

DUCOMMUN INC /DE/
Form 10-Q
August 03, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the quarterly period ended July 1, 2017

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

200 Sandpointe Avenue, Suite 700, Santa Ana, California (Address of principal executive offices)	92707-5759 (Zip code)
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Registrant's telephone number, including area code: (657) 335-3665

23301 Wilmington Avenue, Carson, California 90745-6209

(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 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 a smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

As of July 25, 2017, the registrant had 11,319,366 shares of common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements

Ducommun Incorporated and Subsidiaries

Condensed Consolidated Balance Sheets

(Unaudited)

(In thousands, except share and per share data)

	July 1, 2017	December 31, 2016
Assets		
Current Assets		
Cash and cash equivalents	\$7,372	\$ 7,432
Accounts receivable, net of allowance for doubtful accounts of \$536 and \$495 at July 1, 2017 and December 31, 2016, respectively	81,965	76,239
Inventories	129,398	119,896
Production cost of contracts	12,673	11,340
Other current assets	10,438	11,034
Total Current Assets	241,846	225,941
Property and equipment, net of accumulated depreciation of \$142,034 and \$135,484 at July 1, 2017 and December 31, 2016, respectively	110,788	101,590
Goodwill	82,554	82,554
Intangibles, net	97,155	101,573
Non-current deferred income taxes	286	286
Other assets	3,143	3,485
Total Assets	\$535,772	\$ 515,429
Liabilities and Shareholders' Equity		
Current Liabilities		
Current portion of long-term debt	\$—	\$ 3
Accounts payable	71,659	57,024
Accrued liabilities	25,814	29,279
Total Current Liabilities	97,473	86,306
Long-term debt, less current portion	169,627	166,896
Non-current deferred income taxes	31,895	31,417
Other long-term liabilities	17,837	18,707
Total Liabilities	316,832	303,326
Commitments and contingencies (Notes 11, 13)		
Shareholders' Equity		
Common stock - \$0.01 par value; 35,000,000 shares authorized; 11,317,337 and 11,193,813 issued at July 1, 2017 and December 31, 2016, respectively	113	112
Additional paid-in capital	77,670	76,783
Retained earnings	147,225	141,287
Accumulated other comprehensive loss	(6,068)	(6,079)
Total Shareholders' Equity	218,940	212,103
Total Liabilities and Shareholders' Equity	\$535,772	\$ 515,429
See accompanying notes to Condensed Consolidated Financial Statements.		

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Ducommun Incorporated and Subsidiaries
Condensed Consolidated Statements of Income
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Net Revenues	\$140,938	\$133,437	\$277,235	\$275,585
Cost of Sales	114,747	107,222	226,117	222,401
Gross Profit	26,191	26,215	51,118	53,184
Selling, General and Administrative Expenses	19,720	18,949	40,547	41,625
Operating Income	6,471	7,266	10,571	11,559
Interest Expense	(1,907)	(1,935)	(3,500)	(4,334)
Gain on Divestitures	—	—	—	18,815
Income Before Taxes	4,564	5,331	7,071	26,040
Income Tax Expense	741	1,470	1,133	8,629
Net Income	\$3,823	\$3,861	\$5,938	\$17,411
Earnings Per Share				
Basic earnings per share	\$0.34	\$0.35	\$0.53	\$1.56
Diluted earnings per share	\$0.33	\$0.34	\$0.51	\$1.55
Weighted-Average Number of Common Shares Outstanding				
Basic	11,237	11,155	11,253	11,127
Diluted	11,491	11,264	11,556	11,245

See accompanying notes to Condensed Consolidated Financial Statements.

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Ducommun Incorporated and Subsidiaries
 Condensed Consolidated Statements of Comprehensive Income
 (Unaudited)
 (In thousands)

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Net Income	\$3,823	\$3,861	\$5,938	\$17,411
Other Comprehensive (Loss) Income				
Amortization of actuarial losses and prior service costs, net of tax benefit of \$88 and \$73 for the three months ended July 1, 2017 and July 2, 2016, respectively, and \$151 and \$141 for the six months ended July 1, 2017 and July 2, 2016, respectively	114	117	254	240
Change in unrealized gains and losses on cash flow hedges, net of tax of \$72 and \$87 for the three months ended July 1, 2017 and July 2, 2016, respectively, and \$144 and \$326 for the six months ended July 1, 2017 and July 2, 2016, respectively	(122)	(148)	(243)	(556)
Other Comprehensive (Loss) Income	(8)	(31)	11	(316)
Comprehensive Income	\$3,815	\$3,830	\$5,949	\$17,095

See accompanying notes to Condensed Consolidated Financial Statements.

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Ducommun Incorporated and Subsidiaries
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(In thousands)

	Six Months Ended	
	July 1, 2017	July 2, 2016
Cash Flows from Operating Activities		
Net Income	\$5,938	\$17,411
Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities:		
Depreciation and amortization	11,530	11,331
Gain on divestitures	—	(18,815)
Stock-based compensation expense	3,164	1,985
Deferred income taxes	478	(3,144)
Provision for (recovery of) doubtful accounts	41	(24)
Other	(2,286)	(3,401)
Changes in Assets and Liabilities:		
Accounts receivable	(5,767)	2,738
Inventories	(9,502)	(12,875)
Production cost of contracts	(1,777)	792
Other assets	938	7,690
Accounts payable	14,998	9,871
Accrued and other liabilities	(1,508)	(1,484)
Net Cash Provided by Operating Activities	16,247	12,075
Cash Flows from Investing Activities		
Purchases of property and equipment	(16,242)	(7,619)
Proceeds from sale of assets	3	—
Proceeds from divestitures	—	55,272
Net Cash (Used in) Provided by Investing Activities	(16,239)	47,653
Cash Flows from Financing Activities		
Borrowings from senior secured revolving credit facility	123,000	9,200
Repayments of senior secured revolving credit facility	(110,800)	(4,200)
Repayments of senior unsecured notes and term loans	(10,000)	(60,000)
Repayments of other debt	(3)	(14)
Net (cash paid) proceeds from issuance of common stock under stock plans	(2,265)	(992)
Net Cash Used in Financing Activities	(68)	(56,006)
Net (Decrease) Increase in Cash and Cash Equivalents	(60)	3,722
Cash and Cash Equivalents at Beginning of Period	7,432	5,454
Cash and Cash Equivalents at End of Period	\$7,372	\$9,176
See accompanying notes to Condensed Consolidated Financial Statements.		

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Ducommun Incorporated and Subsidiaries

Notes to Condensed Consolidated Financial Statements (Unaudited)

Note 1. Summary of Significant Accounting Policies

Description of Business

We are a leading global provider of engineering and manufacturing services for high-performance products and high-cost-of failure applications used primarily in the aerospace and defense (“A&D”), industrial, medical and other industries (collectively, “Industrial”). Our subsidiaries are organized into two strategic businesses: Electronic Systems segment and Structural Systems segment, each of which is a reportable operating segment. Electronic Systems designs, engineers and manufactures high-reliability products used in worldwide technology-driven markets including aerospace, defense, industrial and medical and other end-use markets. Electronic Systems’ product offerings range from prototype development to complex assemblies. Structural Systems designs, engineers and manufactures large, complex contoured aerospace structural components and assemblies and supplies composite and metal bonded structures and assemblies. Structural Systems’ products are used on commercial aircraft, military fixed-wing aircraft and military and commercial rotary-wing aircraft. Both reportable operating segments follow the same accounting principles.

Basis of Presentation

The unaudited condensed consolidated financial statements include the accounts of Ducommun Incorporated and its subsidiaries (“Ducommun,” the “Company,” “we,” “us” or “our”), after eliminating intercompany balances and transactions. The December 31, 2016 condensed consolidated balance sheet data was derived from audited financial statements, but does not contain all disclosures required by accounting principles generally accepted in the United States of America (“GAAP”).

Our significant accounting policies were described in Part IV, Item 15(a)(1), “Note 1. Summary of Significant Accounting Policies” in our Annual Report on Form 10-K for the year ended December 31, 2016. We followed the same accounting policies for interim reporting. The financial information included in this Quarterly Report on Form 10-Q should be read in conjunction with our Annual Report on Form 10-K for the year ended December 31, 2016. In the opinion of management, all adjustments, consisting of recurring accruals, have been made that are necessary to fairly state our condensed consolidated financial position, statements of income, comprehensive income and cash flows in accordance with GAAP for the periods covered by this Quarterly Report on Form 10-Q. The results of operations for the three and six months ended July 1, 2017 are not necessarily indicative of the results to be expected for the full year ending December 31, 2017.

Our fiscal quarters typically end on the Saturday closest to the end of March, June and September for the first three fiscal quarters of each year, and ends on December 31 for our fourth fiscal quarter. As a result of using fiscal quarters for the first three quarters combined with leap years, our first and fourth fiscal quarters can range between 12 1/2 weeks to 13 1/2 weeks while the second and third fiscal quarters remain at a constant 13 weeks per fiscal quarter. Certain reclassifications have been made to prior period amounts to conform to the current year’s presentation.

Use of Estimates

Certain amounts and disclosures included in the unaudited condensed consolidated financial statements requires management to make estimates and judgments that affect the amounts of assets, liabilities (including forward loss reserves), 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.

Supplemental Cash Flow Information

(In thousands)
 Six Months
 Ended
 July 1, July 2,
 2017 2016

Interest paid	\$3,102	\$3,741
Taxes paid	\$685	\$2,479
Non-cash activities:		
Purchases of property and equipment not paid	\$2,878	\$1,278

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Earnings Per Share

Basic earnings per share are computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding in each period. Diluted earnings per share are computed by dividing income available to common shareholders by the weighted-average number of common shares outstanding, plus any potential dilutive shares that could be issued if exercised or converted into common stock in each period.

The net income, weighted-average number of common shares outstanding used to compute earnings per share, were as follows:

	(In thousands, except per share data) Three Months Ended		(In thousands, except per share data) Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Net income	\$3,823	\$3,861	\$5,938	\$17,411
Weighted-average number of common shares outstanding				
Basic weighted-average common shares outstanding	11,237	11,155	11,253	11,127
Dilutive potential common shares	254	109	303	118
Diluted weighted-average common shares outstanding	11,491	11,264	11,556	11,245
Earnings per share				
Basic	\$0.34	\$0.35	\$0.53	\$1.56
Diluted	\$0.33	\$0.34	\$0.51	\$1.55

Potentially dilutive stock options and stock units to purchase common stock, as shown below, were excluded from the computation of diluted earnings per share because their inclusion would have been anti-dilutive. However, these shares may be potentially dilutive common shares in the future.

	(In thousands) Three Months Ended		(In thousands) Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Stock options and stock units	154	674	156	632

Fair Value

Assets and liabilities that are measured, recorded or disclosed at fair value on a recurring basis are categorized using the fair value hierarchy. The fair value hierarchy has three levels based on the reliability of the inputs used to determine fair value. Level 1, the highest level, refers to the values determined based on quoted prices in active markets for identical assets. Level 2 refers to fair values estimated using significant observable inputs. Level 3, the lowest level, includes fair values estimated using significant unobservable inputs.

