(3,566)	46
Cash and Cash Equivalents - Beginning of Period	3,832	174
Cash and Cash Equivalents - End of Period	$ 266	$ 220
Supplemental Disclosures of Cash Flow Information:		
Interest Paid	$ 150	$ 572
Income Taxes Paid	$ 2,118	$ 2,439

Supplemental information for Non-Cash Investing and Financing Activities:
See Note 2 for non-cash investing activities related to the acquisition of business.

See accompanying notes to consolidated financial statements.

DUCOMMUN INCORPORATED AND SUBSIDIARIES

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

Note 1. Summary of Significant Accounting Policies

Consolidation

The consolidated balance sheets, consolidated statements of income and consolidated statements of cash flows are unaudited as of and for the three months and six months ended July 3, 2004 and July 5, 2003 and the consolidated financial statements of cash flows for the six months ended July 3, 2004 and July 5, 2003 are unaudited. The consolidated financial statements include the accounts of Ducommun Incorporated and its subsidiaries ("Ducommun" or the "Company"), after eliminating inter-company balances and transactions. The interim financial statements reflect all adjustments, consisting only of normal recurring adjustments, which are, in the opinion of the Company, necessary for a fair presentation of the results for the interim periods presented. The financial information included in the quarterly report should be read in conjunction with the Company's consolidated financial statements and related notes thereto included in its annual report on Form 10-K for the year ended December 31, 2003.

Cash Equivalents

Cash equivalents consist of highly liquid instruments purchased with original maturities of three months or less. The cost of these investments approximates fair value.

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, the price is fixed or determinable, collection is reasonably assured and delivery of products has occurred or services have been rendered. The Company records provisions for estimated losses on contracts in the period in which such losses are identified.

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts for estimated losses from the inability of customers to make required payments. The allowance for doubtful accounts is evaluated periodically based on the aging of accounts receivable, the financial condition of customers and their payment history, historical write-off experience and other assumptions.

Inventory Valuation

Inventories are stated at the lower of cost or market, cost being determined on a first-in, first-out basis. The Company assesses the inventory carrying value and reduces it if necessary to its net realizable value based on customer orders on hand, and internal demand forecasts using management's best estimates given information currently available. The Company's customer demand is highly unpredictable, and can fluctuate significantly caused by factors beyond the control of the Company. The Company maintains an allowance for inventories for potentially excess and obsolete inventories and gross inventory levels that are carried at costs that are higher than their market values. If market conditions are less favorable than those projected by management, such as an unanticipated decline in demand not meeting expectations, inventory write-downs may be required.

Property and Depreciation

Property and equipment, including assets recorded under capital leases, are recorded at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives and, in the case of leasehold improvements, over the shorter of the lives of the improvements or the lease term. The Company evaluates long-lived assets for recoverability, when significant changes in conditions occur, and recognizes impairment losses, if any, based upon the fair value of the assets.

Goodwill

The Company's business acquisitions have typically resulted in goodwill, which affects the amount of possible impairment expense that the Company will incur. The determination of the value of goodwill requires management to make estimates and assumptions that affect the Company's consolidated financial statements. The Company performs a goodwill impairment test annually in its fourth quarter and between annual tests, in certain circumstances, whenever events may indicate an impairment may have occurred. In assessing the recoverability of the Company's goodwill, management must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges for these assets.

Warranty Liability

The Company quantifies and records an estimate for warranty related costs based on the Company's actual historical and projected return and failure rates and the current repair costs. Should the Company experience actual return and failure rates, or repair costs that are higher than the estimates used to calculate the provision, the Company's operating results for the period or periods in which such returns or additional costs materialize will be adversely impacted.

Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards, No. 109, “Accounting for Income Taxes” (“SFAS No. 109”), which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. SFAS 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized.

Litigation and Commitments

In the normal course of business, the Company and its subsidiaries are defendants in certain litigation, claims and inquiries, including matters relating to environmental laws. In addition, the Company makes various commitments and incurs contingent liabilities. Management’s estimates regarding contingent liabilities could differ from actual results.

Environmental Liabilities

Environmental liabilities are recorded when environmental assessments and/or remedial efforts are probable and costs can be reasonably estimated. Generally, the timing of these accruals coincides with the completion of a feasibility study or the Company’s commitment to a formal plan of action.

Earnings Per Share

Basic earnings per share is computed by dividing income available to common shareholders by the weighted average number of common shares outstanding in each year. Diluted earnings per share is computed by dividing income available to common shareholders plus income associated with dilutive securities by the weighted average number of common shares outstanding plus any potential dilution that could occur if securities or other contracts to issue common stock were exercised or converted into common stock in each period. For the three months ended July 3, 2004 and July 5, 2003, income available to common shareholders was $4,307,000 and $3,991,000, respectively. The weighted average number of common shares outstanding for the three months ended July 3, 2004 and July 5, 2003 were 9,966,000 and 9,874,000, and the diluted shares associated with stock options were 225,000 and 23,000, respectively. For the six months ended July 3, 2004 and July 5, 2003, income available to common shareholders was $6,538,000 and $7,099,000, respectively. The weighted average number of common shares outstanding for the six months ended July 3, 2004 and July 5, 2003 were 9,943,000 and 9,873,000, and the diluted shares associated with stock options were 262,000 and 22,000, respectively.

Comprehensive Income

Statement of Financial Accounting Standards No. 130, “Reporting Comprehensive Income” (“SFAS No. 130”), requires that certain items such as foreign currency translation adjustments, unrealized gains and losses on certain investments in debt and equity securities and minimum pension liability adjustments be presented as separate components of shareholders’ equity. SFAS No. 130 defines these as items of other comprehensive income and as such must be reported in a financial statement that is displayed with the same prominence as other financial statements. Accumulated other comprehensive income was comprised of a minimum pension liability adjustment of $2,041,000, net of tax, at July 3, 2004 and December 31, 2003. No items of other comprehensive income were recorded during the quarters ended July 3, 2004 and July 5, 2003.

Recent Accounting Pronouncements

In January 2003, FASB Interpretation No. 46, “Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51” (“FIN No. 46”), was issued. This Interpretation, as revised in December 2003, requires an investor with a majority of the variable interests (primary beneficiary) in a variable interest entity (“VIE”) to consolidate the entity. It also requires majority and significant variable interest investors to provide certain disclosures. A VIE is an entity in which the voting equity investors do not have a controlling interest, or the equity investment at risk is insufficient to finance the entity’s activities without receiving additional subordinated financial support from other parties. The adoption of FIN No. 46 in 2004 did not have any impact on the Company’s financial position, results of operations or cash flows.

Use of Estimates

Certain amounts and disclosures included in the consolidated financial statements required management to make estimates and judgments that affect the amounts of assets, liabilities, revenues and expenses, and related disclosures of contingent assets and liabilities. These estimates are based on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

Note 2. Acquisition

In August 2003, the Company acquired the assets of DBP Microwave, Inc. (“DBP”), a privately held company based in Azusa, California for $2,322,000 in cash and a $400,000 nonnegotiable promissory note. DBP is a manufacturer of electromechanical RF and microwave switches for both aerospace and nonaerospace applications, and is now part of the Company’s Ducommun Technologies, Inc. (“DTI”), subsidiary. The acquisition was accounted for under the purchase method of accounting and, accordingly, the operating results for this acquisition have been included in the consolidated statements of income since the date of the acquisition. The cost of the acquisition was allocated on the basis of the estimated fair value of the assets acquired and liabilities assumed. This acquisition accounted for approximately $1,669,000 of the excess of cost over net assets acquired at July 3, 2004 and December 31, 2003. The acquisition was funded from internally generated cash, notes and other accounts payable to sellers, and borrowings under the Company’s credit agreement (see Note 5 for additional information). This acquisition strengthened the Company’s position in the aerospace industry and added complementary lines of business. Pro forma results for the three months and six months ended July 3, 2004 and July 5, 2003, assuming the acquisition of DBP occurred at the beginning of the respective periods, would not have been materially different from the Company’s historical results for the period presented.

