

DUCOMMUN INC /DE/
Form 10-Q
November 03, 2016
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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
^x 1934

For the quarterly period ended October 1, 2016

OR

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

For the transition period from _____ to _____
Commission File Number 1-8174

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

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

23301 Wilmington Avenue, Carson, California	90745-6209
(Address of principal executive offices)	(Zip code)

Registrant's telephone number, including area code: (310) 513-7200

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

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

As of October 25, 2016, the registrant had 11,173,659 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)

	October 1, 2016	December 31, 2015
Assets		
Current Assets		
Cash and cash equivalents	\$9,466	\$ 5,454
Accounts receivable, net of allowance for doubtful accounts of \$358 and \$359 at October 1, 2016 and December 31, 2015, respectively	73,820	77,089
Inventories	129,769	115,404
Production cost of contracts	11,095	10,290
Other current assets	8,658	13,389
Assets held for sale	—	41,636
Total Current Assets	232,808	263,262
Property and equipment, net of accumulated depreciation of \$138,333 and \$128,533 at October 1, 2016 and December 31, 2015, respectively	98,586	96,551
Goodwill	82,554	82,554
Intangibles, net	103,835	110,621
Non-current deferred income taxes	212	324
Other assets	2,987	3,769
Total Assets	\$520,982	\$ 557,081
Liabilities and Shareholders' Equity		
Current Liabilities		
Current portion of long-term debt	\$5	\$ 26
Accounts payable	60,173	40,343
Accrued liabilities	30,510	36,458
Liabilities held for sale	—	6,780
Total Current Liabilities	90,688	83,607
Long-term debt, less current portion	176,618	240,661
Non-current deferred income taxes	25,871	26,528
Other long-term liabilities	16,763	18,954
Total Liabilities	309,940	369,750
Commitments and contingencies (Notes 11, 13)		
Shareholders' Equity		
Common stock - \$0.01 par value; 35,000,000 shares authorized; 11,173,659 and 11,084,318 issued at October 1, 2016 and December 31, 2015, respectively	112	111
Additional paid-in capital	76,681	75,200
Retained earnings	140,048	117,623
Accumulated other comprehensive loss	(5,799)	(5,603)
Total Shareholders' Equity	211,042	187,331
Total Liabilities and Shareholders' Equity	\$520,982	\$ 557,081
See accompanying notes to Condensed Consolidated Financial Statements.		

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

	Three Months Ended		Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Net Revenues	\$ 132,571	\$ 161,670	\$ 408,156	\$ 509,435
Cost of Sales	107,348	141,642	329,749	431,439
Gross Profit	25,223	20,028	78,407	77,996
Selling, General and Administrative Expenses	17,171	21,205	58,796	64,707
Operating Income (Loss)	8,052	(1,177)	19,611	13,289
Interest Expense	(1,945)	(3,392)	(6,279)	(16,499)
Loss on Extinguishment of Debt	—	(11,878)	—	(14,720)
Other Income	141	—	141	1,510
Gain on Divestitures	—	—	18,815	—
Income (Loss) Before Taxes	6,248	(16,447)	32,288	(16,420)
Income Tax Expense (Benefit)	1,234	(6,932)	9,863	(6,714)
Net Income (Loss)	\$ 5,014	\$ (9,515)	\$ 22,425	\$ (9,706)
Earnings (Loss) Per Share				
Basic earnings (loss) per share	\$ 0.45	\$ (0.86)	\$ 2.01	\$ (0.88)
Diluted earnings (loss) per share	\$ 0.44	\$ (0.86)	\$ 1.99	\$ (0.88)
Weighted-Average Number of Common Shares Outstanding				
Basic	11,169	11,083	11,141	11,035
Diluted	11,310	11,083	11,261	11,035

See accompanying notes to Condensed Consolidated Financial Statements.

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

	Three Months Ended		Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Net Income (Loss)	\$5,014	\$(9,515)	\$22,425	\$(9,706)
Other Comprehensive Income (Loss)				
Amortization of actuarial losses and prior service costs, net of tax of \$71 and \$83 for the three months ended October 1, 2016 and October 3, 2015, respectively, and \$212 and \$248 for the nine months ended October 1, 2016 and October 3, 2015, respectively	120	139	360	417
Change in unrealized gains and losses on cash flow hedges, net of tax of zero for both the three months ended October 1, 2016 and October 3, 2015, and \$326 and zero for the nine months ended October 1, 2016 and October 3, 2015, respectively	—	—	(556)	—
Other Comprehensive Income (Loss)	120	139	(196)	417
Comprehensive Income (Loss)	\$5,134	\$(9,376)	\$22,229	\$(9,289)
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)

	Nine Months Ended	
	October 1, 2016	October 3, 2015
Cash Flows from Operating Activities		
Net Income (Loss)	\$22,425	\$ (9,706)
Adjustments to Reconcile Net Income (Loss) to		
Net Cash Provided by Operating Activities:		
Depreciation and amortization	17,420	20,064
Gain on divestitures	(18,815)	—
Stock-based compensation expense	2,579	2,792
Deferred income taxes	(1,602)	1,599
Excess tax benefits from stock-based compensation	(57)	(516)
Recovery of doubtful accounts	(26)	(11)
Noncash loss on extinguishment of debt	—	4,970
Other	(4,923)	7,180
Changes in Assets and Liabilities:		
Accounts receivable	5,777	4,836
Inventories	(15,055)	5,525
Production cost of contracts	(1,437)	(560)
Other assets	7,095	1,614
Accounts payable	19,586	(7,626)
Accrued and other liabilities	(5,453)	(18,076)
Net Cash Provided by Operating Activities	27,514	12,085
Cash Flows from Investing Activities		
Purchases of property and equipment	(12,712)	(11,803)
Proceeds from sale of assets	—	289
Insurance recoveries related to property and equipment	—	1,510
Proceeds from divestitures	55,272	—
Net Cash Provided by (Used in) Investing Activities	42,560	(10,004)
Cash Flows from Financing Activities		
Borrowings from senior secured revolving credit facility	29,700	65,000
Repayments of senior secured revolving credit facility	(29,700)	(65,000)
Borrowings from term loans	—	275,000
Repayments of senior unsecured notes and term loans	(65,000)	(305,000)
Repayments of other debt	(22)	(17)
Debt issuance costs	—	(4,848)
Excess tax benefits from stock-based compensation	57	516
Net proceeds from issuance of common stock under stock plans	(1,097)	(1,118)
Net Cash Used in Financing Activities	(66,062)	(35,467)
Net Increase (Decrease) in Cash and Cash Equivalents	4,012	(33,386)
Cash and Cash Equivalents at Beginning of Period	5,454	45,627
Cash and Cash Equivalents at End of Period	\$9,466	\$ 12,241
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. All 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, 2015 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, 2015. 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, 2015. 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 nine months ended October 1, 2016 are not necessarily indicative of the results to be expected for the full year ending December 31, 2016.