Divestitures

On January 22, 2016, we entered into an agreement, and completed the sale on the same date, to sell our operation located in Pittsburgh, Pennsylvania for a preliminary sales price of \$38.5 million in cash. We divested this facility as part of our overall strategy to streamline operations, which included consolidating our footprint. However, the sale of the Pittsburgh operation did not represent a strategic shift in our business and thus, was included in the ongoing operating results in the condensed consolidated income statements for all periods presented. Preliminary net assets sold were \$24.0 million, net liabilities sold were \$4.0 million, and direct transaction costs incurred were \$0.2 million, resulting in a preliminary gain on divestiture of \$18.3 million. In the fourth quarter of 2016, we finalized the sale with a final sales price of \$38.6 million in cash. The final net assets sold were \$24.0 million, net liabilities sold were \$4.0 million, and direct transaction costs incurred were \$0.3 million, resulting in a gain on divestiture of \$18.3 million. In February 2016, we entered into an agreement to sell our Huntsville, Alabama and Iuka, Mississippi (collectively, "Miltec") operations for a preliminary sales price of \$14.6 million, in cash, subject to post-closing adjustments. We

divested this facility as part of our overall strategy to streamline operations, which included consolidating our footprint. However, the sale of the Miltec operation did not represent a strategic shift in our business and thus, was included in the ongoing operating results in the condensed consolidated income statements for all periods presented. We completed the sale on March 25, 2016. Preliminary net assets sold were \$15.4 million, net liabilities sold were \$2.6 million, and direct transaction costs incurred during the current period were \$1.3 million, resulting in a preliminary gain on divestiture of \$0.5 million. In the fourth quarter of 2016, we finalized the sale with a final sales price of \$13.3 million in cash. The final net assets sold were \$15.4 million, net liabilities sold were \$2.7 million, and direct transaction costs incurred were \$1.3 million, resulting in a loss on divestiture of \$0.7 million.

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Cash and Cash Equivalents

Cash equivalents consist of highly liquid instruments purchased with original maturities of three months or less. These assets are valued at cost, which approximates fair value, which we classify as Level 1. See Fair Value above.

Derivative Instruments

We recognize derivative instruments on our condensed consolidated balance sheets at their fair value. On the date that we enter into a derivative contract, we designate the derivative instrument as a fair value hedge, a cash flow hedge, a hedge of a net investment in a foreign operation, or a derivative instrument that will not be accounted for using hedge accounting methods. As of July 1, 2017, all of our derivative instruments were designated as cash flow hedges.

We record changes in the fair value of a derivative instrument that is highly effective and that is designated and qualifies as a cash flow hedge in other comprehensive income (loss), net of tax until our earnings are affected by the variability of cash flows of the underlying hedge. We record any hedge ineffectiveness and amounts excluded from effectiveness testing in current period earnings within interest expense. We report changes in the fair values of derivative instruments that are not designated or do not qualify for hedge accounting in current period earnings. We classify cash flows from derivative instruments in the condensed consolidated statements of cash flows in the same category as the item being hedged or on a basis consistent with the nature of the instrument.

When we determine that a derivative instrument is not highly effective as a hedge, we discontinue hedge accounting prospectively. In all situations in which we discontinue hedge accounting and the derivative instrument remains outstanding, we will carry the derivative instrument at its fair value on our condensed consolidated balance sheets and recognize subsequent changes in its fair value in our current period earnings.

Inventories

Inventories are stated at the lower of cost or net realizable value with cost being determined using a moving average cost basis for raw materials and actual cost for work-in-process and finished goods, with units being relieved and charged to cost of sales on a first-in, first-out basis. Raw materials are based on cost and other inventory classifications are based on net realizable value. Inventoried costs include raw materials, outside processing, direct labor and allocated overhead, adjusted for any abnormal amounts of idle facility expense, freight, handling costs, and wasted materials (spoilage) incurred. Costs under long-term contracts are accumulated into, and removed from, inventory on the same basis as other contracts. We assess the inventory carrying value and reduce 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. We maintain a reserve for potentially excess and obsolete inventories and inventories that are carried at costs that are higher than their estimated net realizable values.

Production Cost of Contracts

Production cost of contracts includes non-recurring production costs, such as design and engineering costs, and tooling and other special-purpose machinery necessary to build parts as specified in a contract. Production costs of contracts are recorded to cost of goods sold using the units of delivery method. We review the value of the production cost of contracts on a quarterly basis to ensure when added to the estimated cost to complete, the value is not greater than the estimated realizable value of the related contracts.

Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss, as reflected on the condensed consolidated balance sheets under the equity section, was comprised of cumulative pension and retirement liability adjustments, net of tax, and change in net unrealized gains and losses on cash flow hedges, net of tax.

Provision for Estimated Losses on Contracts

We record provisions for the total anticipated losses on contracts considering total estimated costs to complete the contract compared to total anticipated revenues in the period in which such losses are identified. The provisions for estimated losses on contracts require us to make certain estimates and assumptions, including those with respect to the future revenue under a contract and the future cost to complete the contract. Our estimate of the future cost to complete a contract may include assumptions as to improvements in manufacturing efficiency, reductions in operating and material costs, and our ability to resolve claims and assertions with our customers. If any of these or other assumptions and estimates do not materialize in the future, we may be required to record additional provisions for estimated losses on contracts.

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Recent Accounting Pronouncements

New Accounting Guidance Adopted in 2017

In December 2016, the FASB issued ASU 2016-19, “Technical Corrections and Improvements” (“2016-19”), which cover a variety of Topics in the Codification. The amendments in ASU 2016-19 represent changes to make corrections or improvements to the Codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. The new guidance was effective for us beginning January 1, 2017. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

In March 2016, the FASB issued ASU 2016-09, “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” (“ASU 2016-09”), which is intended to improve the accounting for employee share-based payments. The new guidance was effective for us beginning January 1, 2017. The adoption of this standard did not have a significant dollar impact on our condensed consolidated financial statements.

In March 2016, the FASB issued ASU 2016-05, “Derivatives and Hedging (Topic 815): Effect of Derivative Contract Novations on Existing Hedge Accounting Relationships” (“ASU 2016-05”), which clarifies that a change in the counter party to a derivative instrument designated as a hedging instrument does not require dedesignation of that hedging relationship, provided that all other hedge accounting criteria are met. The new guidance was effective for us beginning January 1, 2017. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

In July 2015, the FASB issued ASU 2015-11, “Inventory (Topic 330)” (“ASU 2015-11”), which requires inventory within the scope of ASU 2015-11 to be measured at the lower of cost or net realizable value. Subsequent measurement is unchanged for inventory measured using last-in, first-out (“LIFO”) or the retail inventory value. The new guidance was effective for us beginning January 1, 2017. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

Recently Issued Accounting Standards

In May 2017, the FASB issued ASU 2017-09, “Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting” (“ASU 2017-09”), which provides clarity on determining which changes to the terms and conditions of share-based payment awards require an entity to apply modification accounting under Topic 718. The new guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods, which will be our interim period beginning January 1, 2018. Early adoption is permitted, including adoption in any interim period. The amendments should be applied prospectively to an award modified on or after the adoption date. We are evaluating the impact of this standard.

In March 2017, the FASB issued ASU 2017-07, “Compensation - Retirement Benefits (Topic 715): Improving the Presentation of Net Periodic Pension Cost and Net Periodic Postretirement Benefit Costs” (“ASU 2017-07”), which require an employer to report the service cost component in the same line item or items as other compensation costs arising from services rendered by the pertinent employees during the period. The other components of net benefit cost are required to be presented in the income statement separately from the service cost component and outside a subtotal of income from operations, if one is presented. If a separate line item or items are used to present the other components of net benefit cost, that line item or items must be appropriately described. If a separate line item or items are not used, the line item or items used in the income statement to present the other components of net benefit cost must be disclosed. The amendments also allow only the service cost component to be eligible for capitalization when applicable. The new guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods, which will be our interim period beginning January 1, 2018. We are evaluating the impact of this standard.

In January 2017, the FASB issued ASU 2017-04, “Intangibles - Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment” (“ASU 2017-04”), which simplifies the subsequent measurement of goodwill, the amendments eliminate Step Two from the goodwill impairment test. The annual, or interim, goodwill impairment test is performed by comparing the fair value of a reporting unit with its carrying amount. An impairment charge should be recognized for the amount by which the carrying amount exceeds the reporting unit’s fair value; however, the loss recognized should not exceed the total amount of goodwill allocated to that reporting unit. In addition, income tax effects from

any tax deductible goodwill on the carrying amount of the reporting unit should be considered when measuring the goodwill impairment loss, if applicable. The amendments also eliminate the requirements for any reporting unit with a zero or negative carrying amount to perform a qualitative assessment and, if it fails that qualitative test, to perform Step Two of the goodwill impairment test. An entity still has the option to perform the qualitative assessment for a reporting unit to determine if the quantitative impairment test is necessary. The new guidance is effective for annual or interim goodwill impairment tests in fiscal years beginning after December 15, 2019. Early adoption is permitted for interim or annual goodwill impairment tests performed on testing dates after January 1, 2017. We are evaluating the impact of this standard.

In January 2017, the FASB issued ASU 2017-01, "Business Combinations (Topic 805): Clarifying the Definition of a

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Business” (“ASU 2017-01”), which clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions (or disposals) of businesses. The new guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods, which will be our interim period beginning January 1, 2018. We are evaluating the impact of this standard.

In December 2016, the FASB issued ASU 2016-20, “Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers” (“ASU 2016-20”), which cover a variety of Topics in the Codification related to the new revenue recognition standard (ASU 2014-09). The amendments in ASU 2016-20 represent changes to make minor corrections or minor improvements to the Codification that are not expected to have a significant effect on current accounting practice or create a significant administrative cost to most entities. The new guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods, which will be our interim period beginning January 1, 2018. We are evaluating the impact of this standard.

In August 2016, the FASB issued ASU 2016-15, “Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments” (“ASU 2016-15”), which addresses the following eight specific cash flow issues: Debt prepayment or debt extinguishment costs; settlement of zero-coupon debt instruments or other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing; contingent consideration payments made after a business combination; proceeds from the settlement of insurance claims; proceeds from the settlement of corporate-owned life insurance policies (“COLIs”) (including bank-owned life insurance policies [“BOLIs”]); distributions received from equity method investees; beneficial interests in securitization transactions; and separately identifiable cash flows and application of the predominance principle. The new guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods, which will be our interim period beginning January 1, 2018. We are evaluating the impact of this standard.

In May 2016, the FASB issued ASU 2016-12, “Revenue from Contracts with Customers (Topic 606): Narrow-Scope Improvements and Practical Expedients” (“ASU 2016-12”), which amends the guidance in the new revenue standard on collectability, noncash consideration, presentation of sales tax, and transition. The amendments are intended to address implementation issues and provide additional practical expedients to reduce the cost and complexity of applying the new revenue standard. The new guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods, which will be our interim period beginning January 1, 2018. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods with that reporting period. We are evaluating the impact of this standard.