Note 3. Inventories

Inventories consist of the following:

	(In thousands)	
	July 3, 2004	December 31, 2003
Raw materials and supplies	$12,890	$ 10,994
Work in process	39,471	36,794
Finished goods	1,415	1,484
	53,776	49,272
Less progress payments	6,777	9,269
Total	$46,999	$ 40,003

Work in process inventories include amounts under long-term fixed price contracts aggregating $28,548,000 and $25,342,000 at July 3, 2004 and December 31, 2003, respectively.

Note 4. Goodwill

Effective January 1, 2002, the Company adopted Statement of Financial Accounting Standards No. 141, “Business Combinations” (“SFAS No. 141”) and Statement of Financial Accounting Standards No. 142, “Goodwill and Other Intangible Assets” (“SFAS No. 142”). Pursuant to the nonamortization provisions of SFAS No. 142, there was no goodwill amortization expense in 2004 and 2003. There was no change in goodwill during the first six months of 2004.

Note 5. Long-Term Debt

Long-term debt is summarized as follows:

	(In thousands)	
	July 3, 2004	December 31, 2003
Bank credit agreement	$ 600	$ —
Notes and other liabilities for acquisitions	800	2,585
Total debt	1,400	2,585
Less current portion	800	2,185
Total long-term debt	$ 600	$ 400

In December 2002, the Company and its lenders amended the Company's credit agreement. The amended credit agreement provides for a $75,000,000 unsecured revolving credit line gradually declining to $60,000,000 at maturity on September 30, 2005. Interest is payable monthly on the outstanding borrowings based on the bank's prime rate plus a spread based on the leverage ratio of the Company calculated at the end of each fiscal quarter (4.50% at July 3, 2004). A Eurodollar pricing option is also available to the Company for terms of up to six months at the Eurodollar rate plus a spread based on the leverage ratio of the Company calculated at the end of each fiscal quarter (2.58% at July 3, 2004). At July 3, 2004, the Company had $72,338,000 of unused lines of credit, after deducting $600,000 of loans outstanding and $2,062,000 for outstanding standby letters of credit. The credit agreement includes minimum interest coverage, maximum leverage, minimum EBITDA (earnings before interest, taxes, depreciation and amortization) and minimum net worth covenants, an unused commitment fee based on the leverage ratio (.40% per annum at July 3, 2004), and limitations on future dispositions of property, repurchases of common stock, outside indebtedness, capital expenditures and acquisitions.

Note 6. Shareholders' Equity

At July 3, 2004 and December 31, 2003, no preferred shares were issued or outstanding. The Company did not repurchase any of its common stock during 2004 and 2003.

Note 7. Stock Options

The Company has three stock option or incentive plans. Stock awards may be made to directors, officers and key employees under the stock plans on terms determined by the Compensation Committee of the Board of Directors or, with respect to directors, on terms determined by the Board of Directors. Stock options have been and may be granted to directors, officers and key employees under the stock plans at prices not less than 100% of the market value on the date of grant, and expire not more than ten years from the date of grant. The option price and number of shares are subject to adjustment under certain dilutive circumstances. At July 3, 2004, 382,250 common shares were available for future grants and 896,026 common shares were reserved for the exercise of outstanding options.

In accordance with the provisions of Statement of Financial Accounting Standards No. 123, "Accounting for Stock-Based Compensation" ("SFAS No. 123"), the Company applies APB Opinion No. 25, "Accounting for Stock Issued to Employees," and related interpretations in accounting for its plans and does not recognize compensation expense for its stock-based compensation plans based on the fair value method. If the Company had elected to recognize compensation expense based upon the fair value at the grant date for awards under these plans consistent with the methodology prescribed by SFAS No. 123, the Company's net income and earnings per share would be reduced to the pro forma amounts indicated below:

	(In thousands) Three Months Ended		(In thousands) Six Months Ended	
	July 3, 2004	July 5, 2003	July 3, 2004	July 5, 2003
Net Income:				
As reported	$ 4,307	$ 3,991	$ 6,538	$ 7,099
Stock-based employee compensation expense determined under fair value based method for all awards, net of related tax effects	(222)	(109)	(395)	(208)
Pro forma	$ 4,085	$ 3,882	$ 6,143	$ 6,891
Earnings per common share:				
As reported:				
Basic	$ .43	$ .40	$ .66	$ .72
Diluted	.42	.40	.64	.72
Pro forma:				
Basic	$ .41	$ .39	$ .62	$ .70
Diluted	.40	.39	.60	.70

These pro forma amounts may not be representative of future disclosures since the estimated fair value of stock options is amortized to expense over the vesting period, and additional options may be granted in future years.

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Note 8. Employee Benefit Plans

The Company has an unfunded supplemental retirement plan that was suspended in 1986, but which continues to cover certain former executives. The accumulated benefit obligations under the plan at July 3, 2004 and December 31, 2003 were $512,000 and $516,000, respectively, which are included in accrued liabilities.

The Company sponsors for all of its employees, a 401(k) defined contribution plan under which employees can make annual voluntary contributions not to exceed the lesser of an amount equal to 25% of their compensation or limits established by the Internal Revenue Code. The Company generally provides a match equal to 50 percent of the employees' contributions up to the first 4 percent of compensation, except for union employees who are not eligible to receive the match. The Company matching contributions for the three months ended July 3, 2004 and July 5, 2003 were approximately $186,000 and $178,000, respectively. The Company matching contributions for the six months ended July 3, 2004 and July 5, 2003 were approximately $360,000 and $356,000, respectively.

The Company provides certain health care benefits for retired employees. Elgibility for additional employees to become covered by retiree health benefits was terminated in 1988. Employees became eligible for these benefits if they met minimum age and service requirements and were eligible for retirement benefits. The Company accrues postretirement health care benefits over the period in which active employees become eligible for such benefits. The accrued postretirement benefit cost under these plans is included in accrued liabilities. The components of net periodic post retirement benefits cost for these plans are as follows:

	(In thousands) Three Months Ended		(In thousands) Six Months Ended	
	July 3, 2004	July 5, 2003	July 3, 2004	July 5, 2003
Service cost	$ —	$ —	$ —	$ —
Interest cost	18	20	36	40
Expected return on plan assets	—	—	—	—
Amortization of net transition obligation	27	21	48	42
Amortization of actuarial gain	(5)	(5)	(10)	(10)
Net periodic post retirement benefits cost	$ 40	$ 36	$ 74	$ 72

Certain hourly employees at one location of the Company are covered by a defined benefit plan. Pension plan benefits are generally determined on the basis of the retiree's age and length of service. Assets of the defined benefit plan are composed primarily of fixed income and equity securities.

The components of net periodic pension cost for this plan are as follows:

	(In thousands) Three Months Ended		(In thousands) Six Months Ended	
	July 3, 2004	July 5, 2003	July 3, 2004	July 5, 2003
Service cost	$ 127	$ 112	$ 253	$ 224
Interest cost	156	134	312	268
Expected return on plan assets	(182)	(140)	(363)	(280)
Amortized losses	40	43	79	86
Net periodic pension cost	$ 141	$ 149	$ 281	$ 298

On December 31, 2003, the Company's annual measurement date, and July 3, 2004, the accumulated benefit obligation, related to the defined benefit plan, exceeded the fair value of the plan assets. Such excess is referred to as an unfunded accumulated benefit obligation. In accordance with Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions," the Company recognized a minimum pension liability at July 3, 2004 and December 31, 2003 of $2,041,000, net of tax, which decreased shareholders' equity and is included in other long-term liabilities. This charge to shareholders' equity represents a net loss not yet recognized as pension expense. This charge did not affect reported earnings, and would be reversible if either interest rates increase or market performance and plan returns improved or contributions cause the pension plan to return to fully funded status. There were no charges during the three months and six months ended July 3, 2004 and July 5, 2003.