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 required 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)
 Nine Months
 Ended
 October 1, 2016
 October 3, 2015

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Interest paid	\$5,283	\$ 24,066
Taxes paid	5,539	1,150
Non-cash activities:		
Purchases of property and equipment not paid	687	957

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Earnings (Loss) Per Share

Basic earnings (loss) per share are computed by dividing income (loss) 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 (loss), weighted-average number of common shares outstanding used to compute earnings (loss) per share, were as follows:

	(In thousands, except per share data) Three Months Ended		(In thousands, except per share data) Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Net income (loss)	\$5,014	\$ (9,515)	\$22,425	\$ (9,706)
Weighted-average number of common shares outstanding				
Basic weighted-average common shares outstanding	11,169	11,083	11,141	11,035
Dilutive potential common shares	141	—	120	—
Diluted weighted-average common shares outstanding	11,310	11,083	11,261	11,035
Earnings (loss) per share				
Basic	\$0.45	\$ (0.86)	\$2.01	\$ (0.88)
Diluted	\$0.44	\$ (0.86)	\$1.99	\$ (0.88)

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)		(In thousands)	
	Three Months Ended	October 1, 2016	Nine Months Ended	October 3, 2015
Stock options and stock units	515	885	617	902

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.

Cash and Cash Equivalents

Cash equivalents consist of highly liquid instruments purchased with original maturities of three months or less. Our cash accounts are not reduced for checks written until the checks are presented for payment and paid by our bank. 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 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 October 1, 2016, 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 on the 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.

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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 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 market 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. Market value for raw materials is based on replacement cost and for other inventory classifications it is 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.

Assets Held For Sale

In the fourth quarter of 2015, we made the decision to sell our Huntsville, Alabama and Iuka, Mississippi (collectively, "Miltec") operations and our Pittsburgh, Pennsylvania operation, both of which were part of our Electronic Systems operating segment, and as a result, we met the criteria for assets held for sale. However, the proposed sale of these two operations did not represent a strategic shift in our business and thus, were included in the ongoing operating results in the consolidated statements of operations for all periods presented.

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 final sales price of \$38.5 million in cash. We divested this facility as part of our overall strategy to streamline operations, which includes consolidating our footprint. 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 gain on divestiture of \$18.3 million.

In February 2016, we entered into an agreement to sell our Miltec operation 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 includes consolidating our footprint. 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 gain on divestiture of \$0.5 million.

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The carrying values of the major classes of assets and liabilities related to these assets held for sale were as follows:

	(In thousands)
	October 1, 2016
	December 31, 2015
Assets	
Accounts receivable (less allowance for doubtful accounts of zero and \$24 at October 1, 2016 and December 31, 2015, respectively)	\$-\$ 9,395
Inventory	—6,453
Deferred income taxes	—1,246
Other current assets	—3,315
Total current assets	—20,409
Property and equipment, net of accumulated depreciation of zero and \$8,509 at October 1, 2016 and December 31, 2015, respectively	—1,941
Goodwill	—17,772
Other intangible assets	—1,514
	\$-\$ 41,636
Liabilities	
Accounts payable	\$-\$ 4,836
Accrued liabilities	—1,944
	\$-\$ 6,780

Accumulated Other Comprehensive Loss

Accumulated other comprehensive loss, as reflected in the condensed consolidated balance sheets under the equity section, was comprised of cumulative pension and retirement liability adjustments and changes in the fair value, net of tax, of a derivative instrument that is highly effective and that is designated and qualifies as a cash flow hedge.

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.

Recent Accounting Pronouncements**New Accounting Guidance Adopted in 2016**

In August 2015, the FASB issued ASU 2015-15, “Imputation of Interest (Subtopic 835-30)” (“ASU 2015-15”), which provides guidance on the presentation and subsequent measurement of debt issuance costs associated with line-of-credit arrangements. Other guidance does not address presentation or subsequent measurement of debt issuance costs related to line-of-credit arrangements. Thus, the SEC staff would not object to an entity deferring and presenting debt issuance costs as an asset and subsequently amortizing the deferred debt issuance costs ratably over the term of the line-of-credit arrangement, regardless of whether there are any outstanding borrowings on the line-of-credit arrangement. The new guidance was effective for us beginning January 1, 2016. We did not have debt issuance costs associated with line-of-credit arrangements and thus, the adoption of this new guidance did not have a significant impact on our condensed consolidated financial statements.

In June 2015, the FASB issued ASU 2015-10, “Technical Corrections and Improvements” (“ASU 2015-10”), which covers a wide range of Topics in the Codification. The amendments in ASU 2015-10 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 on most entities. The amendments in this new guidance that require transition guidance were effective for us beginning January 1, 2016. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

In April 2015, the FASB issued ASU 2015-05, "Intangibles - Goodwill and Other - Internal-Use Software (Subtopic 350-40):

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Customer's Accounting for Fees Paid in a Cloud Computing Arrangement" ("ASU 2015-05"), which provides guidance on fees paid by a customer in a cloud computing arrangement. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the arrangement as a service contract. The new guidance was effective for us beginning January 1, 2016. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

In April 2015, the FASB issued ASU 2015-03, "Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs" ("ASU 2015-03"), which changes the presentation of debt issuance costs in financial statements. Under ASU 2015-03, an entity presents such costs in the balance sheet as a direct deduction from the related debt liability rather than as an asset. Amortization of those costs is reported as interest expense. The new guidance was effective for us beginning January 1, 2016. As a result of the adoption of this new guidance, we reclassified \$3.4 million of debt issuance costs against \$180.0 million of total debt as of October 1, 2016.

In January 2015, the FASB issued ASU 2015-01, "Income Statement - Extraordinary and Unusual Items (Subtopic 225-20)" ("ASU 2015-01"), which eliminates from U.S. GAAP the concept of extraordinary items. Current guidance requires separate classification, presentation, and disclosure of extraordinary events and transactions. In addition, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. The new guidance was effective for us beginning January 1, 2016. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

In June 2014, the FASB issued ASU 2014-12, "Compensation - Stock Compensation (Topic 718): Accounting for Share-Based Payments When the Terms of an Award Provide that a Performance Target Could be Achieved after the Requisite Service Period" ("ASU 2014-12"), which requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. Thus, the performance target should not be reflected in estimating the grant date fair value of the award. This update further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. The new guidance was effective for us beginning January 1, 2016. The adoption of this standard did not have a significant impact on our condensed consolidated financial statements.

Recently Issued Accounting Standards

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

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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 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 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years, which will be our interim period beginning January 1, 2017. Early adoption is permitted in any interim or annual reporting period. We are evaluating the impact of this standard and currently do not anticipate it will have a significant 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 counterparty 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 is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years, which will be our interim period beginning January 1, 2017. Early adoption is permitted as of the beginning of an interim period on a modified retrospective basis. We are evaluating the impact of this standard and currently do not anticipate it will have a significant impact on our condensed consolidated financial statements.