In May 2016, the FASB issued ASU 2016-11, “Revenue Recognition (Topic 605) and Derivatives and Hedging (Topic 815): Rescission of SEC Guidance Because of Accounting Standards Updates 2014-09 and 2014-06 Pursuant to Staff Announcements at the March 3, 2016 EITF Meeting” (“ASU 2016-11”), which clarifies revenue and expense recognition for freight costs, accounting for shipping and handling fees and costs, and accounting for consideration given by a vendor to a customer. The new guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods, which will be our interim period beginning January 1, 2018. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods with that reporting period. We are evaluating the impact of this standard.

In April 2016, the FASB issued ASU 2016-10, “Revenue from Contracts with Customers (Topic 606): Identifying Performance Obligations and Licensing” (“ASU 2016-10”), which clarifies the following two aspects of Topic 606: (a) identifying performance obligations; and (b) the licensing implementation guidance. The amendments do not change the core principle of the guidance in Topic 606. The new guidance is effective for annual periods beginning after December 15, 2017, including interim periods within those annual periods, which will be our interim period beginning January 1, 2018. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods with that reporting period. We are evaluating the impact of this standard.

In February 2016, the FASB issued ASU 2016-02, “Leases (Topic 842)” (“ASU 2016-02”), which requires lessees to present right-of-use assets and lease liabilities on the balance sheet. Lessees are required to apply a modified retrospective transition approach for leases existing at, or entered into after, the beginning of the earliest comparative period presented in the financial statements. The new guidance is effective for fiscal years beginning after December

15, 2018, including interim periods within those fiscal years, which will be our interim period beginning January 1, 2019. We are evaluating the impact of this standard and currently anticipate it will impact our condensed consolidated financial statements.

In May 2014, the FASB issued ASU 2014-09, "Revenue from Contracts with Customers (Topic 606)" ("ASU 2014-09"), which outlines a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. This new revenue recognition model provides a five-step analysis in determining when and how revenue is recognized. It requires entities to exercise judgment when considering the terms of the contract(s) which include (i) identifying the contract(s) with the customer, (ii) identifying the separate performance obligations in the contract, (iii) determining the transaction price, (iv) allocating the

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transaction price to the separate performance obligations, and (v) recognizing revenue when each performance obligation is satisfied. Thus, it depicts the transfer of promised goods or services to customers in an amount that reflects the consideration an entity expects to receive in exchange for those goods or services. Companies have the option of applying the provisions of ASU 2014-09 either retrospectively to each prior reporting period presented or retrospectively with the cumulative effect of initially applying this guidance recognized at the date of initial application. In August 2015, the FASB issued ASU 2015-14, "Revenue From Contracts With Customers (Topic 606)" ("ASU 2015-14"), which deferred the effective date of ASU 2014-09 by one year to annual periods beginning after December 15, 2017, including interim reporting periods within that reporting period. Early adoption is permitted only as of annual reporting periods beginning after December 15, 2016, including interim reporting periods within that reporting period. The new guidance is effective for us beginning January 1, 2018 and provides us additional time to evaluate the impact that ASU 2014-09 will have on our condensed consolidated financial statements. We are currently completing the assessment and gap identification phases of the implementation project. This includes reviewing current accounting policies and practices to identify potential differences that would result from applying the requirements under the new accounting standard. We are in the process of completing the contract evaluations and validating the results of applying the new revenue guidance. As the percentage of completion, unit of delivery method of recognizing revenue is being eliminated for companies with significant work-in-process inventory time under ASU 2014-09, we currently anticipate most of our revenues will be recognized over time instead of at a point in time, which is our current method for recognizing revenue. As such, our revenues, cost of sales, and related items on our condensed consolidated financial statements will be impacted as well as our financial information technology systems. Further, we have selected a software solution and are in the preliminary stage of implementing the software solution to comply with this new accounting standard. Finally, we expect to adopt the new accounting standard using the modified retrospective method, under which the cumulative effect of initially applying the new guidance is recognized as an adjustment to certain captions on the balance sheet, including the opening balance of retained earnings in the first quarter of 2018.

Note 2. Restructuring Activities

Summary of 2015 Restructuring Plans

In September 2015, management approved and commenced implementation of several restructuring actions, including organizational re-alignment, consolidation and relocation of the New York facilities that was completed in December 2015, closure of the Houston facility that was completed in December 2015, and closure of the St. Louis facility that was completed in April 2016, all of which are part of our overall strategy to streamline operations. We have recorded cumulative expenses of \$2.2 million for severance and benefits and loss on early exit from leases. We do not expect to record additional expenses related to these restructuring plans.

As of July 1, 2017, we have accrued \$0.4 million for loss on early exit from a lease in the Structural Systems segment, which was charged to selling, general and administrative expenses.

Summary of 2016 Restructuring Plan

In May 2016, management approved and commenced implementation of the closure of one of our Tulsa facilities that was completed in June 2016, and was part of our overall strategy to streamline operations. We have recorded cumulative expenses of \$0.2 million for severance and benefits and loss on early exit from a lease. We do not expect to record additional expenses related to this restructuring plan.

As of July 1, 2017, we have accrued \$0.1 million for loss on early exit from a lease in the Electronic Systems segment, which was charged to selling, general and administrative expenses.

Our restructuring activities in the six months ended July 1, 2017 were as follows (in thousands):

	December 31, 2016	Six Months Ended July 1, 2017	Change in	July 1, 2017
	Balance	Cash Charges Payments	Estimates	Balance
Lease termination	\$ 654	\$-\$ (156)	\$	—\$ 498
Ending balance	\$ 654	\$-\$ (156)	\$	—\$ 498

Note 3. Fair Value Measurements

Fair value is defined as the price that would be received for an asset or the price that would be paid to transfer a liability (an exit price) in the principal or most advantageous market in an orderly transaction between market participants on the measurement date. The accounting standard provides a framework for measuring fair value using a fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. This hierarchy requires us to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. Three levels of inputs that may be used to measure fair value are as follows:

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Level 1 - Quoted prices (unadjusted) in active markets for identical assets or liabilities;

Level 2 - Observable inputs other than Level 1 prices, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

Level 3 - Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Our financial instruments consist primarily of cash and cash equivalents and interest rate cap derivatives designated as cash flow hedging instruments. Assets and liabilities measured at fair value on a recurring basis were as follows (in thousands):

	As of July 1, 2017				As of December 31, 2016			
	Fair Value Measurements Using				Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total Balance	Level 1	Level 2	Level 3	Total Balance
Assets								
Money market funds ⁽¹⁾	\$21	\$—	\$—	—\$ 21	\$3,751	\$—	\$—	—\$ 3,751
Interest rate cap hedges ⁽²⁾	—	167	—	167	—	553	—	553
Total Assets	\$21	\$167	\$—	—\$ 188	\$3,751	\$553	\$—	—\$ 4,304

(1) Included as cash and cash equivalents.

(2) Interest rate cap hedge premium included as other current assets and other assets.

The fair value of the interest rate cap hedge agreements was determined using pricing models that use observable market inputs as of the balance sheet date, a Level 2 measurement.

There were no transfers between Level 1, Level 2, or Level 3 financial instruments in the three months ended July 1, 2017.

Note 4. Financial Instruments

Derivative Instruments and Hedging Activities

We periodically enter into cash flow derivative transactions, such as interest rate cap agreements, to hedge exposure to various risks related to interest rates. We assess the effectiveness of the interest rate cap hedges at inception of the hedge. We recognize all derivatives at their fair value. For cash flow designated hedges, the effective portion of the changes in fair value of the derivative contract are recorded in accumulated other comprehensive income (loss), net of taxes, and are recognized in net earnings at the time earnings are affected by the hedged transaction. Adjustments to record changes in fair values of the derivative contracts that are attributable to the ineffective portion of the hedges, if any, are recognized in earnings. We present derivative instruments in our condensed consolidated statements of cash flows' operating, investing, or financing activities consistent with the cash flows of the hedged item.

Our interest rate cap hedges were designated as cash flow hedges and deemed highly effective at the inception of the hedges. These interest rate cap hedges mature concurrently with the term loan in June 2020. During the three months ended July 1, 2017, the interest rate cap hedges continued to be highly effective and \$0.1 million, net of tax, was recognized in other comprehensive income. No amount was recorded in the condensed consolidated income statements during the three months ended July 1, 2017. See Note 8.

The recorded fair value of the derivative financial instruments on the condensed consolidated balance sheets were as follows:

(In thousands)	(In thousands)
July 1, 2017	December 31, 2016
Other Current	Other Current

Derivatives Designated as Hedging Instruments	Term Assets	Term Assets
Cash Flow Hedges:		
Interest rate cap premiums	\$ —\$ 167	\$ —\$ 553
Total Derivatives	\$ —\$ 167	\$ —\$ 553

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Note 5. Inventories

Inventories consisted of the following:

	(In thousands)	
	July 1, 2017	December 31, 2016
Raw materials and supplies	\$69,307	\$ 64,650
Work in process	60,517	56,806
Finished goods	10,130	9,180
	139,954	130,636
Less progress payments	10,556	10,740
Total	\$129,398	\$ 119,896

We net progress payments from customers related to inventory purchases against inventories on the condensed consolidated balance sheets.

Note 6. Goodwill

Gross goodwill and accumulated goodwill impairment were \$164.3 million and \$81.7 million, respectively, both as of July 1, 2017 and December 31, 2016. The remaining net goodwill amount is included in our Electronic Systems segment.

We perform our annual goodwill impairment test during the fourth quarter. If certain factors occur, we may have to perform an impairment test prior to the fourth quarter including significant under performance of our business relative to expected operating results, significant adverse economic and industry trends, significant decline in our market capitalization for an extended period of time relative to net book value, a decision to divest individual businesses within a reporting unit, or a decision to group individual businesses differently.

At times, our market capitalization has declined below book value, which if it continues for an extended period of time, is a factor that could lead to a conclusion that a triggering event has occurred. As our market capitalization declines recently have been temporary in nature and our market capitalization has exceeded our book value, we do not consider these temporary declines in market capitalization to be a triggering event in the fiscal quarter ended July 1, 2017. However, since we recorded a goodwill impairment charge in 2015, it is considered at least reasonably possible that our determination that goodwill for our Electronic Systems segment was not impaired could change in the near term if any the factors noted above occurs.