Amounts recognized in the statement of financial position consist of:

	(In thousands)			
	Pension Benefits		Other Benefits	
	July 3, 2004	December 31, 2003	July 3, 2004	December 31, 2003
Prepaid benefit cost	$ 266	$ 547	$ —	$ —
Accrued benefit cost	—	638	(1,208)	(1,256)
Accumulated other comprehensive income, net of tax	—	(638)	—	—
Net amount recognized	$ 266	$ 547	$ (1,208)	$ (1,256)

The deferred benefit plan assets consist primarily of listed stocks and bonds. The Company's funding policy is to contribute cash to its pension plans so that the minimum contribution requirements established by government funding and taxing authorities are met. The Company was not required to make any contributions to the pension plan in 2003.

Note 9. Indemnifications and Warranty Liability

Indemnifications

The Company has made guarantees and indemnities under which it may be required to make payments to a guaranteed or indemnified party, in relation to certain transactions, including revenue transactions in the ordinary course of business. In connection with certain facility leases the Company has indemnified its lessors for certain claims arising from the facility or the lease. The Company indemnifies its directors and officers to the maximum extent permitted under the laws of the State of Delaware. However, the Company has a directors and officers insurance policy that may reduce its exposure in certain circumstances and may enable it to recover a portion of future amounts that may be payable, if any. The duration of the guarantees and indemnities varies and, in many cases is indefinite but subject to statute of limitations. The majority of guarantees and indemnities do not provide any limitations of the maximum potential future payments the Company could be obligated to make. Historically, payments related to these guarantees and indemnities have been immaterial. The Company estimates the fair value of its indemnification obligations as insignificant based on this history and insurance coverage and has, therefore, not recorded any liability for these guarantees and indemnities in the accompanying consolidated balance sheets. However, there can be no assurances that the Company will not have any future financial exposure under these indemnification obligations.

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Warranty Liability

The Company quantifies and records an estimate for warranty related costs based on the Company's actual historical and projected return and failure rates and the current repair costs. Should the Company experience actual return and failure rates, or repair costs that are higher than the estimates used to calculate the provision, the Company's operating results for the period or periods in which such returns or additional costs materialize will be adversely impacted.

Information regarding the changes in the Company's aggregate warranty liability is as follows:

	(In thousands)	
	July 3, 2004	December 31, 2003
Warranty liability at beginning of period	$1,759	$ 1,697
Accruals for warranties during the period	—	184
Adjustments relating to pre-existing warranties	(13)	(122)
Warranty liability at end of period	$1,746	$ 1,759

Note 10. Leases

The Company leases certain facilities and equipment for periods ranging from 1 to 9 years. The leases generally are renewable and provide for the payment of property taxes, insurance and other costs relative to the property. Rental expense for the three months ended July 3, 2004 and July 5, 2003, was $697,000 and $763,000, respectively. Rental expense for the six months ended July 3, 2004 and July 5, 2003, was $1,441,000 and $1,562,000, respectively. Future minimum rental payments under operating leases having initial or remaining noncancelable terms in excess of one year at July 3, 2004 are as follows:

	(In thousands) Lease Commitments
2004	$ 1,182
2005	1,938
2006	1,026
2007	902
2008	716
Thereafter	1,605
Total	$ 7,369

Note 11. Contingencies

The Ducommun AeroStructures, Inc. (“DAS”) facility located in El Mirage, California has been directed by California environmental agencies to investigate and take corrective action for groundwater contamination. Based upon currently available information, the Company has established a provision for the cost of such investigation and corrective action. DAS expects to spend approximately $1 million for future investigation and corrective action for groundwater contamination at its El Mirage location. However, the Company’s ultimate liability in connection with the contamination will depend upon a number of factors, including changes in existing laws and regulations, and the design and cost of the construction, operation and maintenance of the corrective action.

The Company’s subsidiary, Composite Structures, LLC (“Composite”), and several other companies have been ordered by a California environmental agency to investigate and clean up soil and groundwater contamination at its Monrovia, California facility. Composite has filed a petition for review of the order.

In the normal course of business, Ducommun and its subsidiaries are defendants in certain other litigation, claims and inquiries, including matters relating to environmental laws. In addition, the Company makes various commitments and incurs contingent liabilities. While it is not feasible to predict the outcome of these matters, the Company does not presently expect that any sum it may be required to pay in connection with these matters would have a material adverse effect on its consolidated financial position, results of operations or cash flows.

Note 12. Major Customers and Concentrations of Credit Risk

The Company provides proprietary products and services to most of the prime aerospace and aircraft manufacturers. As a result, the Company’s sales and trade receivables are concentrated principally in the aerospace industry.

The Company had substantial sales to Boeing, Raytheon and Lockheed Martin. During the second quarter of 2004 and 2003, sales to Boeing were $26,846,000 and $28,574,000, respectively; sales to Raytheon were $6,107,000 and $8,423,000, respectively; and sales to Lockheed Martin were $3,534,000 and $3,395,000, respectively. During the six months ended July 3, 2004 and July 5, 2003, sales to Boeing were $54,645,000 and $57,717,000, respectively; sales to Raytheon were $13,756,000 and $15,534,000, respectively; and sales to Lockheed Martin were $6,879,000 and $6,512,000, respectively. At July 3, 2004, trade receivables from Boeing, Raytheon and Lockheed Martin were

$9,266,000, $2,689,000 and $1,589,000, respectively. The sales and receivables relating to Boeing, Raytheon and Lockheed Martin are diversified over a number of different commercial, space and military programs.

Note 13. Business Segment Information

The Company supplies products and services to the aerospace industry. The Company's subsidiaries are organized into two strategic businesses, each of which is a reportable segment. Ducommun AeroStructures, Inc., manufactures aerospace structural components and subassemblies. Ducommun Technologies, Inc., manufactures aerospace electromechanical components and subsystems. The accounting policies of the segments are the same as those of the Company, as described in Note 1, Summary of Significant Accounting Policies.

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Financial information by reporting segment is set forth below:

	(In thousands) Three Months Ended		(In thousands) Six Months Ended	
	July 3, 2004	July 5, 2003	July 3, 2004	July 5, 2003
Net Sales:				
Ducommun AeroStructures, Inc.	$37,550	$34,932	$ 77,076	$ 70,737
Ducommun Technologies, Inc.	19,833	21,279	38,554	40,515
Total Net Sales	$57,383	$56,211	$115,630	$111,252
Segment Operating Income (1):				
Ducommun AeroStructures, Inc.	$ 4,861	$ 4,621	$ 6,636	$ 8,171
Ducommun Technologies, Inc.	3,882	4,283	6,899	7,572
	8,743	8,904	13,535	15,743
Corporate General and Administrative Expenses	(2,595)	(3,080)	(3,763)	(4,889)
Total Operating Income	$ 6,148	$ 5,824	$ 9,772	$ 10,854
Depreciation and Amortization Expenses:				
Ducommun AeroStructures, Inc.	$ 1,520	$ 1,533	$ 3,050	$ 3,068
Ducommun Technologies, Inc.	336	311	679	624
Corporate Administration	5	38	9	76
Total Depreciation and Amortization Expenses	$ 1,861	$ 1,882	$ 3,738	$ 3,768
Capital Expenditures:				
Ducommun AeroStructures, Inc.	$ 1,646	$ 1,151	$ 3,264	$ 2,382
Ducommun Technologies, Inc.	147	323	422	526
Corporate Administration	147	—	147	—
Total Capital Expenditures	$ 1,940	$ 1,474	$ 3,833	$ 2,908

(1) Before certain allocated corporate overhead.

Segment assets include assets directly identifiable with each segment. Corporate assets include assets not specifically identified with a business segment, including cash.