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 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 and net realizable value. Subsequent measurement is unchanged for inventory measured using last-in, first-out (“LIFO”) or the retail inventory value. The new guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years, which will be our interim period beginning January 1, 2017. Early adoption is permitted as of the beginning of an interim or annual reporting period. We are evaluating the impact of this standard, but currently do not anticipate it will have a significant impact on our condensed consolidated financial statements.

In August 2014, the FASB issued ASU 2014-15, “Presentation of Financial Statements - Going Concern (Subtopic 205-40): Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern” (“ASU 2014-15”), which defines management’s responsibility to evaluate whether there is substantial doubt about a company’s ability to continue as a going concern. ASU 2014-15 also provide principles and definitions that are intended to reduce diversity in the timing and content of disclosures in the financial statement footnotes. The new guidance is effective for annual periods ending after December 15, 2016, which will be our year ending December 31, 2016, and interim periods beginning after December 15, 2016, which will be our interim period beginning January 1, 2017. Early adoption is permitted. We are evaluating the impact of this standard and currently do not anticipate it will have a significant impact on 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 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 defer 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 will provide us

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additional time to evaluate the method and impact that ASU 2014-09 will have on our condensed consolidated financial statements. We are evaluating the impact of this standard, and with the percentage of completion, unit of delivery method of recognizing revenue being eliminated under ASU 2014-09, we currently anticipate our revenue, cost of sales, and related items on our condensed consolidated financial statements will be impacted.

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 October 1, 2016, we have accrued \$0.1 million for severance and benefits and early exit from lease in the Electronic Systems segment and \$0.6 million for severance and benefits and loss on early exit from lease in the Structural Systems segment, all of which were 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 is 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 October 1, 2016, we have accrued \$0.1 million for loss on early exit from lease in the Electronic Systems segment, all of which were charged to selling, general and administrative expenses.

Our restructuring activities in the nine months ended October 1, 2016 were as follows (in thousands):

	December 31, 2015	Nine Months Ended October 1, 2016			October 1, 2016
	Balance	Cash Charges	Cash Payments	Change in Estimates	Balance
Severance and benefits	\$ 722	\$49	\$ (766)	\$	—\$ 5
Lease termination	1,181	133	(574)	—	740
Ending balance	\$ 1,903	\$182	\$ (1,340)	\$	—\$ 745

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:

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):

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	As of October 1, 2016				As of December 31, 2015			
	Fair Value				Fair Value			
	Measurements				Measurements			
	Using				Using			
	Level 1	Level 2	Level 3	Total Balance	Level 1	Level 2	Level 3	Total Balance
Assets								
Money market funds ⁽¹⁾	\$6,455	\$—	\$—	—\$ 6,455	\$4,587	\$—	\$—	—\$ 4,587
Interest rate cap hedges ⁽²⁾	—	151	—	151	—	963	—	963
Total Assets	\$6,455	\$151	\$—	—\$ 6,606	\$4,587	\$963	\$—	—\$ 5,550

(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 October 1, 2016.

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 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 October 1, 2016, the interest rate cap hedges continued to be highly effective and less than \$0.1 million, net of tax, was recognized in other comprehensive income. No amount was recorded in the condensed consolidated statements of operations during the three months ended October 1, 2016. See Note 8.

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

	(In thousands) October 1, 2016	(In thousands) December 31, 2015
Other Current Assets	151	962
Other Long Term Assets	—	—

Derivatives Designated as Hedging Instruments

Cash Flow Hedges:

Interest rate cap premiums	\$ — 151	\$ 1 962
Total Derivatives	\$ — 151	\$ 1 962

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Note 5. Inventories

Inventories consisted of the following:

	(In thousands)	
	October 1, 2016	December 31, 2015
Raw materials and supplies	\$68,688	\$ 61,840
Work in process	61,641	49,299
Finished goods	7,783	10,073
	138,112	121,212
Less progress payments	8,343	5,808
Total	\$129,769	\$ 115,404

We net advances from customers related to inventory purchases against inventories in the consolidated balance sheets.

Note 6. Goodwill

Gross goodwill and accumulated goodwill impairment were \$164.3 million and \$81.7 million, respectively, both as of October 1, 2016 and December 31, 2015. The goodwill 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 had 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 October 1, 2016. However, 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)	
	October 1, 2016	December 31, 2015
Accrued compensation	\$17,568	\$ 13,521
Accrued income tax and sales tax	1,096	1,513
Customer deposits	2,512	1,758
Interest payable	209	58
Provision for forward loss reserves	6,258	11,925
Other	2,867	7,683
Total	\$30,510	\$ 36,458

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Note 8. Long-Term Debt

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

	(In thousands)	
	October 1, 2016	December 31, 2015
New term loan	\$180,000	\$245,000
New revolving credit facility	—	—
Other debt (fixed 5.41%)	5	26
Total debt	180,005	245,026
Less current portion	5	26
Total long-term debt	180,000	245,000
Less debt issuance costs	3,382	4,339
Total long-term debt, net of debt issuance costs	\$176,618	\$240,661
Weighted-average interest rate	3.35	% 3.07 %

In June 2015, we completed a new credit facility to replace the Existing Credit Facilities. The new credit facility consisted of a \$275.0 million senior secured term loan, which matures on June 26, 2020 (“New Term Loan”), and a \$200.0 million senior secured revolving credit facility (“New Revolving Credit Facility”), which matures on June 26, 2020 (collectively, the “New Credit Facilities”). The New 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 New 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 New 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 New Revolving Credit Facility are due on June 26, 2020. As of October 1, 2016, we were in compliance with all covenants required under the New Credit Facilities.

We have been making voluntary principal prepayments on a quarterly basis on our senior secured term loan and in conjunction with the closing of the New Credit Facilities in second quarter 2015, we drew down \$65.0 million on the New Revolving Credit Facility and used those proceeds along with current cash on hand to extinguish the existing senior secured term loan of \$80.0 million. We expensed the unamortized debt issuance costs related to the existing senior secured term loan of \$2.8 million as part of extinguishing the existing senior secured term loan in second quarter 2015. We also incurred \$4.8 million of debt issuance costs related to the New Credit Facilities and those costs were capitalized and are being amortized over the five year life of the New Credit Facilities.

In addition, we retired all of the \$200.0 million senior unsecured notes (“Existing Notes”) in July 2015. We drew down on the New Term Loan in the amount of \$275.0 million. Along with the call notice amount and paying the call premium of \$9.8 million, we also paid down the \$65.0 million outstanding on the New Revolving Credit Facility. We expensed the call premium of \$9.8 million and debt issuance costs related to the Existing Notes of \$2.1 million upon extinguishing the Existing Notes in July 2015.