Note 7. Accrued Liabilities

The components of accrued liabilities were as follows:

	(In thousands)	
	July 1, 2017	December 31, 2016
Accrued compensation	\$15,874	\$ 15,455
Accrued income tax and sales tax	41	332
Customer deposits	3,474	3,204
Interest payable	10	273
Provision for forward loss reserves	1,953	4,780
Other	4,462	5,235
Total	\$25,814	\$ 29,279

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Note 8. Long-Term Debt

Long-term debt and the current period interest rates were as follows:

	(In thousands)	
	July 1, 2017	December 31, 2016
Term loan	\$ 160,000	\$ 170,000
Revolving credit facility	12,200	—
Other debt (fixed 5.41%)	—	3
Total debt	172,200	170,003
Less current portion	—	3
Total long-term debt	172,200	170,000
Less debt issuance costs	2,573	3,104
Total long-term debt, net of debt issuance costs	\$ 169,627	\$ 166,896
Weighted-average interest rate	3.12	% 3.25

Our credit facility consists of a \$275.0 million senior secured term loan, which matures on June 26, 2020 (“Term Loan”), and a \$200.0 million senior secured revolving credit facility (“Revolving Credit Facility”), which matures on June 26, 2020 (collectively, the “Credit Facilities”). The Credit Facilities bear interest, at our option, at a rate equal to either (i) the Eurodollar Rate (defined as LIBOR) plus an applicable margin ranging from 1.50% to 2.75% per year or (ii) the Base Rate (defined as the highest of [a] Federal Funds Rate plus 0.50%, [b] Bank of America’s prime rate, and [c] the Eurodollar Rate plus 1.00%) plus an applicable margin ranging from 0.50% to 1.75% per year, in each case based upon the consolidated total net adjusted leverage ratio. The undrawn portions of the commitments of the Credit Facilities are subject to a commitment fee ranging from 0.175% to 0.300%, based upon the consolidated total net adjusted leverage ratio.

Further, we are required to make mandatory prepayments of amounts outstanding under the Term Loan. The mandatory prepayments will be made quarterly, equal to 5.0% per year of the original aggregate principal amount during the first two years and increase to 7.5% per year during the third year, and increase to 10.0% per year during the fourth year and fifth years, with the remaining balance payable on June 26, 2020. The loans under the Revolving Credit Facility are due on June 26, 2020. As of July 1, 2017, we were in compliance with all covenants required under the Credit Facilities.

In addition, we incurred \$4.8 million of debt issuance costs related to the Credit Facilities and those costs were capitalized and are being amortized over the five year life of the Credit Facilities.

We made voluntary principal prepayments of \$5.0 million and \$10.0 million under the Term Loan during the three and six months ended July 1, 2017, respectively.

As of July 1, 2017, we had \$186.8 million of unused borrowing capacity under the Revolving Credit Facility, after deducting \$12.2 million for draw down on the Revolving Credit Facility and \$1.0 million for standby letters of credit. The Credit Facilities were entered into by us (“Parent Company”) and guaranteed by all of our subsidiaries, other than one subsidiary (“Subsidiary Guarantors”) that was considered minor. The Parent Company has no independent assets or operations and the Subsidiary Guarantors jointly and severally guarantee, on a senior unsecured basis, the Credit Facilities. Therefore, no condensed consolidating financial information for the Parent Company and its subsidiaries are presented.

Subsequent to our quarter ended July 1, 2017, we entered into a technical amendment to the Credit Facilities on July 14, 2017 (“First Amendment”) which provides more flexibility to close certain qualified acquisitions permitted under the Credit Facilities.

In October 2015, we entered into interest rate cap hedges designated as cash flow hedges with maturity dates of June 2020, and in aggregate, totaling \$135.0 million of our debt. We paid a total of \$1.0 million in connection with entering into the interest rate cap hedges. See Note 4 for further discussion.

In December 2016, we entered into an agreement to purchase \$9.9 million of industrial revenue bonds (“IRBs”) issued by the city of Parsons, Kansas (“Parsons”) and concurrently, sold \$9.9 million of property and equipment (“Property”) to

Parsons as well as entered into a lease agreement to lease the Property from Parsons (“Lease”) with lease payments totaling \$9.9 million over the lease term. The sale of the Property and concurrent lease back of the Property did not meet the sale-leaseback accounting requirements as a result of our continuous involvement with the Property and thus, the \$9.9 million in cash received

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from Parsons was not recorded as a sale but as a financing obligation. Further, the Lease included a right of offset and thus, the financing obligation of \$9.9 million was offset against the \$9.9 million of IRBs assets and presented net on the condensed consolidated balance sheets with no impact to the condensed consolidated income statements or condensed consolidated cash flow statements.

Note 9. Shareholders' Equity

We are authorized to issue five million shares of preferred stock. At July 1, 2017 and December 31, 2016, no preferred shares were issued or outstanding.

Note 10. Employee Benefit Plans

The components of net periodic pension expense were as follows:

	(In thousands) Three Months Ended July 1, July 2, 2017 2016		(In thousands) Six Months Ended July 1, July 2, 2017 2016	
Service cost	\$132	\$133	\$265	\$266
Interest cost	333	342	665	684
Expected return on plan assets	(382)	(371)	(765)	(741)
Amortization of actuarial losses	202	190	405	381
Net periodic pension cost	\$285	\$294	\$570	\$590

The components of the reclassifications of net actuarial losses from accumulated other comprehensive loss to net income for the three and six months ended July 1, 2017 were as follows:

	(In thousands) Three Months Ended July 1, 2017		Six Months Ended July 1, 2017	
Amortization of actuarial losses - total before tax ⁽¹⁾	\$(202)	\$(405)		
Tax benefit	88	151		
Net of tax	\$(114)	\$(254)		

⁽¹⁾ The amortization expense is included in the computation of periodic pension cost and is a decrease to net income upon reclassification from accumulated other comprehensive loss.

Note 11. Indemnifications

We have made guarantees and indemnities under which we 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, we have indemnified our lessors for certain claims arising from the facility or the lease. We indemnify our directors and officers to the maximum extent permitted under the laws of the State of Delaware.

However, we have a directors and officers insurance policy that may reduce our exposure in certain circumstances and may enable us to recover a portion of future amounts that may be payable, if any. The duration of the guarantees and indemnities vary and, in many cases are indefinite but subject to statutes of limitations. The majority of guarantees and indemnities do not provide any limitations of the maximum potential future payments we could be obligated to make. Historically, payments related to these guarantees and indemnities have been immaterial. We estimate the fair value of our indemnification obligations as insignificant based on this history and insurance coverage and have, therefore, not recorded any liability for these guarantees and indemnities on the accompanying condensed

consolidated balance sheets.

Note 12. Income Taxes

The provision for income taxes is determined using an estimated annual effective tax rate, which is generally less than the U.S. federal statutory rate, primarily due to research and development (“R&D”) tax credits and deductions available for domestic

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production activities. Our effective tax rate may be subject to fluctuations during the year as new information is obtained, which may affect the assumptions used to estimate the annual effective tax rate, including factors such as expected utilization of R&D tax credits, valuation allowances against deferred tax assets, the recognition or derecognition of tax benefits related to uncertain tax positions, and changes in or the interpretation of tax laws in jurisdictions where we conduct business. We recognize deferred tax assets and liabilities for temporary differences between the financial reporting basis and the tax basis of our assets and liabilities along with net operating loss and tax credit carryovers.

We record a valuation allowance against our deferred tax assets to reduce the net carrying value to an amount that we believe is more likely than not to be realized. When we establish or reduce our valuation allowances against our deferred tax assets, the provision for income taxes will increase or decrease, respectively, in the period when that determination is made.

We recorded income tax expense of \$0.7 million (effective tax rate of 16.2%) for the three months ended July 1, 2017 compared to \$1.5 million (effective tax rate of 27.6%) for the three months ended July 2, 2016. FASB ASU 2016-09 became effective beginning January 1, 2017 and required all the tax effects related to share-based payments be recorded through the income statement. This could result in fluctuations in our effective tax rate from period to period, depending on the number of awards exercised and/or vested in the quarter as well as the volatility of our stock price.

As such, the decrease in the effective tax rate for the three months ended July 1, 2017 compared to the three months ended July 2, 2016 was primarily due to tax benefits recognized from share-based payments. During the current year three month period, we recognized tax benefits from deductions of share-based payments in excess of compensation cost recognized for financial reporting purposes of \$0.3 million, which decreased our effective tax rate by 7.2%.

We recorded income tax expense of \$1.1 million (effective tax rate of 16.0%) for the six months ended July 1, 2017 compared to \$8.6 million (effective tax rate of 33.1%) for the six months ended July 2, 2016. The decrease in the effective tax rate for the six months ended July 1, 2017 compared to the six months ended July 2, 2016 was primarily due to the preliminary gain on divestitures of our Pittsburgh and Miltec operations of \$18.8 million, which resulted in a higher state tax liability, compared to the current year six month period. In addition, during the current year six month period, we recognized tax benefits from deductions of share-based payments in excess of compensation cost recognized for financial reporting purposes of \$0.6 million, which decreased the effective tax rate by 8.1%.

Our total amount of unrecognized tax benefits was \$3.4 million and \$3.0 million as of July 1, 2017 and December 31, 2016, respectively. If recognized, \$2.2 million would affect the effective tax rate. We do not reasonably expect significant increases or decreases to our unrecognized tax benefits in the next twelve months.

In 2016, the Internal Revenue Service (“IRS”) commenced an audit of our 2014 and 2015 tax years. Although the outcome of tax examinations cannot be predicted with certainty, we believe we have adequately accrued for tax deficiencies or reductions in tax benefits, if any, that could result from the examination and all open audit years.

Note 13. Contingencies

Structural Systems has been directed by California environmental agencies to investigate and take corrective action for groundwater contamination at its facilities located in El Mirage and Monrovia, California. Based on currently available information, Ducommun has established an accrual for its estimated liability for such investigation and corrective action of \$1.5 million at both July 1, 2017 and December 31, 2016, which is reflected in other long-term liabilities on its condensed consolidated balance sheets.

Structural Systems also faces liability as a potentially responsible party for hazardous waste disposed at landfills located in Casmalia and West Covina, California. Structural Systems and other companies and government entities have entered into consent decrees with respect to these landfills with the United States Environmental Protection Agency and/or California environmental agencies under which certain investigation, remediation and maintenance activities are being performed. Based on currently available information, Ducommun preliminarily estimates that the range of its future liabilities in connection with the landfill located in West Covina, California is between \$0.4 million and \$3.1 million. Ducommun has established an accrual for its estimated liability, in connection with the West Covina landfill of \$0.4 million at July 1, 2017, which is reflected in other long-term liabilities on its condensed consolidated balance sheet. Ducommun’s ultimate liability in connection with these matters will depend upon a number of factors,

including changes in existing laws and regulations, the design and cost of construction, operation and maintenance activities, and the allocation of liability among potentially responsible parties.

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, Ducommun makes various commitments and incurs contingent liabilities. While it is not feasible to predict the outcome of these matters, Ducommun does not presently expect that any sum it

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may be required to pay in connection with these matters would have a material adverse effect on its condensed consolidated financial position, results of operations or cash flows.

Note 14. Business Segment Information

We supply products and services primarily to the aerospace and defense industries. Our subsidiaries are organized into two strategic businesses, Structural Systems and Electronic Systems, each of which is a reportable operating segment.