	(In thousands)	
	July 3, 2004	December 31, 2003
Total Assets		
Ducommun AeroStructures, Inc.	$ 138,294	$ 135,257
Ducommun Technologies, Inc.	51,307	46,603
Corporate Administration	11,113	16,181
Total Assets	$ 200,714	$ 198,041
Goodwill		
Ducommun AeroStructures, Inc.	$ 36,785	$ 36,785
Ducommun Technologies, Inc.	20,416	20,416
Total Goodwill	$ 57,201	$ 57,201

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

Ducommun designs, engineers and manufactures aerostructure and electromechanical components and subassemblies principally for the aerospace industry. The Company manufactures components and assemblies principally for domestic and foreign commercial and military aircraft and space programs. Domestic commercial aircraft programs include the Boeing 737NG, 747, 767 and 777. Foreign commercial aircraft programs include the Airbus Industrie A330, A340 and A340-600 aircraft, Bombardier business and regional jets, and the Embraer 145 and 170/190. Major military programs include the Boeing C-17, F-15 and F-18 and Lockheed Martin F-16, various Sikorsky, Bell, Boeing Apache and Augusta helicopter programs, and various aircraft and shipboard electronics upgrade programs. Space programs include the space shuttle external fuel tank, and various commercial and military space launch and satellite programs.

Critical Accounting Policies

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, the price is fixed or determinable, collection is reasonably assured and delivery of products has occurred or services have been rendered. The Company records provisions for estimated losses on contracts in the period in which such losses are identified.

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts for estimated losses from the inability of customers to make required payments. The allowance for doubtful accounts is evaluated periodically based on the aging of accounts receivable, the financial condition of customers and their payment history, historical write-off experience and other assumptions.

Inventory Valuation

Inventories are stated at the lower of cost or market, cost being determined on a first-in, first-out basis. The Company assesses the inventory carrying value and reduces it if necessary to its net realizable value based on customer orders on hand, and internal demand forecasts using management's best estimates given information currently available. The Company's customer demand is highly unpredictable, and can fluctuate significantly caused by factors beyond the control of the Company. The Company maintains an allowance for inventories for potentially excess and obsolete inventories and gross inventory levels that are carried at costs that are higher than their market values. If market conditions are less favorable than those projected by management, such as an unanticipated decline in demand not meeting expectations, inventory write-downs may be required.

Property and Depreciation

Property and equipment, including assets recorded under capital leases, are recorded at cost. Depreciation and amortization are computed using the straight-line method over the estimated useful lives and, in the case of leasehold improvements, over the shorter of the lives of the improvements or the lease term. The Company evaluates long-lived assets for recoverability, when significant changes in conditions occur, and recognizes impairment losses, if any, based upon the fair value of the assets.

Goodwill

The Company's business acquisitions have typically resulted in goodwill, which affects the amount of possible impairment expense that the Company will incur. The determination of the value of goodwill requires management to make estimates and assumptions that affect the Company's consolidated financial statements. The Company performs a goodwill impairment test annually in its fourth quarter and between annual tests, in certain circumstances, whenever events may indicate an impairment may have occurred. In assessing the recoverability of the Company's goodwill, management must make assumptions regarding estimated future cash flows and other factors to determine the fair value of the respective assets. If these estimates or their related assumptions change in the future, the Company may be required to record impairment charges for these assets.

Income Taxes

The Company accounts for income taxes in accordance with Statement of Financial Accounting Standards, No. 109, "Accounting for Income Taxes" ("SFAS No. 109"), which requires that deferred tax assets and liabilities be recognized using enacted tax rates for the effect of temporary differences between the book and tax bases of recorded assets and liabilities. SFAS No. 109 also requires that deferred tax assets be reduced by a valuation allowance if it is more likely than not that some portion or all of the deferred tax asset will not be realized.

Acquisition

In August 2003, the Company acquired the assets of DBP Microwave, Inc. ("DBP"), a privately held company based in Azusa, California for $2,322,000 in cash and a $400,000 nonnegotiable promissory note. DBP is a manufacturer of electromechanical RF and microwave switches for both aerospace and nonaerospace applications, and is now part of the Company's Ducommun Technologies, Inc. ("DTI"), subsidiary. The acquisition was accounted for under the purchase method of accounting and, accordingly, the operating results for this acquisition have been included in the consolidated statements of income since the date of the acquisition. The cost of the acquisition was allocated on the basis of the estimated fair value of the assets acquired and liabilities assumed. This acquisition accounted for approximately $1,669,000 of the excess of cost over net assets acquired at July 3, 2004 and December 31, 2003, respectively. The acquisition was funded from internally generated cash, notes and other accounts payable to sellers, and borrowings under the Company's credit agreement (see Note 5 for additional information). This acquisition strengthened the Company's position in the aerospace industry and added complementary lines of business.

Results of Operations

Second Quarter of 2004 Compared to Second Quarter of 2003

Net sales in the second quarter of 2004 were $57,383,000, compared to net sales of $56,211,000 for the second quarter of 2003. Net sales in 2004 benefited by approximately $1,501,000 in sales from the August 2003 acquisition of DBP Microwave. The Company's mix of business in the second quarter of 2004 was approximately 61% military, 35% commercial, and 4% space, compared to 67% military, 29% commercial, and 4% space in the second quarter of 2003.

The Company had substantial sales to Boeing, Raytheon and Lockheed Martin. During the second quarter of 2004 and 2003, sales to Boeing were $26,846,000 and $28,574,000, respectively; sales to Raytheon were $6,107,000 and $8,423,000, respectively; and sales to Lockheed Martin were $3,534,000 and $3,395,000, respectively. At July 3, 2004, trade receivables from Boeing, Raytheon and Lockheed Martin were $9,266,000, $2,689,000 and $1,589,000, respectively. The sales and receivables relating to Boeing, Raytheon and Lockheed Martin are diversified over a number of different commercial, space and military programs.

The Company's commercial business is represented on virtually all of today's major commercial aircraft. During the second quarter of 2004, sales related to commercial business were approximately $20,080,000, or 35% of total sales, compared to $16,195,000, or 29% in the second quarter of 2003. The increase in commercial sales in the second quarter of 2004 resulted from the DBP Microwave acquisition and a general increase for commercial aircraft sales. The Boeing 737/737NG program accounted for approximately $7,145,000 in sales in the second quarter of 2004, compared to $6,406,000 in sales in the second quarter of 2003.

Military components manufactured by the Company are employed in many of the country's front-line fighters, bombers, helicopters and support aircraft, as well as many sea-based vehicles. The Company's defense business is widely diversified among military manufacturers and programs. Sales related to military programs were approximately $34,929,000, or 61% of total sales in the second quarter of 2004, compared to $37,745,000, or 67% of total sales in the second quarter of 2003. The decrease in military sales in the second quarter of 2004 resulted from a decrease in military sales at Ducommun Technologies. In the second quarter of 2004, the C-17 program accounted for approximately $7,403,000 in sales, compared to $7,968,000 in sales in the second quarter of 2003, and the Apache helicopter program accounted for approximately $9,561,000 in sales, compared to $8,856,000 in sales in the second quarter of 2003.

In the space sector, the Company produces components for the expendable fuel tanks which help boost the Space Shuttle vehicle into orbit. Components are also produced for a variety of unmanned launch vehicles and satellite programs. During the second quarter of 2004, sales related to space programs were approximately $2,374,000, or 4% of total sales, compared to $2,271,000, or 4% of total sales in the second quarter of 2003.

Gross profit, as a percentage of sales, increased to 24.6% in the second quarter of 2004 from 23.0% in the second quarter of 2003. This increase was primarily related to the impact of spreading fixed overhead costs over greater production activities.