Further, we made net voluntary principal prepayments of \$10.0 million and \$65.0 million under the New Credit Facilities during the three and nine months ended October 1, 2016, respectively.

As of October 1, 2016, we had \$198.5 million of unused borrowing capacity under the New Revolving Credit Facility, after deducting \$1.5 million for standby letters of credit.

The New 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 New Credit Facilities. Therefore, no condensed consolidating financial information for the Parent Company and its subsidiaries are presented.

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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.

Note 9. Shareholders' Equity

We are authorized to issue five million shares of preferred stock. At October 1, 2016 and December 31, 2015, no preferred shares were issued or outstanding.

Note 10. Employee Benefit Plans

The components of net periodic pension expense were as follows:

	(In thousands)		(In thousands)	
	Three Months		Nine Months	
	Ended		Ended	
	October	October 3,	October	October 3,
	2016	2015	2016	2015
Service cost	\$133	\$ 196	\$399	\$ 589
Interest cost	341	338	1,025	1,013
Expected return on plan assets	(370)	(374)	(1,111)	(1,121)
Amortization of actuarial losses	191	222	572	665
Net periodic pension cost	\$295	\$ 382	\$885	\$ 1,146

The components of the reclassifications of net actuarial losses from accumulated other comprehensive loss to net income for the three and nine months ended October 1, 2016 were as follows:

	(In thousands)	
	Three	Nine
	Months	Months
	Ended	Ended
	October	October 1,
	2016	2016
Amortization of actuarial losses - total before tax ⁽¹⁾	\$(191)	\$(572)
Tax benefit	71	212
Net of tax	\$(120)	\$(360)

(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 varies and, in many cases is indefinite but subject to statute of limitations. The majority of guarantees and indemnities do not provide any limitations of the maximum potential future payments 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 in 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 production activities. Our effective tax rate may be subject to fluctuations during the year as new information is obtained,

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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 \$1.2 million (effective tax rate of 19.8%) for the three months ended October 1, 2016 compared to an income tax benefit of \$(6.9) million (effective tax benefit rate of (42.1)%) for the three months ended October 3, 2015. The increase in the effective tax rate for the three months ended October 1, 2016 compared to the three months ended October 3, 2015 was primarily due to pre-tax income in the current three month period compared to a pre-tax loss in the prior year three month period. The increase was partially offset by the U.S. Federal research and development tax credit that was permanently extended in the fourth quarter of 2015 and the deduction for Qualified Domestic Production Activities.

We recorded income tax expense of \$9.9 million (effective tax rate of 30.5%) for the nine months ended October 1, 2016 compared to an income tax benefit of \$(6.7) million (effective tax benefit rate of (40.9)%) for the nine months ended October 3, 2015. The increase in the effective tax rate for the nine months ended October 1, 2016 compared to the nine months ended October 3, 2015 was primarily due to pre-tax income in the current nine month period which included gain on divestitures of our Pittsburgh and Miltec operations of \$18.8 million compared to a pre-tax loss in the prior year nine month period. The increase was partially offset by the U.S. Federal research and development tax credit that was permanently extended in the fourth quarter of 2015 and the deduction for Qualified Domestic Production Activities.

Our unrecognized tax benefits were \$2.9 million and \$3.0 million as of October 1, 2016 and December 31, 2015, respectively. \$2.0 million, if recognized, would affect the annual income tax rate. We do not anticipate any significant increases or decreases to our unrecognized tax benefits in the next twelve months.

During the three months ended October 1, 2016, the Internal Revenue Service (“IRS”) commenced an audit of our 2014 tax year. 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 October 1, 2016 and December 31, 2015, 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 October 1, 2016, which is reflected in other long-term liabilities on its 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 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.

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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 October 1, 2016	October 3, 2015	Nine Months Ended October 1, 2016	October 3, 2015
Net Revenues				
Structural Systems	\$60,931	\$64,170	\$185,642	\$212,306
Electronic Systems	71,640	97,500	222,514	297,129
Total Net Revenues	\$132,571	\$161,670	\$408,156	\$509,435
Segment Operating Income				
Structural Systems	\$5,893	\$(6,028)	\$13,347	\$2,980
Electronic Systems	6,600	8,598	19,769	22,575
	12,493	2,570	33,116	25,555
Corporate General and Administrative Expenses ⁽¹⁾	(4,441)	(3,747)	(13,505)	(12,266)
Operating Income	\$8,052	\$(1,177)	\$19,611	\$13,289
Depreciation and Amortization Expenses				
Structural Systems	\$2,851	\$2,386	\$6,683	\$7,009
Electronic Systems	3,232	4,207	10,661	12,928
Corporate Administration	6	42	76	127
Total Depreciation and Amortization Expenses	\$6,089	\$6,635	\$17,420	\$20,064
Capital Expenditures				
Structural Systems	\$3,555	\$2,329	\$10,149	\$8,080
Electronic Systems	947	758	1,701	3,196
Corporate Administration	—	4	—	10
Total Capital Expenditures	\$4,502	\$3,091	\$11,850	\$11,286

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

Segment assets include assets directly identifiable with each segment. Our segment assets are as follows:

	(In thousands)	
	October 1, 2016	December 31, 2015
Total Assets		
Structural Systems	\$177,831	\$179,134
Electronic Systems	329,606	363,227
Corporate Administration ⁽¹⁾	13,545	14,720
Total Assets	\$520,982	\$557,081
Goodwill and Intangibles		
Structural Systems	\$4,025	\$4,866
Electronic Systems	182,364	207,595
Total Goodwill and Intangibles	\$186,389	\$212,461

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

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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, defense, and sophisticated industrial applications. 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.

Third quarter 2016 summary:

• Third quarter revenues were \$132.6 million

• Net income of \$5.0 million, or \$0.44 per diluted share

• Adjusted EBITDA for the quarter was \$14.9 million

• Backlog increased to \$566.3 million

• Made net voluntary principal prepayments of \$10.0 million on credit facilities during the quarter

Non-GAAP Financial Measures

Adjusted earnings before interest, taxes, depreciation and amortization ("Adjusted EBITDA") was \$14.9 million and \$6.6 million for the three months ended October 1, 2016 and October 3, 2015, 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

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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.

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;

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

- Loss on extinguishment of debt may be useful to our investors for determining current cash flow; and

- Restructuring charges may be useful to our investors in evaluating our core operating performance.