Financial information by reportable operating segment was as follows:

	(In thousands)		(In thousands)	
	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Net Revenues				
Structural Systems	\$59,112	\$60,694	\$116,687	\$124,711
Electronic Systems	81,826	72,743	160,548	150,874
Total Net Revenues	\$140,938	\$133,437	\$277,235	\$275,585
Segment Operating Income				
Structural Systems	\$2,049	\$4,730	\$4,681	\$7,454
Electronic Systems	8,820	6,782	15,924	13,169
	10,869	11,512	20,605	20,623
Corporate General and Administrative Expenses ⁽¹⁾	(4,398)	(4,246)	(10,034)	(9,064)
Operating Income	\$6,471	\$7,266	\$10,571	\$11,559
Depreciation and Amortization Expenses				
Structural Systems	\$2,307	\$1,775	\$4,659	\$3,832
Electronic Systems	3,439	3,668	6,862	7,429
Corporate Administration	2	33	9	70
Total Depreciation and Amortization Expenses	\$5,748	\$5,476	\$11,530	\$11,331
Capital Expenditures				
Structural Systems	\$7,580	\$4,540	\$12,768	\$6,594
Electronic Systems	1,030	407	2,463	754
Corporate Administration	648	—	648	—
Total Capital Expenditures	\$9,258	\$4,947	\$15,879	\$7,348

(1) Includes costs not allocated to either the Structural Systems or Electronic Systems operating segments.

Segment assets include assets directly identifiable to or allocated to each segment. Our segment assets are as follows:

	(In thousands)	
	July 1, 2017	December 31, 2016
Total Assets		
Structural Systems	\$203,297	\$ 175,580
Electronic Systems	318,243	325,780
Corporate Administration ⁽¹⁾	14,232	14,069
Total Assets	\$535,772	\$ 515,429
Goodwill and Intangibles		
Structural Systems	\$3,290	\$ 3,745
Electronic Systems	176,419	180,382
Total Goodwill and Intangibles	\$179,709	\$ 184,127

(1) Includes assets not specifically identified to or allocated to either the Structural Systems or Electronic Systems operating segments, including cash and cash equivalents.

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

Overview

Ducommun Incorporated ("Ducommun," "the Company," "we," "us" or "our") is a leading global provider of engineering and manufacturing services for high-performance products and high-cost-of failure applications used primarily in the aerospace and defense ("A&D"), industrial, medical and other industries (collectively, "Industrial"). We differentiate ourselves as a full-service solution-based provider, offering a wide range of value-added products and services in our primary businesses of electronics, structures and integrated solutions. We operate through two primary business segments: Electronic Systems and Structural Systems, each of which is a reportable segment.

Second quarter 2017 highlights:

• Revenues of \$140.9 million

• Net income of \$3.8 million, or \$0.33 per diluted share

• Adjusted EBITDA of \$13.6 million

• Backlog of \$610.6 million

Defense Industry Environment

In May 2017, Congress passed the fiscal year 2017 Omnibus Appropriations Bill, which funds the U.S. Government through September 30, 2017. The bill provides funding of \$607 billion for the U.S. Department of Defense ("DoD"), including a base budget of \$524 billion and Overseas Contingency Operations ("OCO")/Global War on Terror ("GWOT") funding of \$83 billion. The fiscal year 2017 funding level for the DoD is \$26 billion higher than the funding level for fiscal year 2016.

In May 2017, the President also submitted a budget proposal for fiscal year 2018 to Congress. The proposal includes funding of \$639 billion for the DoD, comprising a base budget of \$574 billion and OCO/GWOT funding of \$65 billion. The fiscal year 2018 funding level for the DoD is \$52 billion above the spending limits established under the Budget Control Act of 2011 ("Budget Control Act," as described below) and an increase of \$32 billion over the fiscal year 2017 funding level. Congress must approve or revise the President's fiscal year 2018 budget proposals through enactment of appropriations bills and other policy legislation, which would then require final Presidential approval. It is uncertain when or if an annual appropriations bill will be enacted for fiscal year 2018 and whether it will be at the levels proposed by the President.

U.S. defense spending through fiscal year 2021 remains subject to statutory spending limits established by the Budget Control Act. The spending limits were modified for fiscal years 2013 through 2017 by the American Taxpayer Relief Act of 2012, the Bipartisan Budget Act of 2013 and the Bipartisan Budget Act of 2015. However, these acts did not provide relief to the spending limits beyond fiscal year 2017. If Congress approves the President's budget proposal or other appropriation legislation with funding levels that exceed the spending limits, automatic across-the-board spending reductions, known as sequestration, would be triggered to reduce funding back to the spending limits. As currently enacted, the Budget Control Act limits defense spending to \$522 billion for fiscal year 2018 with modest increases of 2.5% per year through 2021. The President's budget proposal as well as defense budget estimates for fiscal year 2018 and beyond exceed the spending limits established by the Budget Control Act. As a result, continued budget uncertainty and the risk of future sequestration cuts remain unless the Budget Control Act is repealed or significantly modified. Therefore, the possibility remains that our programs could be materially reduced, extended, or terminated as a result of the U.S. Government's continuing assessment of priorities, changes in government priorities, the implementation of sequestration (particularly in those circumstances where sequestration is implemented across-the-board without regard to national priorities), or other budget cuts in lieu of sequestration.

In March 2017, the outstanding debt of the U.S. reached the debt borrowing limit, known as the debt ceiling. To avoid exceeding the debt ceiling, the U.S. Department of Treasury began employing measures to finance the U.S. Government. Congress will need to raise the debt limit in order for the U.S. Government to continue borrowing money before these measures are exhausted. If the debt ceiling is not raised, the U.S. Government may not be able to pay for expenditures or fulfill its funding obligations and there could be significant disruption to all discretionary programs. Although we believe that key defense, intelligence and homeland security programs would receive priority, the effect on individual programs or us cannot be predicted at this time.

We anticipate there will continue to be a significant amount of debate and negotiations within the U.S. Government over defense spending and the debt ceiling. In the context of these negotiations, it is possible that existing cuts to government programs could be kept in place, replaced with different spending cuts, and/or replaced with a package of broader reforms to reduce the federal deficit. Any of these impacts could have an effect on our financial condition and results of operations.

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Non-GAAP Financial Measures

Adjusted earnings before interest, taxes, depreciation and amortization (“Adjusted EBITDA”) was \$13.6 million and \$13.7 million for the three months ended July 1, 2017 and July 2, 2016, respectively.

When viewed with our financial results prepared in accordance with accounting principles generally accepted in the United States of America (“GAAP”) and accompanying reconciliations, we believe Adjusted EBITDA provides additional useful information to clarify and enhance the understanding of the factors and trends affecting our past performance and future prospects. We define these measures, explain how they are calculated and provide reconciliations of these measures to the most comparable GAAP measure in the table below. Adjusted EBITDA and the related financial ratios, as presented in this Quarterly Report on Form 10-Q (“Form 10-Q”), are supplemental measures of our performance that are not required by, or presented in accordance with, GAAP. They are not a measurement of our financial performance under GAAP and should not be considered as alternatives to net income or any other performance measures derived in accordance with GAAP, or as an alternative to net cash provided by operating activities as measures of our liquidity. The presentation of these measures should not be interpreted to mean that our future results will be unaffected by unusual or nonrecurring items.

We use Adjusted EBITDA non-GAAP operating performance measures internally as complementary financial measures to evaluate the performance and trends of our businesses. We present Adjusted EBITDA and the related financial ratios, as applicable, because we believe that measures such as these provide useful information with respect to our ability to meet our operating commitments.

Adjusted EBITDA has limitations as an analytical tool, and you should not consider it in isolation or as substitutes for analysis of our results as reported under GAAP. Some of these limitations include:

- They do not reflect our cash expenditures, future requirements for capital expenditures or contractual commitments;
- They do not reflect changes in, or cash requirements for, our working capital needs;
- They do not reflect the significant interest expense or the cash requirements necessary to service interest or principal payments on our debt;

Although depreciation and amortization are non-cash charges, the assets being depreciated and amortized will often have to be replaced in the future, and Adjusted EBITDA does not reflect any cash requirements for such replacements;

- They are not adjusted for all non-cash income or expense items that are reflected in our statements of cash flows;
- They do not reflect the impact on earnings of charges resulting from matters unrelated to our ongoing operations; and
- Other companies in our industry may calculate Adjusted EBITDA differently from us, limiting their usefulness as comparative measures.

Because of these limitations, Adjusted EBITDA and the related financial ratios should not be considered as measures of discretionary cash available to us to invest in the growth of our business or as a measure of cash that will be available to us to meet our obligations. You should compensate for these limitations by relying primarily on our GAAP results and using Adjusted EBITDA only as supplemental information. See our Condensed Consolidated Financial Statements contained in this Form 10-Q.

However, in spite of the above limitations, we believe that Adjusted EBITDA is useful to an investor in evaluating our results of operations because these measures:

- Are widely used by investors to measure a company’s operating performance without regard to items excluded from the calculation of such terms, which can vary substantially from company to company depending upon accounting methods and book value of assets, capital structure and the method by which assets were acquired, among other factors;
- Help investors to evaluate and compare the results of our operations from period to period by removing the effect of our capital structure from our operating performance; and
- Are used by our management team for various other purposes in presentations to our Board of Directors as a basis for strategic planning and forecasting.

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The following financial items have been added back to or subtracted from our net income when calculating Adjusted EBITDA:

• Interest expense may be useful to investors for determining current cash flow;

• Income tax expense may be useful to investors because it represents the taxes which may be payable for the period and the change in deferred taxes during the period, and may reduce cash flow available for use in our business;

• Depreciation may be useful to investors because it generally represents the wear and tear on our property and equipment used in our operations;

• Amortization expense may be useful to investors because it represents the estimated attrition of our acquired customer base and the diminishing value of product rights;

• Stock-based compensation may be useful to our investors for determining current cash flow; and

• Gain on divestitures may be useful to our investors in evaluating our on-going operating performance.