Selling, general and administrative expenses, as a percentage of sales, were 13.9% in the second quarter of 2004, compared to 12.6% in the second quarter of 2003. Selling, general and administrative expenses in the second quarter of 2004 included higher employee related costs than the second quarter of 2003.

Interest expense decreased to $76,000 in the second quarter of 2004 compared to $244,000 for the second quarter of 2003. The decrease in interest expense was primarily due to lower debt levels and lower interest rates in 2004 compared to 2003.

Income tax expense increased to $1,765,000 in the second quarter of 2004, compared to $1,589,000 in the second quarter of 2003. The increase in income tax expense was primarily due to the increase in income before taxes as well as a higher effective income tax rate. The Company’s effective tax rate for the second quarter of 2004 was 29.1%, compared to 28.5% in the second quarter of 2003, the difference primarily attributed to higher research and development tax credits in 2003. Cash expended to pay income taxes decreased to $2,025,000 in the second quarter of 2004, compared to $2,423,000 in the second quarter of 2003.

Net income for the second quarter of 2004 was $4,307,000, or $0.42 diluted earnings per share, compared to $3,991,000, or $0.40 diluted earnings per share, in the second quarter of 2003.

Six Months of 2004 Compared to Six Months of 2003

Net sales in the first six months of 2004 were $115,630,000, compared to net sales of $111,252,000 for the first six months of 2003. Net sales in 2004 benefited by approximately $2,761,000 in sales from the August 2003 acquisition of DBP Microwave. The Company’s mix of business in the first six months of 2004 was approximately 61% military, 35% commercial, and 4% space, compared to 66% military, 30% commercial, and 4% space in the first six months of 2003.

The Company had substantial sales to Boeing, Raytheon and Lockheed Martin. During the first six months of 2004 and 2003, sales to Boeing were $54,645,000 and $57,717,000 respectively; sales to Raytheon were $13,756,000 and $15,534,000, respectively; and sales to Lockheed Martin were $6,879,000 and $6,512,000, respectively. At July 3, 2004, trade receivables from Boeing, Raytheon and Lockheed Martin were $9,266,000, $2,689,000 and $1,589,000, respectively. The sales and receivables relating to Boeing, Raytheon and Lockheed Martin are diversified over a number of different commercial, space and military programs.

The Company's commercial business is represented on virtually all of today's major commercial aircraft. During the first six months of 2004, sales related to commercial business were approximately $40,242,000, or 35% of total sales, compared to $33,097,000, or 30% in the first six months of 2003. The increase in commercial sales in the first six months of 2004 resulted from the DBP Microwave acquisition and a general increase for commercial aircraft sales. The Boeing 737/737NG program accounted for approximately $15,756,000 in sales in the first six months of 2004, compared to $12,721,000 in sales in the first six months of 2003.

Military components manufactured by the Company are employed in many of the country's front-line fighters, bombers, helicopters and support aircraft, as well as many sea-based vehicles. The Company's defense business is widely diversified among military manufacturers and programs. Sales related to military programs were approximately $70,726,000, or 61% of total sales in the first six months of 2004, compared to $73,864,000, or 66% of total sales in the first six months of 2003. The decrease in military sales in the first six months of 2004 resulted from a decrease in military sales at Ducommun Technologies. In the first six months of 2004, the C-17 program accounted for approximately $14,858,000 in sales, compared to $17,770,000 in sales in the first six months of 2003, and the Apache helicopter program accounted for approximately $19,923,000 in sales, compared to $16,465,000 in sales in the first six months of 2003.

In the space sector, the Company produces components for the expendable fuel tanks which help boost the Space Shuttle vehicle into orbit. Components are also produced for a variety of unmanned launch vehicles and satellite programs. During the first six months of 2004, sales related to space programs were approximately $4,662,000, or 4% of total sales, compared to $4,291,000, or 4% of total sales, in the first six months of 2003.

At July 3, 2004, backlog believed to be firm was approximately $260,762,000, compared to $283,901,000 at December 31, 2003. The backlog decrease from December 31, 2003 was primarily due to lower bookings for commercial programs, and approximately $9,800,000 for cancellation of a contract on which the Company was losing money. Approximately $93,000,000 of the total backlog is expected to be delivered during 2004.

Gross profit, as a percentage of sales, decreased to 21.2% in the first six months of 2004 from 22.4% in the first six months of 2003. This decrease was primarily the result of initial losses on several new contracts at Ducommun AeroStructures during the first six months of 2004, partially offset by the impact of spreading fixed overhead costs over a greater sales volume. The decline in gross profit margins also included a provision of $1,894,000 established during the first quarter of 2004 for estimated cost overruns on certain of the new contracts at Ducommun AeroStructures. The provision for estimated cost overruns was based on currently available information and various assumptions, including customers' future production rates and delivery schedules and the Company's future cost structure and learning curve assumptions.

Selling, general and administrative expenses, as a percentage of sales, were 12.8% in the first six months of 2004, compared to 12.7% in the first six months of 2003.

Interest expense decreased to $214,000 in the first six months of 2004 compared to $565,000 for the first six months of 2003. The decrease in interest expense was primarily due to lower debt levels and lower interest rates in 2004 compared to 2003.

Income tax expense decreased to $3,020,000 in the first six months of 2004, compared to $3,190,000 in the first six months of 2003. The decrease in income tax expense was primarily due to the decrease in income before taxes partially offset by a higher effective income tax rate. The Company's effective tax rate for the first six months of 2004 was 31.6%, compared to 31.0% in the first six months of 2003, the difference primarily attributed to higher research and development tax credits in 2003. Cash expended to pay income taxes decreased to $2,118,000 in the first six months of 2004, compared to $2,439,000 in the first six months of 2003.

Net income for the first six months of 2004 was $6,538,000, or $0.64 diluted earnings per share, compared to $7,099,000, or $0.72 diluted earnings per share in the first six months of 2003.

Financial Condition

Liquidity and Capital Resources

Net cash provided by operating activities for the first six months of 2004 was $929,000, compared to $8,769,000 in the first six months of 2003. Major elements of the net cash provided by operating activities for the first six months of 2004 included $6,538,000 of net income, $3,738,000 of depreciation and a net increase of $869,000 in the provision for cost overruns, partially offset by a $6,996,000 increase in inventory primarily due to a reduction in progress payments from customers and delays in shipments, a $592,000 increase in accounts receivable due to timing of shipments and billings to customers, and a decrease in accrued and other liabilities of $4,354,000, due mainly to payment of accrued bonuses.

Net cash used in investing activities for the first six months of 2004 consisted primarily of $3,833,000 of capital expenditures.

Net cash used in financing activities in the first six months of 2004 of $668,000 included $1,185,000 of net repayment of borrowings offset by $517,000 of net cash received from the exercise of common stock options.

The Company continues to depend on operating cash flow and the availability of its bank line of credit to provide short-term liquidity. Cash from operations and bank borrowing capacity are expected to provide sufficient liquidity to meet the Company's obligations during 2004. In December 2002, the Company and its lenders amended the Company's credit agreement. The amended credit agreement provides for a $75,000,000 unsecured revolving credit line gradually declining to $60,000,000 at maturity on September 30, 2005. Interest is payable monthly on the outstanding borrowings based on the bank's prime rate plus a spread based on the leverage ratio of the Company calculated at the end of each fiscal quarter (4.50% at July 3, 2004). A Eurodollar pricing option is also available to the Company for terms of up to six months at the Eurodollar rate plus a spread based on the leverage ratio of the Company calculated at the end of each fiscal quarter (2.58% at July 3, 2004). At July 3, 2004, the Company had $72,338,000 of unused lines of credit, after deducting $600,000 of loans outstanding and $2,062,000 for outstanding standby letters of credit. The credit agreement includes minimum interest coverage, maximum leverage, minimum EBITDA (earnings before interest, taxes, depreciation and amortization) and minimum net worth covenants, an unused commitment fee based on the leverage ratio (.40% per annum at July 3, 2004), and limitations on future dispositions of property, repurchases of common stock, outside indebtedness, capital expenditures and acquisitions.