Reconciliations of net income (loss) 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		Nine Months Ended	
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015
Net income (loss)	\$5,014	\$(9,515)	\$22,425	\$(9,706)
Interest expense	1,945	3,392	6,279	16,499
Income tax expense	1,234	(6,932)	9,863	(6,714)
Depreciation	3,249	4,055	10,002	11,862
Amortization	2,840	2,580	7,418	8,202
Stock-based compensation expense	594	331	2,579	2,792
Gain on divestitures	—	—	(18,815)	—
Loss on extinguishment of debt	—	11,878	—	14,720
Restructuring charges	—	806	—	806
Adjusted EBITDA	\$14,876	\$6,595	\$39,751	\$38,461
% of net revenues	11.2	% 4.1	% 9.7	% 7.5

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Results of Operations

Third Quarter of 2016 Compared to Third Quarter of 2015

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) Nine Months Ended			
	October 1, 2016	% of Net Revenues	October 3, 2015	% of Net Revenues	October 1, 2016	% of Net Revenues	October 3, 2015	% of Net Revenues
Net Revenues	\$132,571	100.0 %	\$161,670	100.0 %	\$408,156	100.0 %	\$509,435	100.0 %
Cost of Sales	107,348	81.0 %	141,642	87.6 %	329,749	80.8 %	431,439	84.7 %
Gross Profit	25,223	19.0 %	20,028	12.4 %	78,407	19.2 %	77,996	15.3 %
Selling, General and Administrative Expenses	17,171	12.9 %	21,205	13.1 %	58,796	14.4 %	64,707	12.7 %
Operating Income (Loss)	8,052	6.1 %	(1,177)	(0.7)%	19,611	4.8 %	13,289	2.6 %
Interest Expense Loss on Extinguishment of Debt	(1,945)	(1.5)%	(3,392)	(2.1)%	(6,279)	(1.5)%	(16,499)	(3.2)%
Other Income	141	0.1 %	—	— %	141	— %	1,510	0.3 %
Gain on Divestitures	—	— %	—	— %	18,815	4.6 %	—	— %
Income (Loss) Before Taxes	6,248	4.7 %	(16,447)	(10.2)%	32,288	7.9 %	(16,420)	(3.2)%
Income Tax Expense (Benefit)	1,234	nm	(6,932)	nm	9,863	nm	(6,714)	nm
Net Income (Loss)	\$5,014	3.8 %	\$(9,515)	(5.9)%	\$22,425	5.5 %	\$(9,706)	(1.9)%
Effective Tax (Benefit) Rate	19.8 %	nm	(42.1)%	nm	30.5 %	nm	(40.9)%	nm
Diluted Earnings (Loss) Per Share	\$0.44	nm	\$(0.86)	nm	\$1.99	nm	\$(0.88)	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 nine months of 2016 and 2015, respectively, were as follows:

	Three Months Ended				Nine Months Ended					
	Change	(In thousands) October 1 2016	(In thousands) October 3, 2015	% of Net Revenues October 2016	% of Net Revenues October 2015	Change	(In thousands) October 1 2016	(In thousands) October 3, 2015	% of Net Revenues October 1 2016	% of Net Revenues October 3, 2015
Consolidated Ducommun Military and space										
Defense technologies	\$(12,174)	\$42,008	\$54,182	31.7 %	33.9 %	\$(35,803)	\$124,541	\$160,344	30.5%	31.5%
Defense structures	(3,414)	12,348	15,762	9.3 %	9.8 %	(18,773)	39,053	57,826	9.6%	11.3%
Commercial aerospace	4,495	65,661	61,166	49.5 %	37.8 %	6,377	198,467	192,090	48.6%	37.7%
Industrial	(18,006)	12,554	30,560	9.5 %	18.5 %	(53,080)	46,095	99,175	11.3%	19.5%
Total	\$(29,099)	\$132,571	\$161,670	100.0%	100.0%	\$(101,279)	\$408,156	\$509,435	100.0%	100.0%
Structural Systems Military and space (defense structures)	\$(3,414)	\$12,348	\$15,762	20.3 %	24.6 %	\$(18,773)	\$39,053	\$57,826	21.0%	27.2%
Commercial aerospace	175	48,583	48,408	79.7 %	75.4 %	(7,891)	146,589	154,480	79.0%	72.8%
Total	\$(3,239)	\$60,931	\$64,170	100.0%	100.0%	\$(26,664)	\$185,642	\$212,306	100.0%	100.0%
Electronic Systems Military and space (defense technologies)	\$(12,174)	\$42,008	\$54,182	58.5 %	55.6 %	\$(35,803)	\$124,541	\$160,344	56.0%	53.9%
Commercial aerospace	4,320	17,078	12,758	24.0 %	13.1 %	14,268	51,878	37,610	23.3%	12.7%
Industrial	(18,006)	12,554	30,560	17.5 %	31.3 %	(53,080)	46,095	99,175	20.7%	33.4%
Total	\$(25,860)	\$71,640	\$97,500	100.0%	100.0%	\$(74,615)	\$222,514	\$297,129	100.0%	100.0%

Net revenues for the three months ended October 1, 2016 were \$132.6 million, compared to \$161.7 million for the three months ended October 3, 2015. The year-over-year decrease was primarily due to the following:

- \$18.0 million lower revenues in our industrial end-use markets mainly due to the divestiture of our Pittsburgh operation in January 2016 and closure of our Houston operation in December 2015; and
- \$15.6 million lower revenues in our military and space end-use markets mainly due to the divestiture of our Miltec operation in March 2016 as well as program cancellations and budget changes, which impacted our fixed-wing and helicopter platforms and pushed out scheduled deliveries;
-

Partially offset by \$4.5 million higher revenues in our commercial aerospace end-use markets mainly due to added content with existing customers.

Net revenues for the nine months ended October 1, 2016 were \$408.2 million, compared to \$509.4 million for the nine months ended October 3, 2015. The year-over-year decrease was primarily due to the following:

• \$53.1 million lower revenues in our industrial end-use markets mainly due to the divestiture of our Pittsburgh operation in January 2016 and closure of our Houston operation in December 2015; and

• \$54.6 million lower revenues in our military and space end-use markets mainly due to the divestiture of our Miltec operations in March 2016 as well as program cancellations and budget changes, which impacted our fixed-wing and helicopter platforms and pushed out scheduled deliveries of these products to customers;

• Partially offset by \$6.4 million higher revenues in our commercial aerospace end-use markets mainly due to added content with existing customers.