Reconciliations of net income to Adjusted EBITDA and the presentation of Adjusted EBITDA as a percentage of net revenues were as follows:

	(In thousands)		(In thousands)	
	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Net income	\$3,823	\$3,861	\$5,938	\$17,411
Interest expense	1,907	1,935	3,500	4,334
Income tax expense	741	1,470	1,133	8,629
Depreciation	3,338	3,352	6,668	6,753
Amortization	2,410	2,124	4,862	4,578
Stock-based compensation expense	1,342	985	3,164	1,985
Gain on divestitures	—	—	—	(18,815)
Adjusted EBITDA	\$13,561	\$13,727	\$25,265	\$24,875
% of net revenues	9.6	% 10.3	% 9.1	% 9.0

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Results of Operations

Second Quarter of 2017 Compared to Second Quarter of 2016

The following table sets forth net revenues, selected financial data, the effective tax rate and diluted earnings per share:

	(in thousands, except per share data) Three Months Ended				(in thousands, except per share data) Six Months Ended			
	July 1, 2017	% of Net Revenues	July 2, 2016	% of Net Revenues	July 1, 2017	% of Net Revenues	July 2, 2016	% of Net Revenues
Net Revenues	\$140,938	100.0 %	\$133,437	100.0 %	\$277,235	100.0 %	\$275,585	100.0 %
Cost of Sales	114,747	81.4 %	107,222	80.4 %	226,117	81.6 %	222,401	80.7 %
Gross Profit	26,191	18.6 %	26,215	19.6 %	51,118	18.4 %	53,184	19.3 %
Selling, General and Administrative Expenses	19,720	14.0 %	18,949	14.2 %	40,547	14.6 %	41,625	15.1 %
Operating Income	6,471	4.6 %	7,266	5.4 %	10,571	3.8 %	11,559	4.2 %
Interest Expense	(1,907)	(1.4)%	(1,935)	(1.4)%	(3,500)	(1.3)%	(4,334)	(1.6)%
Gain on Divestitures	—	— %	—	— %	—	— %	18,815	6.8 %
Income Before Taxes	4,564	3.2 %	5,331	4.0 %	7,071	2.5 %	26,040	9.4 %
Income Tax Expense	741	nm	1,470	nm	1,133	nm	8,629	nm
Net Income	\$3,823	2.7 %	\$3,861	2.9 %	\$5,938	2.1 %	\$17,411	6.3 %
Effective Tax Rate	16.2 %	nm	27.6 %	nm	16.0 %	nm	33.1 %	nm
Diluted Earnings Per Share	\$0.33	nm	\$0.34	nm	\$0.51	nm	\$1.55	nm

nm = not meaningful

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Net Revenues by End-Use Market and Operating Segment

Net revenues by end-use market and operating segment during the first fiscal three and six months of 2017 and 2016, respectively, were as follows:

	Three Months Ended				Six Months Ended					
	Change	(In thousands)		% of Net Revenues		Change	(In thousands)		% of Net Revenues	
		July 1 2017	July 2, 2016	July 1 2017	July 2, 2016		July 1 2017	July 2, 2016	July 1 2017	July 2, 2016
Consolidated										
Ducommun										
Military and space										
Defense electronics	\$14,199	\$54,547	\$40,348	38.7 %	30.2 %	\$19,774	\$103,469	\$83,695	37.3%	30.4%
Defense structures	3,380	14,986	11,606	10.6 %	8.7 %	4,115	29,507	25,392	10.6%	9.2%
Commercial aerospace	(7,669)	56,375	64,044	40.0 %	48.0 %	(14,033)	115,774	129,807	41.8%	47.1%
Industrial	(2,409)	15,030	17,439	10.7 %	13.1 %	(8,206)	28,485	36,691	10.3%	13.3%
Total	\$7,501	\$140,938	\$133,437	100.0%	100.0%	\$1,650	\$277,235	\$275,585	100.0%	100.0%
Structural Systems										
Military and space										
(defense structures)	\$3,380	\$14,986	\$11,606	25.4 %	19.1 %	\$4,115	\$29,507	\$25,392	25.3%	20.4%
Commercial aerospace	(4,962)	44,126	49,088	74.6 %	80.9 %	(12,139)	87,180	99,319	74.7%	79.6%
Total	\$(1,582)	\$59,112	\$60,694	100.0%	100.0%	\$(8,024)	\$116,687	\$124,711	100.0%	100.0%
Electronic Systems										
Military and space										
(defense electronics)	\$14,199	\$54,547	\$40,348	66.6 %	55.4 %	\$19,774	\$103,469	\$83,695	64.5%	55.5%
Commercial aerospace	(2,707)	12,249	14,956	15.0 %	20.6 %	(1,894)	28,594	30,488	17.8%	20.2%
Industrial	(2,409)	15,030	17,439	18.4 %	24.0 %	(8,206)	28,485	36,691	17.7%	24.3%
Total	\$9,083	\$81,826	\$72,743	100.0%	100.0%	\$9,674	\$160,548	\$150,874	100.0%	100.0%

Net revenues for the three months ended July 1, 2017 were \$140.9 million, compared to \$133.4 million for the three months ended July 2, 2016. The year-over-year increase was primarily due to the following:

- \$17.6 million higher revenues in our military and space end-use markets mainly due to increased demand, which favorably impacted our helicopter, fixed-wing, and missile platforms; partially offset by

- \$7.7 million lower revenues in our commercial aerospace end-use markets mainly due to the winding down of a regional jet program and continued softness in demand in the business jet market; and

- \$2.4 million lower revenues in our industrial end-use markets.

Net revenues for the six months ended July 1, 2017 were \$277.2 million, compared to \$275.6 million for the six months ended July 2, 2016. The year-over-year increase was primarily due to the following:

- \$23.9 million higher revenues in our military and space end-use markets mainly due to increased demand, which favorably impacted our helicopter and fixed-wing platforms, partially offset by the divestiture of our Miltec operation in March 2016. The net increase was partially offset by

- \$14.0 million lower revenues in our commercial aerospace end-use markets mainly due to the winding down of a regional jet program and continued softness in demand in the business jet market; and

\$8.2 million lower revenues in our industrial end-use markets mainly due to the divestiture of our Pittsburgh operation in January 2016.

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Net Revenues by Major Customers

A significant portion of our net revenues are from our top ten customers as follows:

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Boeing Company	16.5%	16.7%	16.3%	17.6%
Lockheed Martin Corporation	5.3 %	5.8 %	5.8 %	5.2 %
Raytheon Company	14.8%	6.1 %	14.0%	6.6 %
Spirit Aerosystems Holdings, Inc.	7.4 %	8.4 %	7.5 %	8.2 %
United Technologies Corporation	4.2 %	4.8 %	5.2 %	4.6 %
Total top ten customers ⁽¹⁾	62.2%	53.9%	62.0%	53.4%

Includes the Boeing Company (“Boeing”), Lockheed Martin Corporation (“Lockheed Martin”), Raytheon Company (1)(“Raytheon”), Spirit Aerosystems Holdings, Inc. (“Spirit”), and United Technologies Corporation (“United Technologies”).

Boeing, Lockheed Martin, Raytheon, Spirit, and United Technologies represented the following percentages of total accounts receivable:

	July 1, 2017		December 31, 2016	
Boeing	17.0%	7.8	%	
Lockheed Martin	4.1 %	2.9	%	
Raytheon	6.0 %	10.9	%	
Spirit	9.6 %	9.0	%	
United Technologies	3.9 %	7.8	%	

The net revenues and accounts receivable from Boeing, Lockheed Martin, Raytheon, Spirit, and United Technologies are diversified over a number of commercial, military and space programs and were generated by both operating segments.

Gross Profit

Gross profit consists of net revenues less cost of sales. Cost of sales includes the cost of production of finished products and other expenses related to inventory management, manufacturing quality, and order fulfillment. Gross profit margin as a percentage of net revenues decreased year-over-year in the three months ended July 1, 2017 to 18.6% compared to the three months ended July 2, 2016 of 19.6% primarily due to unfavorable product mix, partially offset by higher manufacturing volume.

Gross profit margin as a percentage of net revenues decreased year-over-year in the six months ended July 1, 2017 to 18.4% compared to the six months ended July 2, 2016 of 19.3% primarily due to unfavorable product mix, partially offset by higher manufacturing volume.

Selling, General and Administrative (“SG&A”) Expenses

SG&A expenses increased \$0.8 million year-over-year in the three months ended July 1, 2017 compared to the three months ended July 2, 2016 primarily due to higher compensation and benefit costs.

SG&A expenses decreased \$1.1 million year-over-year in the six months ended July 1, 2017 compared to the six months ended July 2, 2016 primarily due to a decrease of \$1.3 million related to the divestitures of our Pittsburgh and Miltec operations and closure of certain facilities, partially offset by higher compensation and benefit costs.

Interest Expense

Interest expense decreased year-over-year in the three months ended July 1, 2017 compared to the three months ended July 2, 2016 primarily due to a lower outstanding Term Loan balance as a result of voluntary principal prepayments on our credit facilities, partially offset by higher utilization of the Revolving Credit Facility in the current three month period.

Interest expense decreased year-over-year in the six months ended July 1, 2017 compared to the six months ended July 2, 2016 primarily due to a lower outstanding Term Loan balance as a result of voluntary principal prepayments

on our credit facilities, partially offset by higher utilization of the Revolving Credit Facility in the current six month period.

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Gain on Divestitures

There was no gain on divestitures during the three and six months ended July 1, 2017. The gain on divestitures for the three and six months ended July 2, 2016 consisted of the divestitures during the first quarter of 2016 of our Pittsburgh operation with a preliminary pretax gain of \$18.3 million and our Miltec operation with a preliminary pretax gain of \$0.5 million. (see Note 1 to our condensed consolidated financial statements included in Part I, Item 1 of this Form 10-Q).

Income Tax Expense

We recorded income tax expense of \$0.7 million (effective tax rate of 16.2%) for the three months ended July 1, 2017 compared to \$1.5 million (effective tax rate of 27.6%) for the three months ended July 2, 2016. FASB ASU 2016-09 “Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting” became effective beginning January 1, 2017 and required all of the tax effects related to share-based payments to be recorded through the income statement. This could result in fluctuations in our effective tax rate from period to period, depending on the number of awards exercised and/or vested in the quarter as well as the volatility of our stock price.

As such, the decrease in the effective tax rate for the three months ended July 1, 2017 compared to the three months ended July 2, 2016 was primarily due to tax benefits recognized from share-based payments. During the current year three month period, we recognized tax benefits from deductions of share-based payments in excess of compensation cost recognized for financial reporting purposes of \$0.3 million, which decreased the effective tax rate by 7.2%.

We recorded income tax expense of \$1.1 million (effective tax rate of 16.0%) for the six months ended July 1, 2017 compared to \$8.6 million (effective tax rate of 33.1%) for the six months ended July 2, 2016. The decrease in the effective tax rate for the six months ended July 1, 2017 compared to the six months ended July 2, 2016 was primarily due to the preliminary gain on divestitures of our Pittsburgh and Miltec operations of \$18.8 million, which resulted in a higher state tax liability, compared to the current six month period. In addition, during the current six month period, we recognized tax benefits from deductions of share-based payments in excess of compensation cost recognized for financial reporting purposes of \$0.6 million, which decreased the effective tax rate by 8.1%.

Our total amount of unrecognized tax benefits was \$3.4 million and \$3.0 million as of July 1, 2017 and December 31, 2016, respectively. If recognized, \$2.2 million would affect the effective tax rate. We do not reasonably expect significant increases or decreases to our unrecognized tax benefits in the next twelve months.

In 2016, the Internal Revenue Service (“IRS”) commenced an audit of our 2014 and 2015 tax years. Although the outcome of tax examinations cannot be predicted with certainty, we believe we have adequately accrued for tax deficiencies or reductions in tax benefits, if any, that could result from the examination and all open audit years.

Net Income and Earnings per Share

Net income and earnings per share for the three months ended July 1, 2017 were \$3.8 million, or \$0.33 per diluted share, compared to \$3.9 million, or \$0.34 per diluted share, for the three months ended July 2, 2016. The decrease in net income for the three months ended July 1, 2017 compared to the three months ended July 2, 2016 was primarily due to the following:

- \$0.8 million higher SG&A expense; partially offset by

- \$0.7 million of lower income tax expense.