The weighted average interest rate on borrowings outstanding was 4.79% and 5.69% at July 3, 2004 and December 31, 2003, respectively.

The carrying amount of long-term debt approximates fair value based on the terms of the related debt, recent transactions and estimates using interest rates currently available to the Company for debt with similar terms and remaining maturities.

Aggregate maturities of long-term debt during the next five years are as follows: 2005, $1,000,000; 2006, $0; 2007, $0; 2008, $0.

Certain hourly employees at one location of the Company are covered by a defined benefit plan. Pension plan benefits are generally determined on the basis of the retiree's age and length of service. Assets of the defined benefit plan are composed primarily of fixed income and equity securities. On December 31, 2003, the Company's annual measurement date, the accumulated benefit obligation, related to the Company's defined benefit plan, exceeded the fair value of the pension plan assets. Such excess is referred to as an unfunded accumulated benefit obligation. In accordance with Statement of Financial Accounting Standards No. 87, "Employers' Accounting for Pensions," the Company recognized minimum pension liability of $2,041,000, net of tax, which decreased shareholders’ equity and is included in other long-term liabilities at July 3, 2004 and December 31, 2003. Pension expense will be approximately $562,000 in 2004. The Company was not required to make any contributions to the pension plan in 2003, but plans to contribute as much as $1,418,000 in the third quarter of 2004.

The Company expects to spend less than $8,000,000 for capital expenditures in 2004. The Company believes that the ongoing subcontractor consolidation makes acquisitions an increasingly important component of the Company’s future growth. Accordingly, the Company plans to continue to seek attractive acquisition opportunities and to make substantial capital expenditures for manufacturing equipment and facilities to support long-term contracts for both commercial and military aircraft and space programs.

The Company has made guarantees and indemnities under which it may be required to make payments to a guaranteed or indemnified party, in relation to certain transactions, including revenue transactions in the ordinary course of business. In connection with certain facility leases the Company has indemnified its lessors for certain claims arising from the facility or the lease. The Company indemnifies its directors and officers to the maximum extent permitted under the laws of the State of Delaware. However, the Company has a directors and officers insurance policy that may reduce its exposure in certain circumstances and may enable it to recover a portion of future amounts that may be payable, if any. The duration of the guarantees and indemnities varies and, in many cases is indefinite but subject to statute of limitations. The majority of guarantees and indemnities do not provide any limitations of the maximum potential future payments the Company could be obligated to make. Historically, payments related to these guarantees and indemnities have been immaterial. The Company estimates the fair value of its indemnification obligations as insignificant based on this history and insurance coverage and has, therefore, not recorded any liability for these guarantees and indemnities in the accompanying consolidated balance sheets. However, there can be no assurances that the Company will not have any future financial exposure under these indemnification obligations.

As of July 3, 2004 the Company had the following categories of contractual obligations (in thousands):

		Payments due by period			
Contractual Obligations	Total	Less than 1 year	1 - 3 years	3 - 5 years	More than 5 years
Long-term debt	$ 1,400	$ 800	$ 600	$ —	$ —
Operating leases	7,369	2,254	2,345	1,433	1,337
Other long-term liabilities	2,041	1,418	623	—	—
Total	$ 10,810	$ 4,472	$ 3,568	$ 1,433	$ 1,337

The DAS facility located in El Mirage, California has been directed by California environmental agencies to investigate and take corrective action for groundwater contamination. Based upon currently available information, the Company has established a provision for the cost of such investigation and corrective action. DAS expects to spend approximately $1 million for future investigation and corrective action for groundwater contamination at its El Mirage location. However, the Company's ultimate liability in connection with the contamination will depend upon a number of factors, including changes in existing laws and regulations, and the design and cost of the construction, operation and maintenance of the corrective action.

The Company's subsidiary, Composite Structures, LLC ("Composite"), and several other companies have been ordered by a California environmental agency to investigate and clean up soil and groundwater contamination at its Monrovia, California facility. Composite has filed a petition for review of the order.

In the normal course of business, Ducommun and its subsidiaries are defendants in certain other litigation, claims and inquiries, including matters relating to environmental laws. In addition, the Company makes various commitments and incurs contingent liabilities. While it is not feasible to predict the outcome of these matters, the Company does not presently expect that any sum it may be required to pay in connection with these matters would have a material adverse effect on its consolidated financial position, results of operations or cash flows.

Off-Balance Arrangements

The Company's off-balance sheet arrangements consist of operating leases and capital commitments as described above.

Recent Accounting Pronouncements

In January 2003, FASB Interpretation No. 46, "Consolidation of Variable Interest Entities, an Interpretation of ARB No. 51" ("FIN No. 46"), was issued. This Interpretation, as revised in December 2003, requires an investor with a majority of the variable interests (primary beneficiary) in a variable interest entity ("VIE") to consolidate the entity. It also requires majority and significant variable interest investors to provide certain disclosures. A VIE is an entity in which the voting equity investors do not have a controlling interest, or the equity investment at risk is insufficient to finance the entity's activities without receiving additional subordinated financial support from other parties. The adoption of FIN No. 46 in 2004 did not have any impact on the Company's financial position, results of operations or cash flows.

In May 2004, FASB Staff Position No. Financial Accounting Standard 106-2 (FSP FAS 106-2), Accounting and Disclosure Requirements Related to the Medicare Prescription Drug, Improvement and Modernization Act of 2003 (the Act), was issued. FSP FAS 106-2 provides guidance on the accounting for the effects of the Act, including the accounting for and disclosure of any federal subsidy provided by the Act. The method of determining whether a sponsor's plan will qualify for actuarial equivalency is pending until the U.S. Department of Health and Human Services completes its interpretative work on the Act. Based on the current interpretation of the guidance provided in the Act and in relation to the Company's current plan design, any savings to the Company are expected to be immaterial.

Additional Risk Factors

The Company's business, financial condition, results of operations and cash flows may be affected by known and unknown risks, uncertainties and other factors. Any of these risks, uncertainties and other factors could cause the Company's future financial results to differ materially from recent financial results or from currently anticipated future financial results. In addition to those noted elsewhere in this report, the Company is subject to the following risks and uncertainties:

Aerospace Markets Are Cyclical

The aerospace markets in which the Company sells its products are cyclical and have experienced periodic declines. The market for the Company's products sold for new commercial aircraft production is currently experiencing a decline, the depth and duration of which is unknown. The Company's sales are, therefore, unpredictable and tend to fluctuate based on a number of factors, including economic conditions and developments affecting the aerospace industry and the customers served. If the current downturn in commercial aircraft production were to continue for an extended period or if conditions in the commercial aircraft market were to worsen, the negative impact on the Company's business, financial condition and operating results could be further exacerbated.

Commercial Aircraft Production Rates Are Declining

The Company estimates that, in the first six months of 2004, approximately 19% of its sales were for Boeing commercial aircraft and approximately 16% of its sales were for other commercial aircraft and miscellaneous nonaerospace commercial applications. The production rate for new commercial aircraft is expected to decline at least through 2004, and the timing of any rebound in new commercial aircraft production is unknown. These reductions in commercial aircraft production are expected to affect adversely the Company's result of operations and cash flows.

Military and Space-Related Products Are Dependent Upon Government Spending

The Company estimates that, in the first six months of 2004, approximately 65% of its sales were derived from military and space markets. These military and space markets are largely dependent upon government spending, particularly by the United States government. Changes in the levels of spending for military and space could improve or negatively impact the Company's prospects in its military and space markets. The tragedy involving the Space Shuttle Columbia may further affect government spending for space programs, which could adversely affect the Company.