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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		Nine Months Ended		
	October 1, 2016	October 3, 2015	October 1, 2016	October 3, 2015	
Boeing Company	17.8%	15.8 %	17.7%	16.3 %	%
Raytheon Company	7.2 %	9.0 %	6.8 %	8.1 %	%
Spirit Aerosystems Holdings, Inc.	8.3 %	7.6 %	8.2 %	7.7 %	%
United Technologies Corporation	3.9 %	7.6 %	6.0 %	6.7 %	%
Total top ten customers ⁽¹⁾	57.7%	57.1 %	55.7%	55.3 %	%

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

The Boeing Company (“Boeing”), Raytheon Company (“Raytheon”), Spirit Aerosystems Holdings, Inc. (“Spirit”), and United Technologies Corporation (“United Technologies”) represented the following percentages of total accounts receivable:

	October 1, 2016		December 31, 2015	
	%		%	
Boeing	9.3 %		13.3 %	
Raytheon	9.7 %		11.5 %	
Spirit	9.7 %		7.1 %	
United Technologies	5.4 %		5.3 %	

The net revenues and accounts receivable from Boeing, 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 increased year-over-year in the three months ended October 1, 2016 to 19.0% compared to the three months ended October 3, 2015 of 12.4% primarily due to the following:

- The 2015 third quarter included a forward loss reserve charge related to a regional jet program of \$10.0 million; and
- Total material costs as a percentage of revenues decreased 2.1% year-over-year as a result of our on-going supply chain initiatives and improved operating performance.

Gross profit margin increased year-over-year in the nine months ended October 1, 2016 to 19.2% compared to the nine months ended October 3, 2015 of 15.3% primarily due to the following:

- 2015 included a forward loss reserve charge related to a regional jet program of \$12.2 million; and
- Total material costs as a percentage of revenues decreased 2.6% year-over-year as a result of our on-going supply chain initiatives and improved operating performance.

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

SG&A expenses decreased \$4.0 million year-over-year in the three months ended October 1, 2016 compared to the three months ended October 3, 2015 primarily due to the following:

- A decrease of \$2.5 million related to the divestitures of our Pittsburgh and Miltec operations and closures of facilities; and

- A decrease of \$1.0 million in compensation and benefit costs.

SG&A expenses decreased \$5.9 million year-over-year in the nine months ended October 1, 2016 compared to the nine months ended October 3, 2015 primarily due to the following:

- A decrease of \$6.9 million related to the divestitures of our Pittsburgh in January 2016 and Miltec operations in March 2016 and closures of facilities;

- Partially offset by an increase of \$1.2 million in professional services fees; and

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▲ An increase of \$1.0 million in research and development costs related to new technology development.

Interest Expense

Interest expense decreased year-over-year in the three and nine months ended October 1, 2016 compared to the three and nine months ended October 3, 2015 primarily due to a lower outstanding debt balance as a result of net voluntary principal prepayments on our new credit facilities and a lower average interest rate as a result of completing the refinancing of our debt in July 2015.

Gain on Divestitures

Gain on divestitures for the nine months ended October 1, 2016 consisted of the divestitures during the first quarter of 2016 of our Pittsburgh operation with a pretax gain of \$18.3 million and our Miltec operation with a 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 (Benefit)

We recorded income tax expense of \$1.2 million (effective tax rate of 19.8%) for the three months ended October 1, 2016 compared to an income tax benefit of \$(6.9) million (effective tax benefit rate of (42.1)%) for the three months ended October 3, 2015. The increase in the effective tax rate for the three months ended October 1, 2016 compared to the three months ended October 3, 2015 was primarily due to pre-tax income in the current three month period compared to a pre-tax loss in the prior year three month period. The increase was partially offset by the U.S. Federal research and development tax credit that was permanently extended in the fourth quarter of 2015 and the deduction for Qualified Domestic Production Activities.

We recorded income tax expense of \$9.9 million (effective tax rate of 30.5%) for the nine months ended October 1, 2016 compared to an income tax benefit of \$(6.7) million (effective tax benefit rate of (40.9)%) for the nine months ended October 3, 2015. The increase in the effective tax rate for the nine months ended October 1, 2016 compared to the nine months ended October 3, 2015 which included pre-tax income in the current nine month period mainly due to gain on divestitures of our Pittsburgh and Miltec operations of \$18.8 million compared to a pre-tax loss in the prior year nine month period. The increase was partially offset by the U.S. Federal research and development tax credit that was permanently extended in the fourth quarter of 2015 and the deduction for Qualified Domestic Production Activities.

Our unrecognized tax benefits were \$2.9 million and \$3.0 million as of October 1, 2016 and December 31, 2015, respectively. \$2.0 million, if recognized, would affect the annual income tax rate. We do not anticipate any significant increases or decreases to our unrecognized tax benefits in the next twelve months.

During the three months ended October 1, 2016, the Internal Revenue Service (“IRS”) commenced an audit of our 2014 tax year. 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 (Loss) and Earnings (Loss) per Share

Net income (loss) and earnings (loss) per share for the three months ended October 1, 2016 were \$5.0 million, or \$0.44 per diluted share, compared to a net loss and loss per share of \$(9.5) million, or \$(0.86) per share, for the three months ended October 3, 2015. The increase in net income for the three months ended October 1, 2016 compared to a net loss for the three months ended October 3, 2015 was primarily due to the following:

• The 2015 third quarter included a loss on extinguishment of debt of \$11.9 million related to the redemption of the \$200.0 million senior unsecured notes;

• The 2015 third quarter included a forward loss reserve charge related to a regional jet program of \$10.0 million;

• Lower interest expense of \$1.4 million; and

• Improved operating performance.

Net income (loss) and earnings (loss) per share for the nine months ended October 1, 2016 were \$22.4 million, or \$1.99 per diluted share, compared to a net loss and loss per share of \$(9.7) million, or \$(0.88) per share, for the nine months ended October 3, 2015. The increase in net income for the nine months ended October 1, 2016 compared to a net loss for the nine months ended October 3, 2015 was primarily due to the following:

• A pretax gain on divestitures of our Pittsburgh and Miltec operations of \$18.8 million;

•

Prior year included a loss on extinguishment of debt of \$14.7 million related to completing a new credit facility to replace the existing credit facilities along with the redemption of the \$200.0 million senior unsecured notes; 2015 included a forward loss reserve charge related to a regional jet program of \$12.2 million;

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Lower interest expense of \$10.2 million; and

Improved operating performance.

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 nine months ended October 1, 2016 and October 3, 2015:

	Three Months Ended				Nine Months Ended					
	% Change	(In thousands) October 1, 2016	(In thousands) October 3, 2015	% of Net Revenues October 1 2016	% of Net Revenues October 3, 2015	% Change	(In thousands) October 1, 2016	(In thousands) October 3, 2015	% of Net Revenues October 1 2016	% of Net Revenues October 3, 2015
Net Revenues										
Structural Systems	(5.0)%	\$60,931	\$64,170	46.0 %	39.7 %	(12.6)%	\$185,642	\$212,306	45.5 %	41.7 %
Electronic Systems	(26.5)%	71,640	97,500	54.0 %	60.3 %	(25.1)%	222,514	297,129	54.5 %	58.3 %
Total Net Revenues Segment	(18.0)%	\$132,571	\$161,670	100.0 %	100.0 %	(19.9)%	\$408,156	\$509,435	100.0 %	100.0 %
Operating Income										
Structural Systems		\$5,893	\$(6,028)	9.7 %	(9.4)%		\$13,347	\$2,980	7.2 %	1.4 %
Electronic Systems		6,600	8,598	9.2 %	8.8 %		19,769	22,575	8.9 %	7.6 %
		12,493	2,570				33,116	25,555		
Corporate General and Administrative Expenses ⁽¹⁾		(4,441)	(3,747)	(3.3)%	(2.3)%		(13,505)	(12,266)	(3.3)%	(2.4)%
Total Operating Income (Loss)		\$8,052	\$(1,177)	6.1 %	(0.7)%		\$19,611	\$13,289	4.8 %	2.6 %
Adjusted EBITDA										
Structural Systems Operating Income (Loss)		\$5,893	\$(6,028)				\$13,347	\$2,980		
Other Income ⁽²⁾		141	—				141	1,510		
Depreciation and Amortization		2,851	2,386				6,683	7,009		
Restructuring Charges		—	314				—	314		
Electronic Systems		8,885	(3,328)	14.6 %	(5.2)%		20,171	11,813	10.9 %	5.6 %

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Operating Income	6,600	8,598				19,769	22,575		
Gain on Divestitures ⁽³⁾	—	—				18,815	—		
Depreciation and Amortization	3,232	4,207				10,661	12,928		
Restructuring Charges	—	468				—	468		
	9,832	13,273	13.7 %	13.6 %		49,245	35,971	22.1 %	12.1 %
Corporate General and Administrative Expenses ⁽¹⁾									
Operating Loss	(4,441)	(3,747)				(13,505)	(12,266)		
Gain on Divestitures ⁽³⁾	—	—				(18,815)	—		
Depreciation and Amortization	6	42				76	127		
Stock-Based Compensation Expense	594	331				2,579	2,792		
	(3,841)	(3,374)				(29,665)	(9,347)		
Adjusted EBITDA	\$14,876	\$6,571	11.2 %	4.1 %		\$39,751	\$38,437	9.7 %	7.5 %
Capital Expenditures									
Structural Systems	\$3,555	\$2,329				\$10,149	\$8,080		
Electronic Systems	947	758				1,701	3,196		
Corporate Administration	—	4				—	10		
Total Capital Expenditures	\$4,502	\$3,091				\$11,850	\$11,286		

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

(2) Insurance recoveries related to property and equipment included as other income for the nine months ended October 3, 2015.

(3) Includes gain on divestitures of our Pittsburgh and Miltec operations.

Structural Systems

Structural Systems' net revenues in the three months ended October 1, 2016 compared to the three months ended October 3, 2015 decreased \$3.2 million primarily due to a \$3.4 million decrease in military and space revenues mainly due to program cancellations and budget changes which impacted scheduled deliveries on our fixed-wing and helicopter platforms.

Structural Systems' net revenues in the nine months ended October 1, 2016 compared to the nine months ended October 3, 2015 decreased \$26.7 million primarily due to the following:

- An \$18.8 million decrease in military and space revenues mainly due to program cancellations and budget changes which impacted scheduled deliveries on our fixed-wing and helicopter platforms; and
- A \$7.9 million decrease in commercial aerospace revenues mainly due to the wind down of a regional jet program and continued softness in the commercial helicopter end-use market.

The Structural Systems segment operating income in the three and nine months ended October 1, 2016 compared to the three and nine months ended October 3, 2015 increased primarily due to higher gross margins in the current three and nine months ended October 1, 2016 and the prior year three and nine months ended October 3, 2015 included a forward loss reserve charge related to a regional jet program of \$10.0 million and \$12.2 million, respectively.

Electronic Systems

Electronic Systems' net revenues in the three months ended October 1, 2016 compared to the three months ended October 3, 2015 decreased \$25.9 million primarily due to the following:

- An \$18.0 million decrease in our industrial revenues mainly due to the divestiture of our Pittsburgh operation in January 2016 and closure of our Houston operation in December 2015; and
- A \$12.2 million decrease in our military and space revenues mainly due to the divestiture of our Miltec operation in March 2016 and program cancellations and budget changes, which impacted scheduled deliveries on our fixed-wing platforms;
- Partially offset by \$4.3 million increase in commercial aerospace revenues mainly due to added content with our existing customers.

Electronic Systems' net revenues in the nine months ended October 1, 2016 compared to the nine months ended October 3, 2015 decreased \$74.6 million primarily due to the following:

- A \$53.1 million decrease in our industrial revenues mainly due to the divestiture of our Pittsburgh operation in January 2016 and closure of our Houston operation in December 2015; and
- A \$35.8 million decrease in our military and space revenue mainly due to the divestiture of our Miltec operation in March 2016 and program cancellations and budget changes, which impacted scheduled deliveries on our fixed-wing and helicopter platforms;
- Partially offset by \$14.3 million increase in our commercial aerospace revenue mainly due to added content with existing customers.

Electronic Systems' segment operating income in the three and nine months ended October 1, 2016 compared to the three and nine months ended October 3, 2015 decreased primarily due to the effect of lower revenues as a result of the divestitures of our Pittsburgh and Miltec operations and closure of our Houston operation.

Corporate General and Administrative ("CG&A")

CG&A expenses increased \$0.8 million in the three months ending October 1, 2016 compared to the three months ended October 3, 2015 primarily due to higher compensation and benefits of \$0.6 million. CG&A expenses increased \$1.3 million in the nine months ended October 1, 2016 compared to the nine months ended October 3, 2015 primarily due to one-time retirement charges of \$0.9 million.

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,

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trends in our overall level of backlog may not be indicative of trends in our future net revenues. \$453.0 million of total backlog is expected to be delivered over the next 12 months. The following table summarizes our backlog as of October 1, 2016 and December 31, 2015:

	(In thousands)		
	Change	October 1, 2016	December 31, 2015 (1)
Consolidated Ducommun			
Military and space			
Defense technologies	\$24,780	\$ 193,341	\$ 168,561
Defense structures	6,676	65,497	58,821
Commercial aerospace	10,783	279,976	269,193
Industrial	(21,763)	27,472	49,235
Total	\$20,476	\$ 566,286	\$ 545,810
Structural Systems			
Military and space (defense structures)	\$6,676	\$ 65,497	\$ 58,821
Commercial aerospace	4,228	228,264	224,036
Total	\$ 10,904	\$ 293,761	\$ 282,857
Electronic Systems			
Military and space (defense technologies)	\$24,780	\$ 193,341	\$ 168,561
Commercial aerospace	6,555	51,712	45,157
Industrial	(21,763)	27,472	49,235
Total	\$9,572	\$ 272,525	\$ 262,953

(1) Includes \$16.1 million in backlog as of December 31, 2015 for the Pittsburgh and Miltec operations which were divested in the three months ended April 2, 2016.