Net income and earnings per share for the six months ended July 1, 2017 were \$5.9 million, or \$0.51 per diluted share, compared to \$17.4 million, or \$1.55 per diluted share, for the six months ended July 2, 2016. The decrease in net income for the six months ended July 1, 2017 compared to the six months ended July 2, 2016 was primarily due to the following:

- The prior year included a preliminary pretax gain on divestitures of our Pittsburgh and Miltec operations of \$18.8 million; partially offset by

- \$7.5 million lower income tax expense; and

- \$1.1 million lower SG&A expense.

Business Segment Performance

We report our financial performance based upon the two reportable operating segments: Structural Systems and Electronic Systems. The results of operations differ between our reportable operating segments due to differences in competitors, customers, extent of proprietary deliverables and performance. The following table summarizes our

business segment performance for the three and six months ended July 1, 2017 and July 2, 2016:

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	Three Months Ended					Six Months Ended				
	% Change	(In thousands)		% of Net Revenues		% Change	(In thousands)		% of Net Revenues	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016		July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016	
Net Revenues										
Structural Systems	(2.6)%	\$59,112	\$60,694	41.9%	45.5%	(6.4)%	\$116,687	\$124,711	42.1%	45.3%
Electronic Systems	12.5%	81,826	72,743	58.1%	54.5%	6.4%	160,548	150,874	57.9%	54.7%
Total Net Revenues Segment	5.6%	\$140,938	\$133,437	100.0%	100.0%	0.6%	\$277,235	\$275,585	100.0%	100.0%
Operating Income										
Structural Systems		\$2,049	\$4,730	3.5%	7.8%		\$4,681	\$7,454	4.0%	6.0%
Electronic Systems		8,820	6,782	10.8%	9.3%		15,924	13,169	9.9%	8.7%
Corporate General and Administrative Expenses ⁽¹⁾		10,869	11,512				20,605	20,623		
Total Operating Income		\$6,471	\$7,266	4.6%	5.4%		\$10,571	\$11,559	3.8%	4.2%
Adjusted EBITDA										
Structural Systems Operating Income		\$2,049	\$4,730				\$4,681	\$7,454		
Depreciation and Amortization		2,307	1,775				4,659	3,832		
Electronic Systems Operating Income		8,820	6,782				15,924	13,169		
Depreciation and Amortization		3,439	3,668				6,862	7,429		
Corporate General and Administrative Expenses ⁽¹⁾		12,259	10,450	15.0%	14.4%		22,786	20,598	14.2%	13.7%
Operating Loss		(4,398)	(4,246)				(10,034)	(9,064)		

Depreciation and Amortization	2	33			9	70				
Stock-Based Compensation Expense	1,342	985			3,164	1,985				
	(3,054)	(3,228)			(6,861)	(7,009)				
Adjusted EBITDA	\$13,561	\$13,727	9.6 %	10.3 %	\$25,265	\$24,875	9.1 %	9.0 %		
Capital Expenditures										
Structural Systems	\$7,580	\$4,540			\$12,768	\$6,594				
Electronic Systems	1,030	407			2,463	754				
Corporate Administration	648	—			648	—				
Total Capital Expenditures	\$9,258	\$4,947			\$15,879	\$7,348				

(1) Includes costs not allocated to either the Structural Systems or Electronic Systems operating segments.

Structural Systems

Structural Systems' net revenues in the three months ended July 1, 2017 compared to the three months ended July 2, 2016 decreased \$1.6 million primarily due to the following:

- \$5.0 million lower revenues in our commercial aerospace end-use markets mainly due to the winding down of a regional jet program and continued softness in demand in the business jet market; partially offset by
- \$3.4 million higher revenues in our military and space end-use markets mainly due to increased demand, which favorably impacted our helicopter platforms.

Structural Systems' net revenues in the six months ended July 1, 2017 compared to the six months ended July 2, 2016 decreased \$8.0 million primarily due to the following:

- \$12.1 million lower revenues in our commercial aerospace end-use markets mainly due to the winding down of a regional jet program and continued softness in demand in the business jet market; partially offset by
- \$4.1 million higher revenues in our military and space end-use markets mainly due to increased demand, which favorably impacted our helicopter platforms.

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The Structural Systems segment operating income in the three and six months ended July 1, 2017 compared to the three and six months ended July 2, 2016 decreased \$2.7 million and \$2.8 million, respectively, primarily due to lower manufacturing volume and the impact of new program development.

Electronic Systems

Electronic Systems' net revenues in the three months ended July 1, 2017 compared to the three months ended July 2, 2016 increased \$9.1 million primarily due to the following:

\$14.2 million higher revenues in our military and space end-use markets mainly due to increased demand, which favorably impacted our helicopter, fixed-wing, and missile platforms; partially offset by

\$2.7 million lower revenues in our commercial aerospace end-use markets mainly due to continued softness in demand in the business jet market; and

\$2.4 million lower revenues in our industrial end-use markets.

Electronic Systems' net revenues in the six months ended July 1, 2017 compared to the six months ended July 2, 2016 increased \$9.7 million primarily due to the following:

\$19.8 million higher revenues in our military and space end-use markets mainly due to increased demand, which favorably impacted our helicopter and fixed-wing platforms, partially offset by the divestiture of our Miltec operation in March 2016. The net increase was partially offset by

\$8.2 million lower revenues in our industrial end-use markets mainly due to the divestiture of our Pittsburgh operation in January 2016; and

\$1.9 million lower revenues in our commercial aerospace end-use markets mainly due to continued softness in demand in the business jet market.

Electronic Systems' segment operating income in the three and six months ended July 1, 2017 compared to the three and six months ended July 2, 2016 increased \$2.0 million and \$2.8 million, respectively, primarily due to higher manufacturing volume, partially offset by unfavorable product mix.

Corporate General and Administrative ("CG&A") Expenses

CG&A expenses increased \$0.2 million in the three months ended July 1, 2017 compared to the three months ended July 2, 2016. The increase in CG&A expenses was primarily due to higher compensation and benefit costs.

CG&A expenses increased \$1.0 million in the six months ended July 1, 2017 compared to the six months ended July 2, 2016 primarily due to higher compensation and benefit costs of \$1.2 million partially offset by lower professional services fees.

Backlog

Backlog is subject to delivery delays or program cancellations, which are beyond our control. Backlog is affected by timing differences in the placement of customer orders and tends to be concentrated in several programs to a greater extent than our net revenues. Backlog in industrial markets tends to be of a shorter duration and is generally fulfilled within a 3-month period. As a result of these factors, trends in our overall level of backlog may not be indicative of trends in our future net revenues. \$426.0 million of total backlog is expected to be delivered over the next 12 months. The following table summarizes our backlog as of July 1, 2017 and December 31, 2016:

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	(In thousands)		
	Change	July 1, 2017	December 31, 2016
Consolidated Ducommun			
Military and space			
Defense electronics	\$(6,488)	\$191,088	\$197,576
Defense structures	(7,735)	51,143	58,878
Commercial aerospace	20,334	337,005	316,671
Industrial	4,201	31,331	27,130
Total	\$10,312	\$610,567	\$600,255
Structural Systems			
Military and space (defense structures)	\$(7,735)	\$51,143	\$58,878
Commercial aerospace	17,481	296,002	278,521
Total	\$9,746	\$347,145	\$337,399
Electronic Systems			
Military and space (defense electronics)	\$(6,488)	\$191,088	\$197,576
Commercial aerospace	2,853	41,003	38,150
Industrial	4,201	31,331	27,130
Total	\$566	\$263,422	\$262,856

Liquidity and Capital Resources

Available Liquidity

Total debt, the weighted-average interest rate, cash and cash equivalents and available credit facilities were as follows:

	(In millions)			
	July 1, 2017		December 31, 2016	
Total debt, including long-term portion	\$172.2		\$170.0	
Weighted-average interest rate on debt	3.12	%	3.25	%
Term Loan interest rate	3.15	%	3.31	%
Cash and cash equivalents	\$7.4		\$7.4	
Unused Revolving Credit Facility	\$186.8		\$199.0	

Our credit facility consists of a \$275.0 million senior secured term loan, which matures on June 26, 2020 (“Term Loan”), and a \$200.0 million senior secured revolving credit facility (“Revolving Credit Facility”), which matures on June 26, 2020 (collectively, the “Credit Facilities”). We are required to make mandatory prepayments of amounts outstanding under the Term Loan. As of July 1, 2017, we were in compliance with all covenants required under the Credit Facilities. See Note 8 to our condensed consolidated financial statements included in Part I, Item 1 of this Form 10-Q for further information. Subsequent to our quarter ended July 1, 2017, we entered into a technical amendment to the Credit Facilities on July 14, 2017 (“First Amendment”) which provides more flexibility to close certain qualified acquisitions permitted under the Credit Facilities.

In October 2015, we entered into interest rate cap hedges designated as cash flow hedges with maturity dates of June 2020, and in aggregate, totaling \$135.0 million of our debt. We paid a total of \$1.0 million in connection with entering into the interest rate cap hedges.

We expect to spend a total of \$22.0 million to \$26.0 million for capital expenditures in 2017 financed by cash generated from operations, principally to support the expansion of our Parsons, Kansas facility and new contract awards at Structural Systems and Electronic Systems. As part of our strategic plan to become a Tier 2 supplier and win new contract awards, additional up-front investment in tooling will be required for newer programs which have higher engineering content and higher levels of complexity in assemblies.

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We believe the ongoing aerospace and defense subcontractor consolidation makes acquisitions an increasingly important component of our future growth. We will continue to make prudent acquisitions and capital expenditures for manufacturing equipment and facilities to support long-term contracts for commercial and military aircraft and defense programs.

We continue to depend on operating cash flow and the availability of our Credit Facility to provide short-term liquidity. Cash generated from operations and bank borrowing capacity is expected to provide sufficient liquidity to meet our obligations during the next twelve months.

Cash Flow Summary

Net cash provided by operating activities for the six months ended July 1, 2017 increased to \$16.2 million, compared to \$12.1 million in the six months ended July 2, 2016. The higher net cash generated during the first six months of 2017 was primarily due to higher accounts payable mainly due to timing of payments.

Net cash used in investing activities of \$16.2 million for the six months ended July 1, 2017 compared to net cash provided by of \$47.7 million in the six months ended July 2, 2016 primarily due to the prior year six month period included proceeds from the divestiture of our Pittsburgh and Miltec operations of approximately \$55.3 million and purchases of property and equipment mainly to support the expansion of our Parsons, Kansas facility.

Net cash used in financing activities for the six months ended July 1, 2017 of \$0.1 million was primarily due to net cash paid related to the issuance of common stock under stock plans partially offset by net borrowings on our credit facilities.

Off-Balance Sheet Arrangements

Our off-balance sheet arrangements consist of operating leases and indemnities.

Critical Accounting Policies

The preparation of our condensed consolidated financial statements in accordance with accounting principles generally accepted in the United States requires estimation and judgment that affect the reported amounts of net revenues, expenses, assets and liabilities. For a description of our critical accounting policies, please refer to “Critical Accounting Policies” in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations” of our 2016 Annual Report on Form 10-K. There have been no material changes in any of our critical accounting policies during the three and six months ended July 1, 2017.