The Company Is Dependent on Boeing Commercial Aircraft, the C-17 Aircraft and Apache Helicopter Programs

The Company estimates that, in the first six months of 2004, approximately 19% of its sales were for Boeing commercial aircraft, 13% of its sales were for the C-17 aircraft, and 17% of its sales were for the Apache helicopter. The Company's sales for Boeing commercial aircraft and the C-17 aircraft are principally for new aircraft production; and the Company's sales for the Apache helicopter program are principally for replacement rotor blades. Any significant change in production rates for these programs would have a material effect on the Company's results of operations and cash flows. In addition, there is no guarantee that the Company's current significant customers will continue to buy products from the Company at current levels. The loss of a key customer could have a material adverse effect on the Company. For example, the Company manufactures the spoilers for the Boeing 737NG aircraft (the "737 Spoilers"), which contributed approximately $12,062,000 to sales in 2003. The Company has been informed that a competitor has been awarded a contract to produce the 737 Spoilers. Although the precise timing and amount of any transition of work to the competitor is presently unknown, such a transition of work may occur as soon as early 2005.

Terrorist Attacks, Such As Those That Occurred on September 11, 2001, Have Adversely Impacted the Company's Operations and May Do So Again in the Future

The terrorist attacks that occurred on September 11, 2001 have had a negative impact on commercial air travel and, consequently, on the manufacture of commercial aircraft and the demand for the Company's commercial aircraft products. There can be no assurance that the current world political and military tensions, or the United States military actions, will not lead to further acts of terrorism and civil disturbances in the United States or elsewhere. These attacks may strike directly at the physical facilities of the Company, its suppliers or its customers. Such attacks could have an adverse impact on the Company's domestic and international sales, supply chain, production capabilities, insurance premiums or ability to purchase insurance, thereby adversely affecting the Company's financial position, results of operations and cash flows. In addition, the consequences of terrorist attacks and armed conflicts are unpredictable, and their long-term effects upon the Company are uncertain.

The Company Is Experiencing Competitive Pricing Pressures

The aerospace industry is highly competitive and competitive pressures may adversely affect the Company. The Company competes worldwide with a number of United States and international companies that are larger than it in terms of resources and market share. The Company is experiencing competitive pricing pressures, particularly in its Ducommun AeroStructures business. These competitive pricing pressures have had, and are expected to continue to have, a material adverse effect on the Company's business, financial condition and operating results.

The Company Faces Risks of Cost Overruns and Losses on Fixed-Price Contracts

The Company sells its products under firm, fixed-price contracts providing for a fixed price for the products regardless of the production costs incurred by the Company. As a result, mistakes in bidding on contracts, underestimation of the scope of work required under contracts, manufacturing inefficiencies and start-up costs and other factors may result in cost overruns and losses on contracts. The cost of producing products also may be adversely affected by increases in the cost of labor, materials, outside processing, overhead and other factors. In many cases, the Company makes multiyear firm, fixed-price commitments to its customers, without assurance that the Company's anticipated production costs will be achieved.

During the first quarter of 2004, the Company established a provision of $1,894,000 for estimated cost overruns on certain of the new contracts at Ducommun AeroStructures. The provision for estimated cost overruns was based on currently available information and various assumptions, including customers’ future production rates and delivery schedules and the Company’s future cost structure and learning curve assumptions. The Company could incur additional losses or be required to establish additional provisions for cost overruns if actual results should differ from the estimates under these assumptions.

The Company’s Products and Processes Are Subject to Risks from Changes in Technology

The Company’s products and processes are subject to risks of obsolescence as a result of changes in technology. To address this risk, the Company invests in product design and development, and for capital expenditures. There can be no guarantee that the Company’s product design and development efforts will be successful, or that the amounts of money required to be invested for product design and development and capital expenditures will not increase materially in the future.

The Company Faces Risks Associated with Acquisitions and Dispositions of Businesses

A key element of the Company’s long-term strategy has been growth through acquisitions. The Company is continuously reviewing and actively pursuing acquisitions, including acquisitions outside of its current aerospace markets. Acquisitions may require the Company to incur additional indebtedness, resulting in increased leverage. Any significant acquisition may result in a material weakening of the Company’s financial position and a material increase in the Company’s cost of borrowings. Acquisitions also may require the Company to issue additional equity, resulting in dilution to existing stockholders. This additional financing for acquisitions and capital expenditures may not be available on terms acceptable or favorable to the Company. Acquired businesses may not achieve anticipated results, and could result in a material adverse effect on the Company’s financial condition, results of operations and cash flows. The Company also periodically reviews its existing businesses to determine if they are consistent with the Company’s strategy. The Company has sold, and may sell in the future, business units and product lines, which may result in either a gain or loss on disposition.

The Company’s acquisition strategy exposes it to risks, including the risk that the Company may not be able to successfully integrate acquired businesses. The Company’s ability to grow by acquisition is dependent upon, among other factors, the availability of suitable acquisition candidates. Growth by acquisition involves risks that could have a material adverse affect on the Company’s business, financial condition and operating results, including difficulties in integrating the operations and personnel of acquired companies, the potential amortization of acquired intangible assets, the potential impairment of goodwill and the potential loss of key employees of acquired companies. The Company may not be able to consummate acquisitions on satisfactory terms or, if any acquisitions are consummated, to satisfactorily integrate these acquired businesses.

Goodwill Could Be Impaired in the Future

In assessing the recoverability of the Company's goodwill at December 31, 2003, management was required to make certain critical estimates and assumptions. These estimates and assumptions, with respect to the Company's Ducommun AeroStructures, Inc. ("DAS"), reporting unit, included that during the next several years DAS will make improvements in manufacturing efficiency, achieve reductions in operating costs, and obtain increases in sales and backlog. If any of these or other estimates and assumptions are not realized in the future, the Company may be required to record an impairment charge for the goodwill of DAS. The goodwill of DAS was $36,785,000 at July 3, 2004.

Significant Consolidation in the Aerospace Industry Could Adversely Affect the Company's Business and Financial Results

The aerospace industry is experiencing significant consolidation, including among the Company's customers, competitors and suppliers. Consolidation among the Company's customers may result in delays in the award of new contracts and losses of existing business. Consolidation among the Company's competitors may result in larger competitors with greater resources and market share, which could adversely affect the Company's ability to compete successfully. Consolidation among the Company's suppliers may result in fewer sources of supply and increased cost to the Company.

The Company's Manufacturing Operations May Be Adversely Affected by the Availability of Raw Materials and Components from Suppliers

In some cases, the Company's customers supply raw materials and components to the Company. In other cases, the Company's customers designate specific suppliers from which the Company is directed to purchase raw materials and components. As a result, the Company may have limited control over the selection of suppliers and the timing of receipt and cost of raw materials and components from suppliers. The failure of customers and suppliers to deliver on a timely basis raw materials and components to the Company may adversely affect the Company's results of operations and cash flows.

Environmental Liabilities Could Adversely Affect the Company's Financial Results

The Company is subject to various environmental laws and regulations. The Company is investigating and taking corrective action for groundwater contamination at its DAS subsidiary's El Mirage, California site. The Company is also a potentially responsible party at certain sites at which it previously disposed of hazardous wastes. There can be no assurance that future developments, lawsuits and administrative actions, and liabilities relating to environmental matters will not have a material adverse effect on the Company's results of operations or cash flows.

The DAS chemical milling business uses various acid and alkaline solutions in the chemical milling process, resulting in potential environmental hazards. Despite existing waste recovery systems and continuing capital expenditures for waste reduction and management, at least for the immediate future, this business will remain dependent on the availability and cost of remote hazardous waste disposal sites or other alternative methods of disposal.

The DAS facility located in El Mirage, California has been directed by California environmental agencies to investigate and take corrective action for groundwater contamination. Based upon currently available information, the Company has established a provision for the cost of such investigation and corrective action. DAS expects to spend approximately $1 million for future investigation and corrective action for groundwater contamination at its El Mirage location. However, the Company's ultimate liability in connection with the contamination will depend upon a number of factors, including changes in existing laws and regulations, and the design and cost of the construction, operation and maintenance of the corrective action.