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)			
	October 1, 2016	December 31, 2015		
Total debt, including long-term portion	\$180.0	\$ 245.0		
Weighted-average interest rate on debt	3.35 %	3.07 %		
Term Loan interest rate	3.35 %	3.07 %		
Revolving Credit Facility interest rate	— %	— %		
Cash and cash equivalents	\$9.5	\$ 5.5		
Unused Revolving Credit Facility	\$198.5	\$ 198.5		

In June 2015, we completed a new credit facility to replace the Existing Credit Facilities. The new credit facility consists of a \$275.0 million senior secured term loan, which matures on June 26, 2020 (“New Term Loan”), and a \$200.0 million senior secured revolving credit facility (“New Revolving Credit Facility”), which matures on June 26, 2020 (collectively, the “New Credit Facilities”). We are required to make mandatory prepayments of amounts outstanding under the New Term Loan. In addition, we retired all of the \$200.0 million senior unsecured notes (“Existing Notes”) in July 2015. We drew down on the New Term Loan in the amount of \$275.0 million. Along with the call notice amount and paying the call premium of \$9.8 million, we also paid down the \$65.0 million drawn on the New Revolving Credit Facility in the previous quarter. As of October 1, 2016, we were in compliance with all covenants required under the New 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.

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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 \$18.0 million to \$22.0 million for capital expenditures in 2016 financed by cash generated from operations, principally to support new contract awards at Structural Systems and Electronic Systems. As part of our strategic plan to become a Tier 2 supplier, additional up-front investment in tooling will be required for newer programs which have higher engineering content and higher levels of complexity in assemblies.

We continue to depend on operating cash flow and the availability of our New Revolving 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 nine months ended October 1, 2016 increased to \$27.5 million, compared to \$12.1 million in the nine months ended October 3, 2015. The higher net cash generated during the first nine months of 2016 was primarily due to higher net income as a result of lower interest expense and higher gross margin percentage partially offset by higher inventory.

Net cash provided by investing activities of \$42.6 million for the nine months ended October 1, 2016 was primarily due to proceeds from the divestiture of the Pittsburgh and Miltec operations, partially offset by capital expenditures, principally to support new contract awards in both Structural Systems and Electronic Systems.

Net cash used in financing activities for the nine months ended October 1, 2016 of \$66.1 million was primarily due to net voluntary principal prepayments on our new credit facilities of \$65.0 million primarily as a result of the proceeds received from divestiture of the Pittsburgh and Miltec operations during the current-year.

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 2015 Annual Report on Form 10-K. There have been no material changes in any of our critical accounting policies during the three and nine months ended October 1, 2016.

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 October 1, 2016, we had total borrowings of \$180.0 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 October 1, 2016. The Company had previously reported a material weakness in internal control over financial

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reporting related to the design and effective monitoring controls over the accuracy and appropriate classification of reported labor hours associated with contracts accounted for under the percentage-of-completion method using units of delivery. 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, 2015. As a result of the material weakness in the Company's internal control over financial reporting, which was not remediated as of October 1, 2016, the CEO and CFO concluded the Company's disclosure controls and procedures were not effective as of October 1, 2016.

Management's Remediation Activities

We are committed to remediating the control deficiencies that constitute the material weakness described above by implementing changes to our internal control over financial reporting. Our Chief Financial Officer is responsible for implementing changes and improvements in the internal control over financial reporting and for remediating the control deficiencies that gave rise to the material weakness.

Actions to be taken or in process consist of testing of our internal controls that have been implemented and address the ongoing review of the related labor distribution used in the estimates of anticipated costs used in the forward loss reserve analysis that have been implemented.

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 to complete the planned remedial actions during 2016, however, we cannot make any assurances that such actions will be completed during 2016. Until the remediation steps set forth above are fully implemented and concluded to be operating effectively, the material weakness described above will continue to exist.

Changes in Internal Control over Financial Reporting

Except as otherwise discussed above under "Management's Remediation Activities," there were no changes in our internal control over financial reporting during the three months ended October 1, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control 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, 2015 for a discussion of our risk factors. There have been no material changes in the nine months ended October 1, 2016 to the risk factors disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015.

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 No. 2 to Bylaws dated August 1, 2013. Incorporated by reference to Exhibit 99.2 to Form 8-K dated August 5, 2013.
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.
- *10.2 2007 Stock Incentive Plan. Incorporated by reference to Appendix B of Definitive Proxy Statement on Schedule 14a, filed on March 29, 2010.
- *10.3 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.
Form of Nonqualified Stock Option Agreement, for grants to employees under the 2013 Stock Incentive Plan, and the 2007 Stock Incentive Plan. Incorporated by reference to Exhibit 10.8 to Form 10-K for the year ended December 31, 2003.
- *10.4 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.
- *10.5 Form of Performance Stock Unit Agreement for 2016 and after. Incorporated by reference to Exhibit 10.6 to Form 10-Q for the period ended April 2, 2016.
- *10.6 Form of Restricted Stock Unit Agreement. Incorporated by reference to Exhibit 99.1 to Form 8-K dated May 8, 2007.
- *10.7 Form of Directors' Restricted Stock Unit Agreement. Incorporated by reference to Exhibit 99.1 to Form 8-K dated May 10, 2010.
Form of Key Executive Severance Agreement entered with five current executive officers of Ducommun. Incorporated by reference to Exhibit 99.1 to Form 8-K dated January 3, 2008. All of the Key Executive Severance Agreements are identical except for the name of the executive officer, the address for notice, and the date of the Agreement:
- *10.8
- *10.9

Executive Officer	Date of Agreement
Kathryn M. Andrus	February 18, 2014
Douglas L. Groves	February 18, 2014
James S. Heiser	December 31, 2007
Anthony J. Reardon	December 31, 2007
Rosalie F. Rogers	November 5, 2009

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Form of Indemnity Agreement entered with all directors and officers of Ducommun. Incorporated by reference *10.10 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
Kathryn M. Andrus	January 30, 2008
Richard A. Baldrige	March 19, 2013
Joseph C. Berenato	November 4, 1991
Gregory S. Churchill	March 19, 2013
Robert C. Ducommun	December 31, 1985
Dean W. Flatt	November 5, 2009
Douglas L. Groves	February 12, 2013
Jay L. Haberland	February 2, 2009
James S. Heiser	May 6, 1987
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

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

*10.12 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.

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: November 3, 2016 By: /s/ Anthony J. Reardon
Anthony J. Reardon
Chairman, President and Chief Executive Officer
(Principal Executive Officer)

Date: November 3, 2016 By: /s/ Douglas L. Groves
Douglas L. Groves
Vice President, Chief Financial Officer and Treasurer
(Principal Financial Officer)

Date: November 3, 2016 By: /s/ Christopher D. Wampler
Christopher D. Wampler
Vice President, Controller and Chief Accounting Officer
(Principal Accounting Officer)