Recent Accounting Pronouncements

See “Part I, Item 1. Ducommun Incorporated and Subsidiaries—Notes to Condensed Consolidated Financial Statements—Note 1. Summary of Significant Accounting Policies—Recent Accounting Pronouncements” for further information.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our main market risk exposure relates to changes in U.S. and U.K. interest rates on our outstanding long-term debt. At July 1, 2017, we had total borrowings of \$172.2 million under our Term Loan and Revolving Credit Facility that bear interest, at our option, at a rate equal to either (i) the Eurodollar Rate (defined as LIBOR) plus an applicable margin ranging from 1.50% to 2.75% per year or (ii) the Base Rate (defined as the highest of [a] Federal Funds Rate plus 0.50%, [b] Bank of America’s prime rate, and [c] the Eurodollar Rate plus 1.00%) plus an applicable margin ranging from 0.50% to 1.75% per year, in each case based upon the consolidated total net adjusted leverage ratio. A hypothetical 10% increase or decrease in the interest rate would have an immaterial impact on our financial condition and results of operations.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

The Company’s chief executive officer (“CEO”) and chief financial officer (“CFO”) have conducted 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(e)) as of July 1, 2017. The Company had previously reported a material weakness in internal control over

financial reporting related to not maintaining effective controls related to the quarterly and annual accounting and disclosures for income taxes. This material weakness was described in Item 9A in the Management's Report on Internal Control Over Financial Reporting in the Company's Annual Report on Form 10-K for the year ended December 31, 2016. As a result of the material weakness in the Company's internal control over financial reporting, which was not remediated as of July 1, 2017, the CEO and CFO concluded the Company's disclosure controls and procedures were not effective as of July 1, 2017.

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Management's Remediation Activities

We are committed to remediating the control deficiencies that constitute the material weakness described above. Our Chief Financial Officer is responsible for remediating the control deficiency that gave rise to the material weakness. Actions to be taken or in process consist of ensuring we maintain a sustained period of operating effectiveness of our internal control over financial reporting related to the quarterly and annual accounting and disclosures for income taxes.

While significant progress has been made to enhance our internal control over financial reporting relating to the material weakness, additional time will be required to assess and ensure the sustainability of these processes and procedures. We expect the remedial actions described above will have had sufficient time to function during 2017 to allow management to conclude that the material weakness has been satisfactorily remediated and that the existing controls are operating effectively. However, we cannot make any assurances that such actions will be completed during 2017. Until the controls described above have had sufficient time for management to conclude that they are operating effectively, the material weakness described above will continue to exist.

Changes in Internal Control over Financial Reporting

There were no changes in our internal controls over financial reporting during the three months ended July 1, 2017 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

See Note 13 to our condensed consolidated financial statements included in Part I, Item 1 of this Form 10-Q for a description of our legal proceedings.

Item 1A. Risk Factors

See Part I, Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2016 for a discussion of our risk factors. There have been no material changes in the six months ended July 1, 2017 to the risk factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2016.

Item 4. Mine Safety Disclosures

Not applicable.

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Item 6. Exhibits

- 2.1 Agreement and Plan of Merger, dated as of April 3, 2011, among Ducommun Incorporated, DLBMS, Inc. and LaBarge, Inc. Incorporated by reference to Exhibit 2.1 to Form 8-K filed on April 5, 2011.
Stock Purchase Agreement dated January 22, 2016, by and among Ducommun Incorporated, Ducommun LaBarge Technologies, Inc., as Seller, LaBarge Electronics, Inc., and Intervala, LLC, as Buyer. Incorporated by reference to Exhibit 2.1 to Form 8-K dated January 25, 2016.
Stock Purchase Agreement dated February 24, 2016, by and between Ducommun LaBarge Technologies, Inc., as Seller, and General Atomics, as Buyer. Incorporated by reference to Exhibit 2.1 to Form 8-K dated February 24, 2016.
- 3.1 Restated Certificate of Incorporation filed with the Delaware Secretary of State on May 29, 1990. Incorporated by reference to Exhibit 3.1 to Form 10-K for the year ended December 31, 1990.
- 3.2 Certificate of Amendment of Certificate of Incorporation filed with the Delaware Secretary of State on May 27, 1998. Incorporated by reference to Exhibit 3.2 to Form 10-K for the year ended December 31, 1998.
- 3.3 Bylaws as amended and restated on March 19, 2013. Incorporated by reference to Exhibit 99.1 to Form 8-K dated March 22, 2013.
- 3.4 Amendment to Bylaws dated January 5, 2017. Incorporated by reference to Exhibit 99.2 to Form 8-K dated January 9, 2017.
Credit Agreement, dated as of June 29, 2015, among Ducommun Incorporated, certain of its subsidiaries, Bank of America, N.A., as administrative agent, swingline lender and issuing bank, and other lenders party thereto. Incorporated by reference to Exhibit 10.1 to Form 8-K dated June 29, 2015.
First Amendment to Credit Agreement, dated as of July 14, 2017, among Ducommun Incorporated, certain of its subsidiaries, Bank of America, N.A., as administrative agent, swingline lender and issuing bank, and other lenders party thereto.
- *10.3 2007 Stock Incentive Plan. Incorporated by reference to Appendix B of Definitive Proxy Statement on Schedule 14a, filed on March 29, 2010.
- *10.4 2013 Stock Incentive Plan (Amended and Restated March 18, 2015). Incorporated by reference to Appendix B of Definitive Proxy Statement on Schedule 14a, filed on April 22, 2015.
- *10.5 Form of Stock Option Agreement for 2016 and earlier. Incorporated by reference to Exhibit 10.8 to Form 10-K for the year ended December 31, 2003.
- *10.6 Form of Stock Option Agreement for 2017 and after. Incorporated by reference to Exhibit 10.5 to Form 10-K for the year ended December 31, 2016.
- *10.7 Form of Performance Stock Unit Agreement for 2014 and 2015. Incorporated by reference to Exhibit 10.19 to Form 8-K dated April 28, 2014.
- *10.8 Form of Performance Stock Unit Agreement for 2016. Incorporated by reference to Exhibit 10.6 to Form 10-Q for the period ended April 2, 2016.
- *10.9 Form of Restricted Stock Unit Agreement for 2016 and earlier. Incorporated by reference to Exhibit 99.1 to Form 8-K dated May 10, 2010.
- *10.10 Form of Restricted Stock Unit Agreement for 2017 and after. Incorporated by reference to Exhibit 10.9 to Form 10-K for the year ended December 31, 2016.
- *10.11 Form of Directors' Restricted Stock Unit Agreement. Incorporated by reference to Exhibit 99.1 to Form 8-K dated May 10, 2010.
Performance Restricted Stock Unit Agreement dated January 23, 2017 between Ducommun Incorporated and Stephen G. Oswald. Incorporated by reference to Exhibit 10.11 to Form 10-K for the year ended December 31, 2016.

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Form of Indemnity Agreement entered with all directors and officers of Ducommun. Incorporated by reference *10.13 to Exhibit 10.8 to Form 10-K for the year ended December 31, 1990. All of the Indemnity Agreements are identical except for the name of the director or officer and the date of the Agreement:

Director/Officer	Date of Agreement
Richard A. Baldrige	March 19, 2013
Gregory S. Churchill	March 19, 2013
Robert C. Ducommun	December 31, 1985
Dean M. Flatt	November 5, 2009
Douglas L. Groves	February 12, 2013
Jay L. Haberland	February 2, 2009
Stephen G. Oswald	January 23, 2017
Amy M. Paul	January 23, 2017
Robert D. Paulson	March 25, 2003
Anthony J. Reardon	January 8, 2008
Jerry L. Redondo	October 1, 2015
Rosalie F. Rogers	July 24, 2008
Christopher D. Wampler	January 1, 2016

*10.14 Ducommun Incorporated 2016 Bonus Plan. Incorporated by reference to Exhibit 99.3 to Form 8-K dated March 1, 2016.

*10.15 Ducommun Incorporated 2017 Bonus Plan. Incorporated by reference to Exhibit 99.1 to Form 8-K dated February 27, 2017.

*10.16 Directors' Deferred Compensation and Retirement Plan, as amended and restated February 2, 2010. Incorporated by reference to Exhibit 10.15 to Form 10-K for the year ended December 31, 2009.

*10.17 Key Executive Severance Agreement between Ducommun Incorporated and Stephen G. Oswald dated January 23, 2017. Incorporated by reference to Exhibit 99.1 to Form 8-K dated January 27, 2017.

*10.18 Form of Key Executive Severance Agreement between Ducommun Incorporated and each of the individuals listed below. Incorporated by reference to Exhibit 99.2 to Form 8-K dated January 27, 2017. All of the Key Executive Severance Agreements are identical except for the name of the person and the address for notice:

Person	Date of Agreement
Douglas L. Groves	January 23, 2017
Amy M. Paul	January 23, 2017
Anthony J. Reardon	January 23, 2017
Jerry L. Redondo	January 23, 2017
Rosalie F. Rogers	January 23, 2017
Christopher D. Wampler	January 23, 2017

*10.19

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- Employment Letter Agreement dated January 3, 2017 between Ducommun Incorporated and Stephen G. Oswald. Incorporated by reference to Exhibit 99.1 to Form 8-K dated January 9, 2017.
- *10.20 Employment Letter Agreement dated December 19, 2016 between Ducommun Incorporated and Amy M. Paul. Incorporated by reference to Exhibit 10.19 to Form 10-K for the year ended December 31, 2016.
- *10.21 Transition Services Letter Agreement dated January 10, 2017 between Ducommun Incorporated and James S. Heiser. Incorporated by reference to Exhibit 99.1 to Form 8-K dated January 16, 2017.
- *10.22 Form of Performance Stock Unit Agreement for 2017. Incorporated by reference to Exhibit 10.21 to Form 10-Q for the period ended April 1, 2017.

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31.1 Certification of Principal Executive Officer.

31.2 Certification of Principal Financial Officer.

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

101.INS XBRL Instance Document

101.SCH XBRL Taxonomy Extension Schema

101.CAL XBRL Taxonomy Extension Calculation Linkbase

101.DEF XBRL Taxonomy Extension Definition Linkbase

101.LAB XBRL Taxonomy Extension Label Linkbase

101.PRE XBRL Taxonomy Extension Presentation Linkbase

* Indicates an executive compensation plan or arrangement.

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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.

Date: August 3, 2017 By: /s/ Stephen G. Oswald
Stephen G. Oswald
President and Chief Executive Officer
(Principal Executive Officer)

Date: August 3, 2017 By: /s/ Douglas L. Groves
Douglas L. Groves
Vice President, Chief Financial Officer and Treasurer
(Principal Financial Officer)

Date: August 3, 2017 By: /s/ Christopher D. Wampler
Christopher D. Wampler
Vice President, Controller and Chief Accounting Officer
(Principal Accounting Officer)