The Company's subsidiary, Composite Structures, LLC ("Composite"), and several other companies have been ordered by a California environmental agency to investigate and clean up soil and groundwater contamination at its Monrovia, California facility. Composite has filed a petition for review of the order.

Product Liability Claims in Excess of Insurance Could Adversely Affect the Company's Financial Results and Financial Condition

The Company faces potential liability for personal injury or death as a result of the failure of products designed or manufactured by the Company. Although the Company maintains product liability insurance, any material product liability not covered by insurance could have a material adverse effect on the Company's financial condition, results of operations and cash flows.

Damage or Destruction of the Company's Facilities Caused by Earthquake or Other Causes Could Adversely Affect the Company's Financial Results and Financial Condition

Although the Company maintains standard property casualty insurance covering its properties, the Company does not carry any earthquake insurance because of the cost of such insurance. Most of the Company's properties are located in Southern California, an area subject to frequent and sometimes severe earthquake activity. Even if covered by insurance, any significant damage or destruction of the Company’s facilities could result in the inability to meet customer delivery schedules and may result in the loss of customers and significant additional costs to the Company. As a result, any significant damage or destruction of the Company’s properties could have a material adverse effect on the Company’s business, financial condition or results of operations.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Not applicable.

Item 4. Controls and Procedures

The Company’s chief executive officer and chief financial officer have concluded, based on an evaluation of the Company’s disclosure controls and procedures (as defined in the Securities Exchange Act of 1934 Rules 13a-15(e) and 15d-15(c)), that such disclosure controls and procedures were effective as of the end of the period covered by this report. No change in the Company’s internal control over financial reporting occurred during the period covered by this report that has materially affected, or is reasonable likely to materially affect, the Company’s internal control over financial reporting.

PART II - OTHER INFORMATION

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

The 2004 annual meeting of shareholders of the Company was held on May 5, 2004. At the meeting, H. Frederick Christie was elected as a director of the Company. In the election of a director, the shareholder vote was as follows: H. Frederick Christie, For – 9,278,584, Withheld – 269,909. The other directors whose terms of office continued after the annual meeting were Joseph C. Berenato, Eugene P. Conese, Jr., Ralph D. Crosby, Jr., Robert C. Ducommun, Thomas P. Mullaney and Richard D. Paulson. Mr. Christie was elected to serve for a three-year term expiring at the annual meeting of shareholders in 2007, and thereafter until his successor is elected. At the annual meeting of shareholders, an amendment to the 2001 Stock Incentive Plan to increase the number of shares thereunder by 500,000 shares also was approved. In the approval of the amendment of the 2001 Stock Incentive Plan, the shareholder vote was as follows: For – 6,013,355, Against – 2,221,424, Abstain – 10,783.

Item 6. Exhibits and Reports on Form 8-K.

(a) Exhibits

11 Reconciliation of the Numerators and Denominators of the Basic and Diluted Earnings Per Share Computations

31.1 Certification of Principal Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

31.2 Certification of Principal Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002

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

(b) The Company filed a report on Form 8-K, dated May 10, 2004, reporting under Item 12 that the Company issued a press release dated May 10, 2004 regarding first quarter 2004 results.

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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.

DUCOMMUN INCORPORATED
(Registrant)

By: /s/ James S. Heiser

James S. Heiser
Vice President, Chief Financial Officer
And General Counsel
(Duly Authorized Officer of the Registrant)

By: /s/ Samuel D. Williams

Samuel D. Williams
Vice President and Controller
(Chief Accounting Officer of the Registrant)

Date: August 9, 2004

EXHIBIT 11

DUCOMMUN INCORPORATED AND SUBSIDIARIES
RECONCILIATION OF THE NUMERATORS AND DENOMINATORS OF
THE BASIC AND DILUTED EARNINGS PER SHARE COMPUTATIONS

	For the Quarter Ended July 3, 2004		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS			
Income Available to Common Stockholders	$ 4,307,000	9,966,000	$ 0.43
Effect of Dilutive Securities			
Stock Options		225,000	
Diluted EPS			
Income Available to Common Stockholders + Assumed Conversions	$ 4,307,000	10,191,000	$ 0.42

	For the Quarter Ended July 5, 2003		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS			
Income Available to Common Stockholders	$ 3,991,000	9,874,000	$ 0.40
Effect of Dilutive Securities			
Stock Options	—	23,000	
Diluted EPS			
Income Available to Common Stockholders + Assumed Conversions	$ 3,991,000	9,897,000	$ 0.40

	For the Six Months Ended July 3, 2004		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS			
Income Available to Common Stockholders	$ 6,538,000	9,943,000	$ 0.66
Effect of Dilutive Securities			
Stock Options		262,000	
Diluted EPS			
Income Available to Common Stockholders + Assumed Conversions	$ 6,538,000	10,205,000	$ 0.64

	For the Six Months Ended July 5, 2003		
	Income (Numerator)	Shares (Denominator)	Per-Share Amount
Basic EPS			
Income Available to Common Stockholders	$ 7,099,000	9,873,000	$ 0.72
Effect of Dilutive Securities			
Stock Options	—	22,000	
Diluted EPS			
Income Available to Common Stockholders + Assumed Conversions	$ 7,099,000	9,895,000	$ 0.72

Exhibit 31.1

**Certification of Principal Executive Officer
Pursuant to Section 302 of the
Sarbanes-Oxley Act of 2002**

I, Joseph C. Berenato, certify that:

1. I have reviewed this Quarterly Report of Ducommun Incorporated (the “registrant”) on Form 10-Q for the period ended July 3, 2004;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant’s other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (was defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
    a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
    b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
    c. Evaluated the effectiveness of the registrant’s disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
    d. Disclosed in this report any change in the registrant’s internal control over financial reporting that occurred during the registrant’s most recent fiscal quarter (the registrant’s fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant’s internal control over financial reporting; and

5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

    a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

    b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: August 9, 2004

/s/ Joseph C. Berenato

Joseph C. Berenato
Chairman and Chief Executive Officer

Certification of Principal Financial Officer
Pursuant to Section 302 of the
Sarbanes-Oxley Act of 2002

I, James S. Heiser, certify that:

1. I have reviewed this Quarterly Report of Ducommun Incorporated (the "registrant") on Form 10-Q for the period ended July 3, 2004;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer(s) and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (was defined in Exchange Act Rules 13a-15(f) and 15d-15(f) for the registrant and have:
   a. Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
   b. Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
   c. Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
   d. Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant’s other certifying officer(s) and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant’s auditors and the audit committee of the registrant’s board of directors (or persons performing the equivalent functions):

   a. All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant’s ability to record, process, summarize and report financial information; and

   b. Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant’s internal control over financial reporting.

Date: August 9, 2004

/s/ James S. Heiser

James S. Heiser
Vice President and Chief Financial Officer

Exhibit 32

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

In connection with the Quarterly Report of Ducommun Incorporated (the “Company”) on Form 10-Q for the period ending July 3, 2004 as filed with the Securities and Exchange Commission on the date hereof (the “Report”), we, Joseph C. Berenato, Chairman and Chief Executive Officer of the Company, and James S. Heiser, Vice President and Chief Financial Officer of the Company, certify pursuant to 18 U.S.C. § 1350, as adopted pursuant to § 906 of the Sarbanes-Oxley Act of 2002, that to the best of our knowledge:

(1) The Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

By: /s/ Joseph C. Berenato

Joseph C. Berenato
Chairman and Chief Executive Officer

By: /s/ James S. Heiser

James S. Heiser
Vice President and Chief Financial Officer

Date: August 9, 2004

The foregoing certification is accompanying the Form 10-K solely pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, and is not being filed as part of the Form 10-K or as a separate disclosure document.